

Financial Dispute Prevention and Resolution in China: Synthesizing Global Experience

Hui Huang^{*}, Shahla Ali[‡]

ABSTRACT: In light of the recent global financial crisis, this article aims to critically examine China's structure of financial dispute prevention and institutional dispute resolution mechanisms, and based on the results of such examination, set out suggested reform proposals for China. At present, in relation to financial dispute prevention through regulatory oversight, China adopts a traditional sectoral system of financial regulation, which has exhibited some limitations in meeting the regulatory challenges in a rapidly changing market. Its present system of financial dispute resolution similarly consists of segmented systems of arbitration, mediation and direct negotiation with financial institutions. In quest of a solution to the challenge of regulatory limitation and strengthened financial dispute resolution capacity, a comparative analysis is conducted of the financial regulatory and dispute resolution regimes in some advanced economies including the US, the UK and Australia, each of which is representative of a distinct regulatory model. In examining these overseas experiences for guidance, regard is given not only to their objective advantages and disadvantages, but also to the local conditions in China. It is concluded that the US regulatory model merits consideration in the short term, and with the further growth of China's financial markets in the long run, the Australian model of both financial regulation and dispute resolution provides the preferred direction for reform.

Keywords: Financial Crisis; Dispute Resolution; Financial Regulation; Chinese Law; Comparative Study

^{*} Associate Professor, Faculty of Law, Chinese University of Hong Kong (Conjoint Professor, Faculty of Law, University of New South Wales, Sydney, Australia). PhD, University of New South Wales; B. Eng., LLB, LLM, Tsinghua University (China). This paper draws on sections of a revised paper presented at the 6th Asian Law Institute Conference in Hong Kong in May 2009, and I thank the participants for their comments. I am grateful to Professor Douglas W. Arner of University of Hong Kong, Professor Tiantao Shi of Tsinghua University, Dr Dong Yang of Renmin University and Dr Kuan-Chun Johnny Chang of National Chengchi University for the ideas arising out of our discussions on the topic.

[‡] Assistant Professor and Deputy Director, LLM in Arbitration and Dispute Resolution, Faculty of Law, University of Hong Kong. B.A., Stanford University; M.A., Landegg International University, Switzerland; J.D., Boalt Hall School of Law, University of California at Berkeley; Ph.D, University of California at Berkeley. The author thanks the Government of Hong Kong's University Grants Committee for its kind support through its Public Policy Research Grant (HKU7001-PPR-10).

I. Introduction

The recent global financial crisis has called into question the adequacy of systems of financial regulation and dispute resolution at the national and supranational level. To date, while not immune to the fallout, China has fared relatively well in the global downturn which has steered all major Western economies into recession.¹ However, this suggests by no means that China's systems of financial dispute prevention and resolution are free of problems. Over the past quarter century, China's transition to a market-based economy has unleashed unprecedented economic growth, and the country's financial system has to develop fast to support that metamorphosis. But this transition has not been without limitations, nor is it complete. The healthy development and stability of the financial system is critical to the success of China's further economic and social transformation. As such, it is imperative that China's financial regulatory regime and mechanisms of financial dispute resolution be improved to meet the need of developing a more efficient financial system.

This article proceeds as follows. Part II traces the historical development of China's system of financial regulation and dispute resolution. This is followed by a more detailed discussion of the current Chinese financial regulatory and dispute resolution framework in Part III. The article then turns to the more important question of how China might consider reforming its financial governance regime in the future. Part IV examines the effects of the current global financial crisis in China, and identifies several major structural challenges facing the Chinese financial regulatory regime and system of dispute resolution. Part V then looks at relevant experiences and lessons in overseas jurisdictions including the US, the UK and Australia. It conducts a comparative analysis of these jurisdictions as well as a contextual consideration of China's local conditions, with a view to setting forward an appropriate agenda for reform of China's structure of financial dispute prevention and resolution. Part VI contains a concluding remark.

¹ See generally: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

II. A Historical Overview

In order to truly appreciate how far China has advanced with respect to its systems of financial governance and dispute resolution, it is essential to have a brief historical review of China's financial and legal system.

A. Before 1978: Limited Financial Dispute Resolution Mechanisms

After the founding of the People's Republic of China (PRC) in 1949, the Communist Party of China gradually steered the nation towards a centrally planned economy modelled on that operating in the Soviet Union.² Under the so-called 'Socialist Transformation' policy, private businesses were turned into collective ownership and eventually state ownership. Thereafter, as the economy was centrally planned and comprised overwhelmingly of state-owned enterprises (SOE), there was little need for the existence of financial markets to fund businesses and allocate resources.

Hence, the financial markets established before the 'Socialist Transformation' policy were dismantled during this time. First, all stock exchanges ceased to operate in 1952, putting an end to the securities market.³ Second, the People's Insurance Company of China (PICC) was shut down in 1959, quickly followed by the closure of the insurance market altogether.⁴ Finally, in the banking sector, the People's Bank of China (PBC) became the only bank operating in China both as the central bank and a commercial bank. Although the PBC provided the traditional service of saving and lending, it functioned essentially as an instrument of the government rather than a real commercial bank as understood in Western economies.⁵ The PBC was used primarily as a conduit through which state money was channelled to fund SOEs under the direction of the government. In short, there was no financial regulation in the true sense of the term.

Prior to 1978, similar to the condition of financial regulation, formal legal institutions were largely dissolved. During this time, perceptions of law remained largely negative for ideological and political reasons. Prevailing thought was that, "justice should not be separated artificially from the masses of ordinary people by the barriers of lawyers, laws, and law courts."⁶ Rather, "the people in their masses could judge and decide questions of policy as well as the concrete disputes arising in everyday life." Systems of law were not viewed as "flexible enough to meet the needs of struggle under rapidly changing revolutionary conditions"⁷ but rather "an

² See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

³ Hui Huang, *International Securities Markets: Insider Trading Law in China* (London, Kluwer Law International, 2006), 7-8.

⁴ Linbo Fan, 'The Insurance Market System' in Joseph J. Norton *et al* (eds), *Financial Regulation in the Greater China Area: Mainland China, Taiwan and Hong Kong SAR* (London, Kluwer Law International, 2000), 158.

⁵ Leung P *et al*, *Banking Law in the People's Republic of China* (Welwyn Garden City: EMIS Professional, 2004), 6.

⁶ Mao Tse Dong, cited in Lubman.

⁷ Carlos Wing-hung Lo, "China's Legal Awakening: Legal Theory and Criminal Justice in Deng's Era" (Hong Kong University Press, 1995). P. 10

instrument for the oppression of antagonistic classes.”⁸ During the 1949-78 period, people’s mediation was encouraged as the preferred means of resolving civil and commercial disputes. Largely oriented toward the infusion of Socialist ideology and reaffirming class struggle,⁹ peoples mediation was an informal avenue for promoting “correct thought,” (si-xiang) in the context of civil dispute resolution.¹⁰ In 1966 all law schools were closed, and lawyers were sent to work in the countryside for considerably longer periods of time than most intellectuals.¹¹

B. 1978-1992: Market Regulation and Dispute Resolution

Regulatory Oversight

In 1978, the economic reform policy was introduced by the Third Plenary Session of the 11th National People’s Congress, marking an important watershed in the development of China’s financial markets and indeed the general economy.¹² First, the banking system was reformed to keep up with the transition to a market-oriented economy. As a starting point, the ‘Big Four’ state-owned banks were established or re-opened to provide specialized services, including the Agricultural Bank of China (ABC) in January 1979 for the agricultural sector, the Bank of China (BOC) in March 1979 for foreign exchange businesses, the Construction Bank of China (CBOC) in May 1983 for big construction projects, the Industrial and Commercial Bank of China (ICBC) in January 1984 taking over the commercial activities of the PBC.¹³

In order to increase market competition in the banking sector, more commercial banks were allowed to be set up at the national and local levels, most of which are jointly owned by the state and private investors, such as the Communication Bank in 1987. In 1994, three policy banks, i.e., the China Development Bank, the Agricultural Development Bank of China, and the Export-import Bank of China, were created to free the ‘Big Four’ banks from the provision of policy loans, enabling them to function as real commercial banks.

