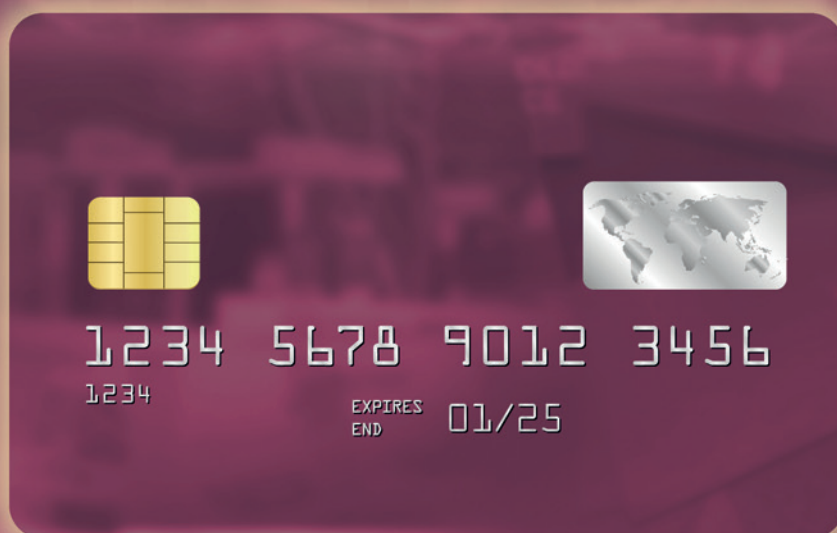


Chargeback



Consumer Protection on Prepayment and Retailer Insolvency

Review of Chargeback and Beyond

信用卡退款保障機制及
法律保障的研究

預繳式消費與商戶倒閉



消費者委員會

CONSUMER COUNCIL

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Abbreviations

AE Rules	The Merchant Reference Guide of American Express
AI or AIs	Authorized institution or authorized institutions
CCA	The United Kingdom Consumer Credit Act 1974
CMMC	The Australia Code Compliance Monitoring Committee
Council	Consumer Council
ECC-Net	European Consumer Centres Network
EU	European Union
FOS	Financial Ombudsman Services
Guidance Note	The Guidance Note issued by the Australia Code Compliance Monitoring Committee in 2014
HKMA	Hong Kong Monetary Authority
IPPs	Instalment Payment Plans
IPPs Circular	Circular issued by the Hong Kong Monetary Authority to all authorized institutions dated 16 August 2010
Manual	Supervisory Policy Manual for Credit Card Business (CR-S-5) issued by the Hong Kong Monetary Authority
J.V. Fitness	J.V. Fitness Ltd
OFT	The United Kingdom Office of Fair Trading
Regulation Z	Truth in Lending Act, Regulation Z
Section 75	Section 75 of the UK Consumer Credit Act 1974
Section 278	Section 278 of the Australian Consumer Law
TICF	Travel Industry Compensation Fund
UK	The United Kingdom
USA	The United States of America
Visa Rules	The Visa Core Rules
2011 Inquiry	The Inquiry conducted by the Australia Code Compliance Monitoring Committee in 2011
2013 Inquiry	The Inquiry conducted by the Australia Code Compliance Monitoring Committee in 2013

Online Content

All websites and electronically available materials referenced in this report were last accessed on 15 February 2017.

Executive Summary

Introduction

Consumers often pay for goods or services in advance of receiving them, either in the form of deposit or purchase price. This is very popular among different industries in Hong Kong, notably in purchase of flight tickets, beauty package, fitness club membership, mobile phones, electric appliances and home furniture. Consumers may prepay in accordance with trade usage, such as the requirement for deposit upon placing an order for home furniture; or act upon specific business models, such as online shopping. They may also make prepayment simply for convenience or attracted by special offers. But what underlying the prepayment are risks of losing money, particularly in the event of retailer insolvency where consumers, as unsecured creditors without preferential right under the insolvency law, have a very slim chance to recover their money. Apart from not being able to enjoy the purchased goods or services, they may also suffer financial loss. When a sizeable retailer goes out of business, a large group of consumers will be affected and the loss involved could be enormous. Predicaments faced by consumers will also arouse public attention and discussion.

Credit card is one of the most preferred forms of payment in Hong Kong. According to the statistics of the Hong Kong Monetary Authority (“HKMA”), the total value of retail sales spending for credit cards issued in Hong Kong in 2016 is about HK\$ 474.4 billion, where a significant part of which could be prepayment. Although consumer protection in retailer insolvency could be strengthened by changing the hierarchy of creditors’ claim in favour of prepaid consumers, this would involve very difficult issues to resolve. A more pragmatic approach would be to improve the protection of credit card prepayment in the event of retailer insolvency. Consumers who paid by credit card may apply to their card issuers to recover prepayment through the chargeback mechanism. In view of the above, the Consumer Council (“the Council”) has conducted an in-depth study on how the chargeback mechanism could be enhanced to better protect consumer prepayment in retailer insolvency.

Scope of the study

The objectives of this study are:

- (1) To evaluate the application, operation and limitation of chargeback as a means to protect consumers in the event of retailer insolvency;

- (2) To recommend measures to strengthen the protection of chargeback in the interest of consumers; and
- (3) To explore the introduction of the concept of connected lender liability by legislation with a view to enhancing legal protection of consumers in retailer insolvency.

