20 May 2010

Ms AU King-chi, JP
Permanent Secretary for Financial Services & the Treasury
Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I, Admiralty Centre
18, Harcourt Road
Hong Kong

Dear King-chi,

The Hong Kong General Chamber of Commerce ("The Chamber") is pleased to submit its views on the proposals to establish an Investor Education Council and a Financial Dispute Resolution Centre.

In the attached submission we have discussed some fundamental issues concerning both proposals. Those issues have been brought to our attention by our members, principally from those sitting on our financial services and legal committees, who are most concerned about the proposals. In short, we question whether the two proposed public bodies are fully justified, for example, in terms of the respective purposes that they would serve. The Investor Education Council, as proposed, did not strike us as one that would deliver a lot of extra value to the community. As for the proposal of setting up a Financial Dispute Resolution Centre, we are worried about possible abuse of the proposed procedures.

We strongly urge the government to address the issues we raised in the submission, and further discuss with stakeholders to allay concerns, before making its decision. If you have any question or if you would like to further discuss with us, you are most welcome to contact me.

Regards,

Alex Fong
CEO

Att.

Consultation on the Proposed Establishment of an Investor Education Council and a Financial Dispute Resolution Centre

The Hong Kong General Chamber of Commerce (the "Chamber") is pleased to submit its views on the proposals to establish an Investor Education Council and a Financial Dispute Resolution Centre. We will deal with the two proposals separately in our comments, though there are common concerns such as questions about the necessity and policy rationale for the creation of two new public bodies, as well as the cost implications.

Part I: Investor Education Council

Investor education is the key to enhance financial literacy. Our concerns, however, are that the proposal of creating a new public body to coordinate investor education may not be necessary. We are also keen to receive government assurance that the proposed Investor Education Council (IEC) would not effectively become a watchdog, and that it should not predict market movement or arouse the public's interest in investing.

While we agree that more can be done to provide investors with basic financial knowledge, such as matters related to risks, we do not see that the best solution is to establish a publicly-funded IEC as a coordinator of investor education. Many financial services providers have been actively promoting investor education on an ongoing basis. Industry bodies also organise investment education activities regularly. We do not see the need for centralized government coordination of these self-initiated activities in the private sector, and doubt what additional value such coordination may bring, especially if we take into account the cost involved.

On the purpose of the IEC, we are worried that it would be effectively trying to equip investors with knowledge of complicated products which might not be suitable for general and small investors.

For instance, section 2.2 of the consultation document says:

> "...IEC should [...] help (the general public) improve the quality of financial decisions to be made."

And, in subsection (d), it says:

> "This (understanding of the risk) needs to be complemented by a good general awareness of the types of financial products that can help them achieve their goals..."

These objectives need further clarification and review as it might create false expectation of the IEC. We do not believe that a government-funded body like the IEC should attempt to provide financial advisory services to the public. The IEC could educate the

public on investment risks and provide guidelines on assessing one's financial needs and investment decisions, but it should not make suggestions on what they ought to invest in.

The consultation paper suggests in section 2.2(e) that the IEC would try to enhance the general public's understanding of the importance of "staying informed about financial matters". In doing so, however, the IEC should avoid predicting future market movement or giving any information that could be perceived as forecasts of market trends.

As for the cost of setting up and operating the IEC, although the consultation document mentions that the budget for the IEC will come from the Securities and Futures Commission (SFC), we do not believe that it will be cost free. The SFC is funded publicly, and in the end taxpayers are paying for the IEC although there will not be a separate budget request for the IEC. The Chamber is aware that there are growing views that the very substantial cash reserve built up by the SFC from obligatory fees and levies paid by listed companies and their investors have reached inappropriate levels; effectively funding the IEC and the proposed Financial Dispute Resolution Centre (discussed in Part II below) out of those funds seems to be of dubious fairness to those who have contributed them and would rather see a reduction in the calculation of future fees and levies.

Last but not least, if the IEC is set up under the aegis of the SFC, it surely exposes itself, and probably the SFC, to liability claims if the advice that it gives on prudent investment turns out to be wrong. A public body giving investment advice must expect to be seen as doing so with more responsibility than a private sector advisor. The cost of meeting such potential liability claims could be huge.

An effective way to enhance the general public's financial literacy in the long run is to start the related education in primary and secondary schools. Furthermore, universities in Hong Kong can also play a bigger role in educating the public on financial matters and investment risks.

Part II: Financial Dispute Resolution Centre

The Chamber has questions and reservations about the rationale behind the proposal of setting up a new financial dispute resolution scheme which, according to the consultation document, purports to provide a quick, simple, customer friendly service for dispute resolution.

According to the proposal, the new scheme will be administered by a Financial Dispute Resolution Centre (FDRC). All financial services providers in the selected sectors – covering licensees and regulates of the Hong Kong Monetary Authority and the SFC – are required to join the scheme as members. The FDRC will handle disputes of a monetary nature only, primarily through mediation, and failing which, arbitration. External mediators and arbitrators will be engaged. The FDRC will have no authority to

investigate into breach of regulations or systemic irregularities. Fees for mediation and arbitration are proposed to be fixed.

The Chamber would like to raise two major questions about the scheme, as follows:

Is there a sufficiently strong public policy reason to set up a new scheme for resolving disputes arising out of private investment loss?