The other parts of the financial system also underwent significant reforms and developed rapidly. The securities market was brought back to life in the early 1980s, culminating in the establishment of Shanghai Stock Exchange and Shenzhen Stock Exchange in 1990 and 1991 respectively. Likewise, the insurance market was revived

8 Ibid. p. 257.

9 Stanley Lubman, writing in 1967, at the peak of the Cultural Revolution, was one of the first to study the resolution of conflict in pre and post revolutionary China. His article, “Mao and Mediation: Politics and Dispute Resolution in Communist China,” examined how disputes on a community wide basis were resolved. His primary focus centered on the political/ revolutionary function of mediation during the early years of Communist rule. (Lubman, 1290).

10 Ibid. see S. Schram in Lubman. P. 1303.

11 Ralph H. Folsom and Jonh H. Minan, *Law in the People’s Republic of China: Commentary, Readings and Materials* (Dordrecht: Martinus Publishers, 1989). P. 12.

¹² See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

¹³ Yangxin Huang, ‘The Banking Market System’ in Joseph J. Norton *et al* (eds), *Financial Regulation in the Greater China Area: Mainland China, Taiwan and Hong Kong SAR* (London, Kluwer Law International, 2000), 27-28.

with the reopening of the PICC in 1980 and the formation of more insurance companies thereafter.

As a consequence of the reform, the PBC took on a dual role in financial regulation. It performed the major functions of the central bank while at the same time supervising and regulating the whole financial system, including banking, securities and insurance. Thus, this effectively rendered the PBC the single financial regulator at that time.

With the emergence of China's market economy in 1978, formal and informal legal institutions, arbitral tribunals and professionalised mediation services proliferated. The Company Law, Laws on Economic Contracts, and Labor Laws were developed to keep pace with the development of China's consumer-oriented commodity market, privatization and the specialization of labor.¹⁴ In conjunction with the creation of a framework for direct foreign investment, agencies like the China International Economic and Trade Arbitration Commission (CIETAC) were created.

From December 1978 (Third Plenum of the 11th Central Committee of the CCP) to September 1981, more than 200 laws were passed regulating economic and commercial activity.¹⁵ In light of economic reforms, Qiao Shi, Chairman of the Standing Committee of the National People's Congress, noted that laws were needed to "standardize the subject in the market, regulate the relationships among different subjects in the market and keep fair competition, and... improve, consolidate macro regulations... promot[ing] harmonious economic development."¹⁶ Privatization and open market reforms removed the centralization of economic authority, and thus the centralization of dispute-resolution authority. This could be seen at the local level with the transition from managerial dispute-resolution under a planned economy to increasingly decentralized, court-centered litigation in an open market system.¹⁷

With the growth of legal regulations, the demand for formal institutions to adjudicate a growing number of disputes likewise intensified. The number of civil disputes rose to 2.4 million cases in 1990, "with most of the increase attributable to the rise in contract and property disputes and in suits arising out of... claims for personal damages..."¹⁸ Indirectly, through transformations in the structure of the state, decision making power and authority became decentralized. Again, those working outside of the factory or work unit were no longer under the authority of the factory manager. Rather, external agencies were necessary to settle disputes. Regional arbitral bodies, such as CIETAC became increasingly active in the late 1970's in response to an increasing number of commercial and trade disputes.

Alongside the development of formal legal regulations, informal methods of dispute-resolution continued to receive continued support both within courts, arbitral bodies and informal dispute resolution structures. The renewed Chinese Civil Procedures Code of 1991 emphasized that mediation, if conducted, should be

¹⁴ From: Spanogle and Baranski, "Chinese Commercial Dispute Resolution Methods: The State Commercial and Industrial Administration Bureau," 35 *American Journal of Comparative Law*. 761 (1987). p. 133.

¹⁵ Spanogle and Baranski, "Chinese Commercial Dispute Resolution Methods: The State Commercial and Industrial Administration Bureau," 35 *American Journal of Comparative Law*. 761 (1987). p. 133.

¹⁶ "To Establish the Legal Framework of Socialist Market Economy," *China Law*, 1994, vol. 12.

¹⁷ Mingxin Pei, "Citizens v. Mandarins: Administrative Litigation in China," *The China Quarterly*, No. 152 (December 1997) p. 862.

¹⁸ Stanley Lubman, *Sino-American Relations and China's Struggle for the Rule of Law* (Columbia University: East Asian Institute, October 1997). p. 15.

lawful.¹⁹ Chinese Legal Yearbook statistics indicated that mediation was used to resolve more than 90 per cent of all civil cases during the mid 1980s²⁰ and nearly 60 per cent of civil cases in the late 1990s.²¹

C. 1992-present: Multiple Sectors-based Regulators & Proliferation of Dispute Resolution Mechanisms

With the rapid development of the financial markets since the early 1990s, China has been moving steadily towards a sectors-based financial regulatory model²² with separate regulators for banking, securities and insurance.²³ First, in October 1992, responsibility for securities regulation was spined off from the PBC to the State Council Securities Commission (SCSC) and the China Securities Regulatory Commission (CSRC). These two securities regulators were merged and the surviving CSRC was vested with the exclusive authority to regulate the securities market in April 1998.²⁴ Second, in keeping with the booming insurance market, the China Insurance Regulatory Commission (CIRC) was established in November 1998. Finally, in April 2003, the China Banking Regulatory Commission (CBRC) was set up to take over the function of direct banking regulation from the PBC.

Together with the PBC as the central bank, the above three highly specialized and mutually independent regulatory commissions make up China's financial regulatory framework, collectively referred to as '*Yihang Sanhui*' (one bank, three commissions). Different regulatory commissions are responsible for the administration and supervision of different financial sectors, namely banking, securities and insurance. This sectors-based regulatory model corresponds to the segmentation of financial services and markets in China, a policy commonly known as '*Fenye Jingying, Fenye Jianguan*' (separate operation, separate regulation).²⁵ As shall be discussed later, the adoption of this regulatory regime has been heavily influenced by overseas experience, particularly the US.

In addition to an acceleration in court use, since 1992, arbitral institutions such as the China International Economic and Trade Arbitration Commission (CIETAC) have continued to see a growing case load in managing and resolving financial disputes. Since it was founded in 1956, CIETAC has administered more than 10,000 international arbitration cases. Approximately 700 cases are filed with CIETAC each

¹⁹ Fu Hualing and Richard Cullen, "From Mediator to Adjudicator: The Limits of Civil Justice Reform in China" (November 25, 2008) SSRN-id1306800.

²⁰ Ibid. p. 223.

²¹ *Zhongguo Falu Nianjian* (Law Yearbook of China) (Beijing: Zhongguo Falu Nianjian She, 1983-1995).

²² See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

²³ For fuller discussion of the development of China's financial reform after its WTO accession, see e.g., J. Barth et al. (eds), *Financial Restructuring and Reform in Post-WTO China* (Kluwer 2006).

²⁴ Hui Huang, *International Securities Markets: Insider Trading Law in China* (London, Kluwer Law International, 2006), 18-19.

²⁵ See Hui Huang, 'Financial Regulatory Modernization: Experiences and Lessons from Common Law Jurisdictions' (2009) 1 *Guangdong Shehui Kexue [Guangdong Social Science]* 181, 185.

year, most of which are international.²⁶ In addition to litigation through the courts and arbitration through CIETAC, financial disputes are resolved through provincial arbitral bodies such as the Beijing Arbitration Commission (BAC) and local mediation services which will be discussed in greater detail below.

III. The Current Structure of Financial Dispute Resolution and Regulation

Financial Regulatory Oversight

As discussed above, the current financial regulatory structure in China has the defining feature of being sectors-based.²⁷ As the central bank, the PBC assumes responsibility for monetary policy and the stability of the financial system generally. The CBRC, the CSRC and the CIRC are the authorities responsible for regulating the banking, securities and insurance sectors respectively. These four regulatory bodies will be examined below in detail.²⁸

First, the PBC is the central bank in China, a role legally confirmed by the Law of PRC on the People's Bank of China (PBC Law).²⁹ Pursuant to the PBC Law, the PBC must formulate and implement monetary policies, guard against financial risks and maintain financial stability under the leadership of the State Council.³⁰ As with most central banks in the world, the PBC performs a threefold role: as the currency-issuing bank; as the bank of banks; and as the government bank.³¹ More specifically, the PBC issues the Chinese currency, namely Renminbi, and serves as a bankers' bank for other banks and financial institutions. It seeks to stabilize the currency and the financial system by indirect, macro-economic means rather than through a direct, interventionist approach as it did in the planned economy era. It therefore exercises macro-economic control over the financial markets primarily through monetary tools such as deposit reserves, rediscount rate, interest rate and open market operations.³²

Second, in 2003, the CBRC came into existence as the banking 'watch dog', taking over the role previously performed by the PBC. The legal and regulatory framework for banking regulation comprises the Law of the PRC on Commercial

²⁶ See: CIETAC, available at: http://www.cietac.org.cn/english/introduction/intro_1.htm

²⁷ See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

²⁸ See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

²⁹ Zhonghua Renmin Gongheguo Zhongguo Renmin Yinhang Fa [The Law of PRC on the People's Bank of China] (adopted at the 3rd session of the Standing Committee of the 8th National People's Congress of the PRC on 18 March 1995, amended on 27 December 2003), art 2.

³⁰ PBC Law, art. 2.

³¹ PBC Law, art. 4. It should be noted that the State Administration of Foreign Exchange is a government agency under the leadership of the PBC, and it acts as the implementation branch of the PBC in relation to foreign exchange administration and supervision. See State Administration of Foreign Exchange, http://www.safe.gov.cn/model_safe/whjjs/whjjs_detail.jsp?id=1&ID=1602000000000000 (accessed 9 October 2009).

³² PBC Law, art. 23.

Banks,³³ and the Law of the PRC on Banking Regulation and Supervision.³⁴ Like its peers in the securities and insurance markets, the CBRC is a ministry rank unit under the direct leadership of the State Council.

Third, against the backdrop of the fast-growing insurance market, the CIRC was set up in 1998 to assume regulatory responsibility for the insurance industry in China under the Insurance Law of the PRC.³⁵ Like the CBRC, the CIRC is charged with both market conduct regulation and prudential regulation in relation to insurance companies.

Finally, the legal and regulatory framework for the securities market in China is largely based on the Securities Law of the PRC (Securities Law).³⁶ As noted before, established in 1992 and upgraded in 1998, the CSRC is the oldest of the three industry-specific regulatory bodies in the financial markets and has assumed responsibility for securities regulation in China. It should be noted that the coverage of the Securities Law and therefore the authority of the CSRC is so broad as to include the regulation of shares, corporate bonds, treasury bonds, securities investment funds, and derivative products such as futures contracts, options and warrants.³⁷

Resolution of Financial Disputes

Within the four sectors described above, there are four primary ways to resolve commercial or financial disputes, namely negotiation, mediation, arbitration and litigation³⁸.

A. Negotiation, Consumer Complaints Council and Media Intervention

When faced with a financial dispute, most consumers prefer to negotiate directly with financial companies or banks as a first resort. Most contracts in China include a clause stipulating that negotiation should be employed before other dispute settlement mechanisms are pursued³⁹.

In addition to direct negotiations with banks and financial institutions, individuals have increasingly turned to the media as a forum for resolution. An online survey conducted jointly by the local web portal “Sina Finance” and “Shanghai

³³ Zhonghua Renmin Gongheguo Shangye Yinhang Fa [Law of the PRC on Commercial Banks] (adopted at the 13th session of the Standing Committee of the 8th National People’s Congress of the PRC on 10 May 1995, amended on 27 December 2003).

³⁴ Zhonghua Renmin Gongheguo Yinhangye Jiandu Guanli Fa [Law of the PRC on Banking Regulation and Supervision] (adopted at the 6th session of the Standing Committee of the 10th National People’s Congress of the PRC on 27 December 2003, amended on 31 October 2006).

³⁵ Zhonghua Renmin Gongheguo Baoxian Fa [Insurance Law of the PRC] (adopted at the 14th session of the Standing Committee of the 8th National People’s Congress of the People’s Republic of China on 30 June 1995, amended 28 October 2002 and 28 February 2009), art. 9.

³⁶ Zhonghua Renmin Gongheguo Zhengquanfa [Securities Law of the PRC] (promulgated by the 6th session of the Standing Committee of the 9th National People’s Congress of the PRC on 29 December 1998 and effective from 1 July 1999, amended in 2004 and 2005).

³⁷ *Ibid.*, art. 2.

³⁸ US Government Export Portal. “Dispute Avoidance and Resolution” China Business Information Centre. [Export.gov](http://www.export.gov). 23 Jan, 2011 Available at http://www.export.gov/china/exporting_to_china/disputeavoidanceandresolution.pdf

³⁹ See note 1

Securities News” in March, 2010 found that while most individuals first negotiate with company representatives (43.6%) or seek assistance from legal institutions (20.5%), 25.6% of the respondents indicated that they sought intervention through media channels and 10.3% the China Consumers’ Association (“CCA”)⁴⁰. However, it is to be noted that the CCA only implements the Law of the PRC on Protecting Consumer Rights and Interests, which is not specifically tailored to financial products⁴¹. The latest analysis on the complaints received by CCA published on its website indicates that 94.7% of the complaints accepted were related to consumer goods, clothing, electronics, housing and agricultural products⁴². It is therefore an open question whether the CCA can truly assist in the resolution of disputes relating to financial products.

B. Arbitral Tribunals

Arbitration is among the preferred methods of dispute resolution in China⁴³. Ad hoc arbitration is not recognized under Chinese law if it takes place within China. Rather, arbitration must be conducted by an officially recognized arbitral institution. As a consequence, parties selecting China as their arbitration location will be constrained in their choice of applicable procedural and substantive rules, and, if an arbitration is necessary, will be required to choose arbitrators from lists maintained by the arbitration institution they select.

Chinese Arbitration Commissions

There are a number of arbitration commissions located throughout China. The most well known is the China International Economic and Trade Arbitration Commission (CIETAC). CIETAC deals with disputes arising from economic transactions. In 2003, CIETAC adopted Financial Dispute Arbitration Rules, which specifically applies to disputes arising from, or in connection with financial transactions⁴⁴ between parties⁴⁵. While, as yet, there are no special programs set up after the financial crisis, nevertheless CIETAC has indicated an intention to carry out further amendments to the CIETAC Arbitration Rules in accordance with developments in the PRC markets by requesting submission of proposals in late 2009⁴⁶.

CIETAC was founded in April 1956 by the China Council for the Promotion of International Trade (CCPIT) to meet the needs of the continuing development of China’s economic and trade relations with foreign countries after adopting its “open door” policy.⁴⁷ CIETAC’s main headquarters are located in Beijing with two sub-commissions in Shanghai and Shenzhen, respectively known as the CIETAC

⁴⁰ <http://survey.finance.sina.com.cn/result/43948.html> [Chinese]

⁴¹ See Shanghai Financial News, 我国金融消费者保护立法之路漫漫, published on 6 August, 2010, at <http://www.shfinancialnews.com/xww/2009/jrb/node5019/node5036/node5038/userobject1ai63147.html> [Chinese]; and China Legal Service (HK) Ltd 《消費者權益保護法》修訂與金融消費者保護, published on 27 October 2010 at

http://www.chinalegal.com.hk/index.php?option=com_content&view=article&id=395:2010&catid=102 [Chinese]

⁴² China Consumers’ Association, 2010 3rd Quarter Analysis on Complaints dealt with by the Association, published on 18 October 2010 at <http://www.cca.org.cn/web/xfxx/picShow.jsp?id=49299>

⁴³ Li Shou-shuang, *Insight into Commercial Dispute Resolution in China*, 2007, Hong Kong Lawyer

⁴⁴ Article 3 of the CIETAC Financial Dispute Arbitration Rules

⁴⁵ Sanzhu Zhu, *Securities Dispute Resolution in China*, 2007, Aldershot England, Ashgate p 229

⁴⁶ <http://cn.cietac.org/NewsFiles/NewsDetail.asp?NewsID=896> [Chinese]

⁴⁷ *Ibid.*

Shanghai Sub-Commission and the CIETAC South China Sub-Commission.⁴⁸ CIETAC also successively established 19 liaison offices in different regions and specific business sectors. Within each of CIETAC's headquarters and each of its sub-commissions is a secretariat established to handle logistical matters and daily affairs under the leadership of their respective secretaries-general.⁴⁹

In addition to CIETAC, there are over 140 local arbitration commissions that have been established in most major cities, including Beijing, Shanghai, Guangzhou and Shenzhen⁵⁰. These local arbitration commissions, like CIETAC, have not introduced any special programs for the resolution of financial disputes. This is probably due to the fact that mainland China was among the least severely affected countries during the financial crisis. Nevertheless, many local arbitration commissions have established specialized financial arbitration commissions in recognition of the growing demand for financial dispute settlements. The first specialized financial arbitration commission was set up in Shanghai in December 2007, followed by Guangdong, Chongqing, Wuhan and Hangzhou⁵¹. The spokesperson for Chongqing Financial Arbitration Commission envisaged that PRC citizens may seek the assistance of these financial arbitration commissions when faced with abusive bank practice⁵². It is also expected that the Shenzhen Arbitration Commission will follow suit this year⁵³.