The purpose of setting up the FDRC is to help resolve monetary disputes. But the key question is: what constitutes a monetary dispute? It seems that the consultation document is defining "monetary disputes" for the purpose of the FDRC as investment loss:

> "The main concern of an aggrieved consumer is usually about recovering a part, or all, of the "lost" principal as quickly as possible. Sometimes it is also not clear to him/her as to where to lodge his/her complaint.
>
> We propose that consumers should be provided with an independent and affordable avenue for resolving monetary disputes with the financial services providers." (paras 2.4 and 2.5)

It is questionable whether the government has a duty to provide a dedicated channel for consumers to recover investment loss that involves no alleged misconduct or suspected systemic irregularity with financial institutions. The consultation document says it is important to ensure that there are effective processes for resolving problems when "things go wrong" (Executive Summary, Para 3). For some consumers, "things (that) go wrong" are equivalent to suffering loss, and the consultation document seems to identify with this view. This is a cause for concerns.

Consumers should bear the risks of their investment decisions if they are properly informed of the risks entailed and not misled. If they are not well informed or if they are misled, it suggests possible irregularities, but in such case the matter will fall outside the ambit of the FDRC. It is open to question whether investors should be encouraged, albeit indirectly, to try recovering investment loss through a government-established channel when there is no irregularity involved.

It requires a strong public policy justification to use public resources (at least in the beginning of the FDRC, according to the proposal) to provide another channel for consumers to recover investment loss, on top of the existing channels in the law courts and the Alternative Dispute Resolution (or ADR; through mediation or arbitration), which is being actively promoted by the Department of Justice as part of their efforts to promote better access to civil justice.

Complaints arising out of investment loss should primarily be sorted out between the providers and consumers because they are of purely commercial nature. As noted in the consultation document, financial services providers are required by regulators to have in

place a complaint handling procedure dealing with customer complaints. Procedures therefore exist within individual institutions to deal with disputes about investment loss, which should be able to deal with the majority of the disputes, so long as the regulators ensure that the complaints are handled in a fair and effective manner. There is no evidence suggesting that the internal complaint handling procedures of financial institutions are failing to achieve the "fair and effective" requirement.

When internal procedures fail to resolve disputes, the parties can always elect to go to mediation or arbitration, or litigate. The consultation document mentions that it is not clear to consumers where they might pursue their claims outside the financial institutions concerned. We believe that as the awareness of ADR continues to rise in the wake of the government's active promotion, it will not require the setting up of new bodies like the proposed FDRC to help channel disputes to private mediation or arbitration.

We agree that any alleged misconduct or suspected systemic irregularities should be investigated and handled by regulators, instead of the FDRC (Paras 3.10 (c), 4.4-4.7), and that the FDRC should not have any investigative power. But that will leave the FDRC with the limited role of helping to resolve disputes purely about investment loss, which, as argued above, is unnecessary and lacks a strong public policy reason as basis. Furthermore, it would be difficult to establish a clear division of work between the FDRC and the regulators because most disputes are expected to involve both monetary and regulatory issues.

The government has a duty to highlight clearly to stakeholders and the public that the FDRC will not deal with alleged misconduct or suspected systemic irregularities. In the aftermath of the Lehman minibond incident, there might be an expectation that a new scheme would be put in place to deal with claims arising from alleged misconduct or suspected systemic irregularities. The FDRC might be wrongly perceived by members of the public to be serving such a purpose. The government should make it very clear to stakeholders and the public about this, in order to avoid arousing false expectations. Indeed, whether a new mechanism is needed to deal with incidents like the minibonds, which affect a large number of small investors and involve complicated potential regulatory issues, will depend on whether such incidents are likely to happen again. But one way or another, we do not see that the FDRC is a solution to incidents of that magnitude.

Last but not least, when mediation and arbitration are being promoted, the Chamber is of the view that we should move gradually. The financial services sector is concerned that there might not be sufficient mediators or arbitrators who have the specialized knowledge to deal with possibly complicated financial and legal issues involved in claims.

How to avoid possible abuse of the new scheme?

The consultation paper provides no satisfactory answer to alleviate the service providers' worries that the scheme would attract frivolous or vexatious claims. Since the declared

purpose is to resolve monetary disputes (which in fact means investment loss), it effectively encourages investors to make use of the scheme as and when they suffer loss.

The proposed fee for a claimant for making each claim is $100, and the proposed fixed charge when it goes to mediation is $500 per case for claims below $100,000, and $2,000 for claims between $100,000 and $500,000. If the case goes to arbitration, a claimant pays a fixed charge of $5,000. We do not believe that these fee levels would prevent frivolous or vexatious claims, especially at the mediation stage.

It is proposed in the consultation document that financial institutions should pay a higher fee, so that they would have more incentive to make the best use of their own complaint handling system. We believe that the financial institutions already have every incentive to resolve monetary disputes in-house, but not all claimants share the same incentive, in particular for those who set out to claim the biggest possible amount to cover their loss, irrespective of the merits of their claims.

We notice that intake officers are proposed to play a "gatekeeping" role by gathering information from both claimants and financial institutions, including institutions' responses to the issues of disputes. Intake officers will then decide whether FDRC should accept a case for mediation. There is a lack of detail on the criteria for the intake officer's deliberation. There are also questions about whether intake officers are well equipped to understand possibly complicated financial and legal issues involved in investments. We are concerned that the gatekeeping function might not serve the crucial purpose of blocking vexatious claims.

Conclusion

We believe that the discussion above touches on some fundamental issues concerning the proposed setting up of the IEC and the FDRC. We strongly urge the government to address those issues seriously and further discuss with stakeholders to allay concerns, before making its decision.

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Submitted by:
The Hong Kong General Chamber of Commerce
20 May 2010