International Arbitration Commissions

The International Court of Arbitration (ICC), the Arbitration Institute of the Stockholm Chamber of Commerce (SCC), the Hong Kong International Arbitration Center (HKIAC), the Singapore International Arbitration Centre and the American Arbitration Association (AAA) are international alternatives to Chinese arbitration at CIETAC or local arbitral commissions⁵⁴. These international arbitration centres provide neutral jurisdictions for the resolution of foreign related financial disputes. In particular, CIETAC and HKIAC have signed a Cooperation Agreement aimed at facilitating arbitration in Asia in February 2008⁵⁵.

C. Mediation/Conciliation

Mediation and conciliation processes have a long standing history in China based on unique philosophical, political and social roots. China's civil procedure law as well as arbitration law allows for the unique combination of conciliation into arbitration proceedings if parties consent. In the context of both arbitration and litigation proceedings before a Chinese arbitral tribunal, parties will be encouraged to

⁴⁸ Ibid.

⁴⁹ Ibid.

⁵⁰ See note 1

⁵¹ Shanghai Arbitration Centre. "Establishment of the Shanghai Financial Arbitration Commission" Published on 19 Dec, 2007 at http://www.arsh.sjtu.edu.cn/view_news.jsp?newsid=77 [Chinese]

⁵² Chongqing Daily. 渝成立西部首家金融仲裁院 属国内第2专门机构 www.cq.xinhuanet.com Published on 29 July 2010 at http://www.cq.xinhuanet.com/business/2010-07/29/content_20471602.htm [Chinese]

⁵³ Shenzhen Arbitration Commission. "Introduction of the Shenzhen Financial Arbitration Commission" www.fabao365.net Published on 12 January 2010 at <http://www.fabao365.com/news/657785.html> [Chinese]

⁵⁴ See note 1

⁵⁵ Hong Kong International Arbitration Centre. Press Release "CIETAC and HKIAC Sign Cooperation Agreement" Published on 21 February 2008. Access may be obtained at <http://www.hkiac.org/newspdf/27.pdf>

participate in mediation with mediators selected by the arbitral panels⁵⁶. In the case of litigation, mediation presided over by a judge is a required step according to the PRC Civil Procedure Law⁵⁷.

CIETAC arbitration is marked by the option of a combined arbitration-conciliation process.⁵⁸ According to CIETAC officials, this represents “an advantageous mixture of the merits of both, which not only [helps to] resolve disputes, but also renews positive business and personal relations between the parties.”⁵⁹ From 1990 to 1997, CIETAC handled about 4,200 cases. Among these cases, at least 800 were settled by the parties through conciliation performed by arbitrators.⁶⁰ During the arbitration proceedings, parties are generally asked if they would like to try conciliation and if they consent, conciliation proceedings ensue. The arbitrators may, at any time during the proceedings, play the role of conciliator in an attempt to resolve the dispute. Either party may end the conciliation at any time if it thinks it is no longer necessary or will be fruitless.⁶¹ This special feature is outlined in Article 45 of the 2000 CIETAC Arbitration Rules.⁶²

The conciliation phase⁶³ focuses on assisting parties to establish and analyze the facts of their case and evaluate the strengths and weaknesses of each side’s case.⁶⁴ According to Article 46 of the 2000 CIETAC Arbitration Rules, “the arbitration tribunal may conciliate cases in the manner it considers appropriate.”⁶⁵ This provides the CIETAC Arbitrator with a great deal of influence over how the process is conducted. In particular, it allows for ex parte private caucuses between the arbitrator

⁵⁶ See note 1

⁵⁷ Community Legal Information, Setting up business in Mainland China – Resolving commercial disputes in Mainland China, at http://www.hkcliv.org/en/topics/businessAndCommerce/setting_up_business_in_Mainland_China/resolving_commercial_disputes_in_china/index.shtml

⁵⁸ The combination of conciliation and arbitration in China is modelled on the Chinese Civil Procedure law. The 1991 Civil Procedure Law allows domestic civil courts to conciliate all disputes before it. Article 85 of the Civil Procedure Law provides for the basic principles of conciliation in civil litigation, which includes parties’ voluntary participation in conciliation, and conciliation by determining the facts and distinguishing “right from wrong.” With specific reference to the parties’ voluntary participation, Article 88 of the Civil Procedure Law provides that “agreement in conciliation must be reached between the two parties of their own accord and no coercion is allowed.” A party is free to revoke his/her prior agreement to settlement by refusing to sign the receipt, in which case the court resumes the litigation and issues a judgment on the merits. (See: Cao Lijun, COMBINING CONCILIATION AND ARBITRATION IN CHINA: OVERVIEW AND LATEST DEVELOPMENTS, *International Arbitration Law Review*, Sweet & Maxwell [2006])

⁵⁹ *Ibid.*

⁶⁰ Wang Shengchang, Practical Differences in Arbitration Procedures in China and Hong Kong: An Overview, *ICC INT’L COURT OF ARB. BULLETIN: INTERNATIONAL COMMERCIAL ARBITRATION IN ASIA (SPECIAL SUPPLEMENT)* 76, 81 (1998).

⁶¹ *ibid.*

⁶² CIETAC Arbitration Rules (2000), available at www.cietac.org: If both parties have a desire for conciliation or one party so desires and the other party agrees to it when consulted by the arbitration tribunal, the arbitration tribunal may conciliate the case under its cognizance in the process of arbitration.

⁶³ Tang Houzhi, Arbitration: A Method Used by China to Settle Foreign Trade and Economic Disputes, 4 *PACE L. REV.* 519, 521 (1984).

⁶⁴ James A. R. Nafziger & Ruan Jiafang, Chinese Methods of Resolving International Trade, Investment, and Maritime Disputes, 23 *WILLIAMETTE L. REV.* 619, 635 (1987).

⁶⁵ *Id.*

and one of the parties. According to Article 49 of the rules, once an agreement is reached the parties, will sign a settlement agreement and the tribunal will close.⁶⁶

If, during the course of the arbitration proceedings, the parties reach a settlement agreement between themselves through conciliation without the involvement of CIETAC, any of the parties may, if stipulated in their arbitration agreement, request that CIETAC appoint a sole arbitrator to render an arbitration award in accordance with the content of the settlement agreement.⁶⁷ In such cases, the arbitration fee is generally reduced, commensurate with the quantity of work and amount of the actual expenses incurred by CIETAC. On the other hand, parties are free to terminate the conciliation if they feel it is of no use and continue with the arbitration proceedings.⁶⁸

D. Court System

Commercial or financial disputes may be resolved through litigation in Chinese courts. However, local factors such as regional protectionism together with general disadvantages of legal proceedings mean that litigation is often the last resort. No special procedures have been adopted by the courts after the financial crisis.

While no dedicated financial dispute resolution procedures have been established by the Judiciary, it is apparent that the number of financial disputes taken to the courts is on the rise. The Shanghai No.1 Intermediate People's Court recently held a news conference in December of 2010 regarding disputes relating to bank investment products⁶⁹. The Court shared that it had dealt with a total of 80 relevant cases in the past year. The main issues revolved around (i) misleading or fraudulent practices; (ii) unfair standard agreement contracts and (iii) inaccurate or dishonest disclosure of bank financial statements. The Court also expressed that it faced considerable difficulties in the adjudication of such cases due to the technicality of financial products and the lack of developed laws in this area. The Court suggested that the general public increase its awareness of the risks involved in investing in new financial products and closely inspect the terms of such products to prevent the occurrence of future disputes.

⁶⁶ CIETAC Arbitration Rules (2000), available at www.cietac.org: [the parties will] sign a settlement agreement in writing when an amicable settlement is reached through conciliation conducted by the arbitration tribunal, and the arbitration tribunal will close the case by making an arbitration award in accordance with the contents of the settlement agreement unless otherwise agreed by the parties.

⁶⁷ Ibid.

⁶⁸ Ibid. Article 47: The arbitration tribunal shall terminate conciliation and continue the arbitration proceedings when one of the parties requests a termination of conciliation or when the arbitration tribunal believes that further efforts to conciliate will be futile.

⁶⁹ Shanghai No.1 Intermediate People's Court . 上海法院：银行理财产品纠纷多发 吁加强风险防范 [China Daily](http://www.chinadaily.com.cn/hqgj/jryw/2010-12-28/content_1477713.html).
Published on 28 December, 2010 at http://www.chinadaily.com.cn/hqgj/jryw/2010-12-28/content_1477713.html [Chinese]

IV. Structural Challenges

A. The Global Financial Crisis and its Effects in China

In China, the effects of the financial crisis have been severe, though certainly not quite as severe as in major overseas markets. It has prompted the Chinese government to take extraordinary measures such as the enormous stimulus package of 4 trillion yuan,⁷⁰ but the full extent of the economic impact of the global financial crisis is yet to be determined and understood.⁷¹

The impact of the financial crisis in the US in July 2007 flowed into the Chinese equities market. The Shanghai Stock Exchange Composite Index started to slide from its peak of 6124 on 16 October 2007, down to 1664 on 28 October 2008, representing a deep drop of up to 73% in just one year.⁷² This forced the CSRC to suspend the application of IPOs for about ten months since September 2008, in a bid to prevent further market decline and panic.

It should be noted that although China's financial markets and institutions have been affected by the global financial crisis, the impact appears less direct and less severe than is the case with overseas markets. To date, the Chinese financial system as a whole has been relatively sound: no major financial institutions have fallen and no major scandals over transactions of complex financial products have occurred. The losses suffered by Chinese financial institutions as noted above are essentially the consequence of their ill-fated investment in overseas markets rather than in domestic markets. Further, the overall risk exposure of China's financial institutions and listed companies in overseas markets is quite limited and manageable. For example, the Lehman bond investment by the ICBC accounted for just 0.03 percent of its total bond portfolio and 0.01 percent of its total assets. Thus, according to Mr Yao Gang, the Vice-Chairman of the CSRC, the global financial crisis has had only a limited impact on China's stock market.⁷³

⁷⁰ Li Yanping and Chia-Peck Wong, 'China Announces 4 Trillion Yuan Economic Stimulus' (9 November 2008), available at <http://www.bloomberg.com/apps/news?pid=20601068&sid=aIpq71F4BM9Q> (accessed 8 October 2009).

⁷¹ See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

⁷² See Shanghai Stock Exchange, <http://www.sse.com.cn/sseportal/ps/zhs/yjcb/sztjyb.shtml> (accessed 8 October 2009).

⁷³ Li Lin, 'The Vice-Chairman of the CSRC said the impact of the financial crisis on China's stock market is limited' (17 April 2009), available at <http://finance.huanqiu.com/roll/2009-04/436518.html> (accessed 8 October 2009).

It should be noted that while the impact of the global financial crisis on China's financial system is mild, it is a totally different story for the real economy in China. Ms Xiaoling Wu, the Deputy-Director of the Finance and Economics Committee of the 11th National People's Congress of the PRC, commented that the real impact of the global financial crisis in China is on its real economy rather than its financial system. See Xiaoling Wu, Keynote Speech at the Symposium on 'Economic Conditions and Policy Analysis in 2009', GuiYang China, 13 January 2009. Indeed, as China's economy has relied heavily on exports, it has been hit hard by the weak demand overseas, resulting in many factories being forced to shut their doors and millions of migrant workers being sent home. See e.g., '20 Million Laid-off Migrant Workers May Send China's Unemployment Rate to 10%', available at <http://www.chinastakes.com/2009/2/20-million-laid-off-migrant-workers-may-send-chinas-unemployment-rate-to-10.html> (accessed 8 October 2009) ('due to the financial crisis, about 20 million out of 130 million migrant workers, had returned home as they became jobless or failed to find jobs thanks to the economic slowdown').

However, one would be wrong to believe that China's financial regulatory system is completely problem-free, judging from the relatively good health of the Chinese financial markets in the financial storm. China can take some comfort from the fact that its financial system has sustained relatively modest losses in the current financial crisis. At the same time, China's financial markets are not free of challenges. If China is to fulfil its promise as the world's fastest growing economy, it is essential to address these challenges with a view to developing a more efficient financial system.⁷⁴

The focus of the discussion here is on the structural issues of China's financial regulation and financial dispute handling mechanisms, as opposed to the substantive regulatory requirements like capital and other prudential standards.⁷⁵ This is because the regulatory framework has a significant impact on the extent to which regulatory regimes are successful in achieving their objectives.⁷⁶ Indeed, the current financial crisis has brought to the fore the importance of the financial supervisory structure. As US president Obama insightfully pointed out,

And this wasn't just the failure of individuals; this was a failure of the entire system... Where there were gaps in the rules, regulators lacked the authority to take action. Where there were overlaps, regulators lacked accountability for their inaction.⁷⁷

The new financial landscape brought about by financial modernization and innovation demands suitably designed reforms to China's current financial regulatory structure which is based on the traditional segmentation of financial services and markets. Added to this picture is the longstanding problem of structural imbalances with China's financial system, which requires a regulatory framework better able to take concerted action across the financial sectors.

With regard to China's systems of financial dispute resolution, following the financial crisis, China saw the emergence of a few dedicated structures focused on the resolution of financial disputes in Shanghai and Shenzhen. In addition to these dedicated structures, China also has a large number of diverse routes to resolution which include direct settlement negotiation, mediation, arbitration and litigation. At present, no centralized agency charged with investigation and resolution of financial related consumer complaints exists. Such a system could offer the benefits of investigation coupled with a forum for offering recommendations on structural improvements to the retail side of financial product sales.

Existing systems of mediation as a route to financial dispute resolution continue to face challenges such as limited accountability and lack of clarity as to the underlying

⁷⁴ See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

⁷⁵ For discussion of substantive regulatory standards like capital adequacy requirements, see e.g., Hui Huang, 'The Evolution of the Basel Accord: New Issues of Banking Regulation and New Solutions' (2006) 28(1) *Huanqiu Falu Pinglun [Global Law Review]* 100.

⁷⁶ Llewellyn, D, 'Institutional structure of financial regulation and supervision: The basic issues', paper given to the World Bank, Washington DC, June, 2006 (setting out a number of reasons why the institutional structure is important, including regulatory culture, clarity of responsibility, conflicts between objectives, regulatory costs, coverage and regulatory arbitrage).

⁷⁷ 'Remarks by the President on 21st Century Financial Regulatory Reform (June 17, 2009)', available at http://www.whitehouse.gov/the_press_office/Remarks-of-the-President-on-Regulatory-Reform/ (accessed 8 October 2009).

values and principles relevant to the effective resolution of disputes.⁷⁸ Determining how mediation may best overcome existing challenges in the context of changing social values and a burgeoning caseload at the local level are pressing questions facing China's legislature, policymakers and affected citizens both at the local and national levels.

V. Possibilities for Reform: Aligning Supervisory Structures with Country Needs

In exploring ways to further advance China's financial regulatory framework and system of dispute resolution, a comparative analysis of the financial dispute resolution and regulatory structure in various jurisdictions is conducted below. The US, the UK and Australia are chosen for comparison due to the fact that they are all typical of one of three major regulatory models currently in use around the world.

A. Major Structural Models of Financial Governance and Dispute Resolution

1. US: the 'multiple-regulators' model or 'sectoral regulation' model

The US financial governance and dispute resolution takes place within a complex patchwork of authorities at both federal and state levels, which can be understood as a product of the US history and political culture.⁷⁹ In the aftermath of the Great Depression, the New Deal introduced a series of restrictive measures such as the Banking Act of 1933, also known as the Glass-Steagall Act, which segmented financial markets and confined financial institutions to specific business lines. As a result, the businesses of banking, securities and insurance were separated from each other, subject to separate statutes, and supervised by separate regulatory agencies.⁸⁰ This sectoral regulatory framework includes:

- (1) five federal depository institution regulators in addition to state-based supervision, including the famous Federal Reserve which also serves as the central bank in the US;
- (2) one federal securities regulator, namely the Securities and Exchange Commission (SEC), and one federal futures regulator, namely the Commodity Futures Trading Commission (CFTC). The US has additional state-based supervision of securities firms as well as self-regulatory organizations with broad regulatory powers;

⁷⁸ Fu Hualing and Richard Cullen, "From Mediator to Adjudicator: The Limits of Civil Justice Reform in China" (October 2007)

⁷⁹ See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

⁸⁰ See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

(3) insurance regulation is almost wholly state-based, with more than 50 regulators.⁸¹

As this regulatory structure consists of separate agencies responsible for different financial industries, it is aptly termed institutionally-based regulatory model.

Following the passage of the Gramm-Leach-Bliley Act of 1999 (GLB) which permits the establishment of so-called financial holding companies or bank holding companies which may engage in any financial activities including insurance and securities,⁸² and the introduction of functional regulation to cope with the changed financial landscape, under which ‘similar activities should be regulated by the same regulator...’⁸³ the current US financial regulation is more like a combination of functional and institutional regulation or a transition from institutional to functional regulation.⁸⁴ Whichever is the case, there is a common feature of institutional and functional regulation, namely regulatory authority being divided according to financial sectors (either institutionally-based or activities-based) and as such there being a multiplicity of regulators. It follows that institutional and functional regulation can be collectively referred to as the ‘multiple-regulators’ model or ‘sectoral regulation’ model.

Similar to US financial regulatory structures, financial dispute resolution in the United States is marked by multiple overlapping systems and agencies.

In the United States, the use of alternative dispute resolution in the financial arena has largely been in the area of securities as well as refinancing negotiations. The Financial Industry Regulatory Authority (“FINRA”) offers investors the option to resolve disputes via mediation or arbitration of which arbitration is the more popular option. Through August 2010, 3778 arbitration cases were filed and 562 parties agreed to go to mediation.⁸⁵ FINRA deals with a variety of cases such as unauthorized trading, failure to supervise, negligence, breach of contract, misrepresentation and breach of fiduciary duty. The three most popular claims made by investors in FINRA arbitrations in 2009 were: Breach of Fiduciary Duty (2,836), Misrepresentation (2,005), Breach of Contract (1,658), Negligence (1,602) and Failure to Supervise (1,029).⁸⁶

In addition, many states have increased their focus on mediation and arbitration in foreclosure filings to cope with a growing caseload. In Florida, foreclosure filings increased 400% over 3 years thus placing an increasing burden on the limited resources of the courts.⁸⁷ Consequently, the Florida Supreme Court created a Task Force on Residential Mortgage Foreclosures which is currently developing a proposed statewide process (particularly mediation and other forms of ADR for

⁸¹ US Department of the Treasury, *Blue Print for a Modernized Financial Regulatory Structure* (2008).

⁸² 12 U.S.C. §1843(k) (2000).

⁸³ H.R. Rep. No. 106-434, at 157 (1999).

⁸⁴ Heidi M. Schooner & Michael Taylor, ‘United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets’ (2003) 38 *Texas International Law Journal* 317, 328.

⁸⁵ “FINRA - Dispute Resolution Statistics.” *FINRA - Home Page*. Aug. 2010. Web. 10 Oct. 2010. <<http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/>>

• ⁸⁶ Soreide, Leif. “Statistics Reveal Chances of Recovering in a FINRA Arbitration - Finra, Securities, Arbitration.” *Free Press Release - Online Press Release Distribution Service*. Feb. 2010. Web. 10 Oct. 2010. <<http://www.free-press-release.com/news-statistics-reveal-chances-of-recovering-in-a-finra-arbitration-1266711057.html>>

⁸⁷ *Florida Supreme Court Task Force on Residential Mortgage Foreclosure Cases*. Rep. Florida Supreme Court, 2009 pg1

foreclosure cases⁸⁸. In February, the court also established a foreclosure mediation program⁸⁹. Other states such as New Mexico, Connecticut, Oregon, Rhode Island and Missouri are also considering similar legislation that will give homeowners facing foreclosure access to alternative dispute resolution options.⁹⁰

There are also a number of well-established private providers of mediation and arbitration services. For example, the American Arbitration Association (“AAA”) is a full-service ADR provider dealing with a comprehensive range of disputes, including financial services, employment, intellectual property, technology⁹¹. Joining efforts with leading arbitration institutions from other countries⁹², the AAA established the Commercial Arbitration and Mediation Centre for the Americas (“CAMCA”) to specifically address private commercial disputes. Another reputable institution is JAMS (formerly known as the Judicial Arbitration and Mediation Service) which specializes in mediating and arbitrating complex business and commercial cases⁹³. However, the impartiality of these private providers has come under scrutiny. In particular the National Arbitration Forum, an association offering arbitration and mediation services in Minnesota, was accused of being biased towards businesses in consumer-business arbitrations.⁹⁴

2. UK: the ‘single-regulator’ to “dual regulatory” model

In sharp contrast to the US model, traditionally the UK consolidated its regulation of banking, securities and insurance by the Financial Services Authority (FSA).⁹⁵ The FSA was created by the Financial Services and Market Act (2000) to unify regulatory and supervisory functions previously carried out by nine bodies in the UK. However, financial regulation and dispute resolution in the UK is presently undergoing a massive transition in the aftermath of the financial crisis.

In June 2010, the abolition of the FSA was announced. Under the new system of financial regulation, the Bank of England will be in charge of macro-prudential regulation. A new Prudential Regulation Authority will be created as a subsidiary of the Bank, and will conduct prudential regulation. A new Consumer Protection and Regulatory Authority will be created to take on the regulation of the conduct of all financial services businesses, and take over responsibility for the Financial Ombudsman Service and the Financial Services Compensation Scheme.

The Financial Ombudsman Service (FOS) which was established by Parliament as an independent public body in 2006 operates as a centralized entity charged with the resolution of financial disputes. Since 2006, it has also received an increase in

⁸⁸ "Task Force on Residential Mortgage Foreclosure Cases." Task Force on Residential Mortgage Foreclosure Cases. 27 Mar. 2009. Supreme Court of Florida. <<http://www.floridasupremecourt.org/clerk/adminorders/2009/AOSC09-8.pdf>>.

⁸⁹ Ibid

⁹⁰ Court ADR Connection. Apr. 2009. Resolution Systems Institution. <<http://aboutrsi.org/newsletters/?id=37#story153>>.

⁹¹ <http://www.adr.org/>

⁹² , The British Columbia International Commercial Arbitration Centre, the Mexico City National Chamber of Commerce, and the Quebec National and International Commercial Arbitration Centre. See Introduction (English) of the CAMCA Mediation and Arbitration Rules at <http://www.adr.org/sp.asp?id=22092#Inte>

⁹³ <http://www.jamsadr.com/>

⁹⁴ Bank v Consumers (Guess Who Wins) Businessweek. <http://www.businessweek.com/magazine/content/08_24/b4088072611398.htm>

⁹⁵ See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

complaints due to the recent financial turmoil.⁹⁶ The FOS provides free and independent advice to consumers regarding the resolution of disputes with financial companies.⁹⁷ If it decides the case has merit, it will attempt to resolve the complaint via mediation. Where informal settlements fail, the FOS may set up more detailed investigations including an ‘appeal’ to one of their panel of ombudsmen for a final decision.⁹⁸ In 2008/2009 financial year, 51% of complaints were resolved via mediation, 41% via adjudication and only 8% by a formal review carried out by an ombudsman. Complaints regarding investment disputes increased by 30% in 2008 from the previous year while disputes in unsecured loans and mortgages increased by 44% and 11% respectively.⁹⁹

As a supplement to the work of the FOS, arbitration and mediation cases in the United Kingdom are also on the rise following the recent financial crisis. A report by TheCityUK, an independent body established to promote the UK financial and related professional services industry, indicates that the total number of disputes resolution through arbitration and mediation sums up to a total of 34,541 in 2009, up 78% from the 2007 figures of only 19,384 cases¹⁰⁰.

Arbitration in the United Kingdom is governed by the Arbitration Act 1996 which lays out detailed rules on how an arbitration process should be conducted. The arbitration process may be conducted by arbitrators chosen by the concerned parties.

The members of the Panel on of Independent Mediators, whose members handle an estimated one in five of all meditations conducted in the United Kingdom, are also well recognized as leading commercial mediators in the UK¹⁰¹. IDRS is an independent institution run by the Chartered Institute of Arbitrators which provides arbitration services for commercial dispute resolutions for consumers and businesses. The Centre for Effective Dispute Resolutions (CEDR), a leading alternative dispute resolution body in Europe provides commercial and workplace mediation service while the London Court of International Arbitration (“LCIA”) deals with mostly international disputes.

3. Australia: the ‘twin-peaks’ model or ‘objectives-based regulation’ model

Australia’s current financial regulatory regime consist of two regulators.¹⁰² The first regulator, the Australian Securities and Investment Commission (ASIC), has responsibility for business conduct regulation across banking, securities and insurance.¹⁰³ The second regulator in the Australian regime, namely the Australian Prudential Regulatory Authority (APRA), is responsible for prudential regulation, ensuring the financial soundness of all licensed financial institutions except for securities firms which are regulated by the ASIC.

⁹⁶ Annual Review Financial Ombudsman Service. Rep. UK: Financial Ombudsman Service, 2009. pg 7

⁹⁷ "In a Crisis." BBC. <http://www.bbc.co.uk/raw/money/in_a_crisis/?noflash>

⁹⁸ "Financial Ombudsman Post Mooted." *News.gov.hk*. 23 May 2009. Web. <<http://news.gov.hk/en/category/businessandfinance/090523/html/090523en03002.htm>>.

⁹⁹ Ibid

¹⁰⁰ TheCityUK. “Dispute Resolution in London & the UK”. September 2010. Available at <http://aryme.com/docs/adr/2-2-2178/arbitraje-mediacion-uk-2010-uk-the-cityuk-arbitration-mediation.pdf>

¹⁰¹ Themediator magazine. “PIM introduces “Senior Mediators” brand” Available at <http://www.themediatormagazine.co.uk/news/1-latest/49-pim-senior-mediators>

¹⁰² See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

¹⁰³ Australian Securities and Investments Commission Act 2001.

Similar to the twin peaks financial regulatory system in Australia,¹⁰⁴ there are two external dispute resolution schemes approved by the Australian Securities and Investment Commission: the Financial Ombudsman Service and the Credit Ombudsman Service¹⁰⁵. One of these two mechanisms are used when mandatory internal complaints procedures within financial service providers in Australia fail to provide for resolution.

On 1 July 2008, three of the largest existing complaints schemes in the financial services industry of Australia were consolidated into a centralized financial dispute resolution scheme. The Banking and Financial Services Ombudsman, the Insurance Ombudsman Service and the Financial Industry Complaints Service were merged into a single external dispute resolution service under a newly created company. Subsequently, on 1 January 2009, the Credit Union Dispute Resolution Centre and Insurance Brokers Disputes Limited were also merged in to become the Mutuals division and the Insurance Broking divisions respectively¹⁰⁶.

From 1 January 2010, the Financial Ombudsman Service Terms of Reference were in effect, and apply to disputes lodged on or after the date on which the Terms of Reference came into force¹⁰⁷.

The new terms are directed at increasing consistency in treatment of consumers as well as financial service providers, and replace five separate sets of rules and guidance procedures. For general insurance claims, the jurisdiction of the FOS has been increased from AU\$280,000 to amounts under AU\$500,000 – but compensation payments remain capped at AU\$280,000. Clients of insurance brokers will also be able to bring claims of up to AU\$500,000, a large increase from the previous limit of AU\$100,000. Compensation also remains capped at AU\$100,000, but is set to increase to AU\$150,000 on 1 January 2012¹⁰⁸. Consequential losses and interest may also be added to compensation awards.

The ability of the Financial Ombudsman Service to make determinations against Australian Financial Service licensees in respect of complaints about matters not included in the definition of ‘financial services’ under the Corporations Act or the Australian Securities and Investments Commission Act has potentially expanded the jurisdiction of the FOS to include “rental properties, antiques and collectibles, estate and structuring advice if a representative of an AFS licensee provides advice in relation to them that results in a loss.”

The FOS is also empowered to hear complaints from non-retail clients “at its discretion”.

¹⁰⁴ See: Huang, Hui, Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (November 23, 2009). *Journal of Corporate Law Studies*, Vol. 10, pp. 219-254, 2010.

¹⁰⁵ <https://storm.asic.gov.au/fido/fido.nsf/byheadline/Financial+services+complaints+schemes?openDocument> please note that this differs from the number of EDR schemes set out on the ASIC website at <http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC+approved+external+complaints+resolution+schemes?opendocument> – for further, please see the Financial Co-operative Dispute Resolution Scheme below

¹⁰⁶ http://www.fos.org.au/centric/home_page/news/the_financial_ombudsman_service_establishes_mutuals_and_insurance_broking_divisions.jsp

¹⁰⁷ http://www.fos.org.au/centric/home_page/about_us/terms_of_reference_b.jsp

¹⁰⁸ http://www.insurancenews.com.au/local/new-year-new-fos-terms-of-reference?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+insurancenews%2Fallstories+%28All+Stories+and+Events%29

However, an FOS ombudsman cited the jurisdiction of FOS-predecessor, the Financial Industry Complaints Service, as also having the same discretion, which was rarely exercised. Furthermore, the jurisdiction of the FOS is not limited by the definitions in the Corporations Act¹⁰⁹. It should be noted that ASIC encourages external dispute resolution schemes to “accept complaints or disputes from a broader range of complainants or disputants than set out in the retail client definition or those who are provided with credit or credit services and guarantors under the National Credit Act”¹¹⁰.

The Credit Ombudsman Service

In addition to the Financial Ombudsman Service, another external dispute resolution scheme has recently emerged from obscurity in respect of financial advice and investment-related disputes – the Credit Ombudsman Service Limited.

The Credit Ombudsman Service was originally incorporated as the Mortgage Industry Ombudsman Service Limited in 2003, before adopting its present name in 2004¹¹¹. It provides a free dispute resolution service for consumer complaints against its members, which include, non-bank lenders, finance brokers, credit unions, building societies, debt collection firms, financial planners, trustees, servicers, aggregators, mortgage managers etc¹¹².

It was in the past considered an external dispute resolution scheme only for the mortgage broking industry, but this was the result of misinformation and the investment industry’s relative ignorance of its existence¹¹³.

However, financial advisory and investment groups appear to be taking greater notice of the scheme, which has also had its profile raised by the introduction of the national consumer credit regime in Australia.

B. The Way Forward for China

As shown above, the US, the UK and Australia are representatives of three major structural models of financial regulation adopted by jurisdictions around the world: the ‘multiple-regulators’ model or ‘sectoral regulation’ model; the ‘single-regulator’ model or ‘integrated regulation’ model; and the ‘twin-regulators’ model or ‘objectives-based’ model. While the US has a multiplicity of financial regulators and systems of dispute resolution segregated on the basis of the type of financial institutions or activities, the UK sits at the other end of the spectrum with traditionally one universal regulator for most of its financial markets. Australia lies between the US and the UK, dividing responsibility for financial regulation between the ASIC and the APRA.

1. A Comparison of the Structural Models

Naturally, each regulatory model and corresponding systems of financial dispute resolution has its own advantages and disadvantages. The merits of one model are always the demerits of another, and vice versa. The US multiple-regulators model and segmented dispute resolution framework have several significant problems. First, it is essentially a model designed for the traditional segmented financial markets, and thus

¹⁰⁹ <http://www.moneymanagement.com.au/news/criticism-of-expanding-fos-jurisdiction>

¹¹⁰ Regulatory Guide 139.78

¹¹¹ <http://www.cosl.com.au/COSLs-History>

¹¹² <http://www.cosl.com.au/COSLs-Role>

¹¹³ <http://www.moneymanagement.com.au/news/fos-alternative-emerges>

is ill-suited to the new financial landscape brought about by financial modernization such as the emergence of large financial conglomerates. As each regulator is focused on its designated part of the financial system, they often fail to see the woods for the trees. In other words, no single regulator possesses all of the information and authority necessary to monitor systemic risk. Similarly, segmented routes to resolution post-dispute make the route to redress unclear. By contrast, a unified regulator is able to approach financial regulation from a large perspective, dealing with regulatory hazards in a holistic fashion.

Although the traditional UK single-regulator model and centralized system of financial dispute resolution addresses the above problems facing the US multiple-regulators model, it does not come without its own shortcomings. First, while the UK model has the advantage of economy of scale, there are concerns that a single regulator is far too powerful.¹¹⁴ This problem is somewhat mitigated in Australia by creating two regulators. Second, the broad scope of regulatory responsibilities assigned to a single regulator may be such that the senior management of the regulator is overloaded and regulatory efficiency reduced. In contrast, the division of regulatory tasks to a number of regulators allows regulatory diversity and specialisation.¹¹⁵ Third, a unified agency may be susceptible to reputational contagion, as a mistake in one part of the agency may undermine their credibility over the broad range of their responsibilities. Since its formation, the UK's FSA has been the subject of much criticism over its handling of one insurance company, Equitable Life. This has brought a lot of negative publicity to the FSA generally for what is essentially a single failure in their prudential regulatory role only.¹¹⁶

2. Short and Long-term Recommendations

While each of the three regulatory and dispute resolution models have their own strengths and weaknesses, it is important to examine their potential contribution in the Chinese context with a view to finding an appropriate solution to the needs of China's financial governance and dispute resolution systems.

As shown earlier, the Chinese financial regulatory regime is broadly similar to the US, both adopting the traditional sectoral structure with a multiplicity of regulators. One major difference is that unlike the US, China has removed the central bank, i.e., the PBC, from the responsibility for regulating individual banks. This is in line with the international trend of divesting the central bank of a direct role in banking supervision, as evidenced by both the UK and the Australian models.

Given the similarity of financial regulatory and multiple dispute resolution structures, in the short term, China may gain insights from the US practice without radically changing the overarching structural model. In the US, the Federal Reserve is given umbrella regulatory authority over bank holding companies. Under the recent reform plan announced by the Obama administration, the Federal Reserve will have new authority to supervise all firms that could pose a threat to financial stability, even

¹¹⁴ Drummond, M., 'Sherry sours merger', *The Australian Financial Review*, Feb, 2008.

¹¹⁵ Jeremy Cooper, Deputy Chairman of ASIC, 'The Integration of financial regulatory authorities-the Australian experience' (2006) (speech delivered at the Securities and Exchange Commission of Brazil 30th Anniversary Conference, Rio de Janeiro, Brazil, September 2006).

¹¹⁶ Heidi M. Schooner & Michael Taylor, 'United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets' (2003) 38 *Texas International Law Journal* 317, 344.

those that do not own banks.¹¹⁷ This effectively extends the Federal Reserve's consolidated supervision to all large, interconnected financial groups whose failure could have serious systemic effects. As a result, financial firms will not be able to escape regulatory oversight simply by manipulating their legal structure. Moreover, a new Financial Services Oversight Council of financial regulators is to be created to improve interagency cooperation and prevent things falling down the cracks amongst various regulators.

China's current development of dedicated financial dispute resolution mechanisms within provincial level courts and arbitration tribunals, negotiation and some budding facilitative mediation services provide the opportunity to continue to gather experience in the field of financial dispute resolution and build greater public awareness. Such diverse and multiple routes to resolution (whether through court-based mechanisms, arbitration, negotiation or mediation services), in the short term, appear to provide the benefit of developing a pool of experience and at the same time provide growing confidence among users in the ability of such mechanisms to effectively resolve financial disputes.

In the intermediate or long run however, China cannot rely on the US experience given its anachronistic character, but instead needs to consider the Australian model or to a lesser extent the direction that the UK model is moving in which is largely similar to the Australian model. The Australian and the UK models attempt to thoroughly overhaul the regulatory structure, taking a novel approach to financial regulation and dispute resolution. They are better adapted to the realities of modern financial markets than the sectoral structure, dispensing with the traditional boundaries between banking, securities and insurance.

The key difference between the UK and the Australian models is that while the former assigns all regulatory responsibilities to a single regulator, the latter divides responsibilities and creates two separate regulators: one for prudential regulation and the other for business conduct regulation. Similarly, there are two external dispute resolution schemes approved by the Australian Securities and Investment Commission: the Financial Ombudsman Service and the Credit Ombudsman Service¹¹⁸. One of these two mechanisms are used when mandatory internal complaints procedures within financial service providers in Australia fail to provide for resolution. Experience has shown that this dual system of regulation has served to create greater effectiveness given the distinct requirements of prudential and other business conduct regulation.

Similarly, the differences in dispute resolution case-type handled by the Australian Financial Ombudsman Service (which hears disputes involving financial service providers) and the Australian Credit Ombudsman Service (which hears disputes involving non-bank lenders, finance brokers, credit unions, building societies, debt collection firms, financial planners, trustees, servicers, aggregators, mortgage managers etc¹¹⁹) are notable. Specialization in case handling between the two

¹¹⁷ US Department of the Treasury, 'Financial Regulatory Reform: A New Foundation' available at <http://www.ustreas.gov/initiatives/regulatoryreform/> (accessed 18 October 2009).

¹¹⁸ <https://storm.asic.gov.au/fido/fido.nsf/byheadline/Financial+services+complaints+schemes?openDocument> please note that this differs from the number of EDR schemes set out on the ASIC website at <http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC+approved+external+complaints+resolution+schemes?opendocument> – for further, please see the Financial Co-operative Dispute Resolution Scheme below

¹¹⁹ <http://www.cosl.com.au/COSLs-Role>

Ombuds services allows for the development of more refined expertise in these two areas.

Recent reviews of the financial dispute resolution structure in Australia have found that the existence of two competing dispute resolution schemes is inherently positive for consumers and financial service providers. Despite some complaints in respect of the jurisdiction of such schemes¹²⁰, the broad range of disputes covered by the two schemes can enhance consumer protection in the financial services market of Australia. The efforts made under these schemes in respect of financial hardship in particular have the potential to alleviate or mitigate some of the effects of the aftermath from the financial crisis¹²¹.

VI. Conclusion

The article has shown that the financial dispute resolution and regulatory system in China has undergone significant changes since economic reforms in the late 1990s. The current Chinese regulatory regime is broadly similar to its US counterpart, adopting a traditional sectoral regulatory structure. It comprises the PBC as the central bank and three sector-specific regulators, namely the CBRC, the CSRC, and the CIRC responsible for banking, securities and insurance respectively. Similarly, its financial dispute resolution structures are just emerging at the provincial level as specialized programs within courts and arbitral tribunals.

In quest of potential insights that may contribute to the advancement of China's system of financial dispute resolution and regulation, a comparative analysis is carried out of the financial regulatory and dispute resolution regimes in major Western economies including the US, the UK and Australia. Each of these jurisdictions represents a different regulatory approach, namely the 'multiple-regulators' model or 'sectoral regulation' model in the US, the 'single-regulator' model or 'integrated regulation' model in the UK, and the 'twin-peaks' model or 'objectives-based regulation' model in Australia. When looking to these models for guidance, regard is had not only to their objective merits, but also to China's local conditions. It is finally submitted that the US model merits consideration in the short term, and with the further growth of China's financial markets in the long run, the Australian model provides the preferred direction for reform over the UK one.

¹²⁰ See:

http://www.bankingday.com/nl06_news_selected.php?act=2&stream=1&selkey=10450&hlc=2&hlw=financial+ombudsman+service&s_keyword=financial+ombudsman+service&s_searchfrom_date=631112400&s_searchto_date=1297148351&s_pagesize=11&s_word_match=2&s_articles=1&stream=1

¹²¹ http://www.bankingday.com/nl06_news_selected.php?act=2&stream=1&selkey=9722&hlc=2&hlw=financial+ombudsman+service&s_keyword=financial+ombudsman+service&s_searchfrom_date=631112400&s_searchto_date=1297148351&s_pagesize=11&s_word_match=2&s_articles=1&stream=1