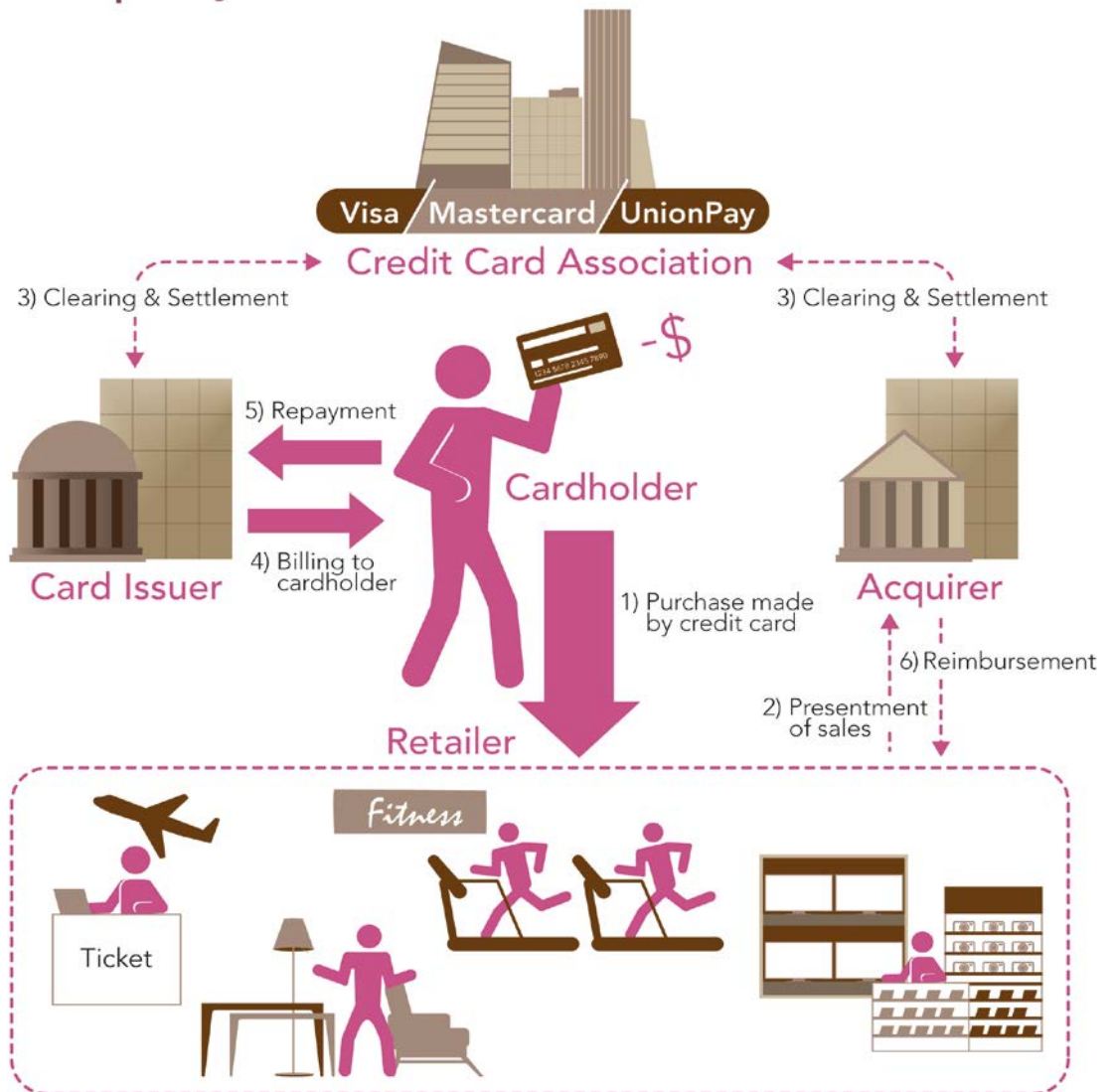
Methodology

A questionnaire survey (“**the Survey**”) was sent to 20 major card issuers and 2 major card associations in Hong Kong in 2016. Replies from 15 card issuers and 1 card association were received. Furthermore, the Council has also reviewed the respondent card issuers’ websites and cardholder agreements, and conducted a research on credit card prepayment protection in different overseas jurisdictions. Besides, the Council also analysed 3 sizeable retailer insolvencies including California Fitness, DSC and Oasis Airlines. From the above, the Council has identified the deficiencies of the existing chargeback mechanism and made recommendations to improve consumer protection in prepayment and retailer insolvency.

The Credit Card Cycle and the Parties Involved

The first step to understand chargeback mechanism is to understand a credit card transaction cycle and the relationship of the parties involved. A typical credit card transaction usually involves five entities, namely cardholder, retailer, card issuer (e.g. banks), credit card association (e.g. Visa and Mastercard) and acquirer (e.g. banks). The card issuer enters into an agreement with and issues credit card to the consumer, who uses the credit card to pay for the goods or service. Then the acquirer processes the payment in accordance with its agreement with the retailer. The transaction will be cleared and settled by the credit card association. On the other hand, the consumer will pay the outstanding amount before the due date shown on the credit card statement. Both the acquirer and the card issuer are members of the credit card association and are contractually bound by operational rules of the respective credit card association (“**scheme rules**”). But neither the retailer nor the cardholder is a member of the credit card association or is bound by the scheme rules. The diagram below explains the relationship of parties and procedures involved in a credit card transaction.

A 5-party Credit Card Transaction



Chargeback

Chargeback essentially is a mechanism set out in the scheme rules of credit card associations which allows transactions to be reversed and makes refund of the transaction amount or outstanding transaction amount to the cardholder under specified circumstances, for instance, where the retailer fails to deliver goods or services after payment.

To illustrate, a consumer purchased a television from a retailer by credit card but the retailer closed down before delivery. The consumer is unable to seek either refund or delivery of the television. It is also not optimistic that the consumer can obtain any compensation through the winding-up process. In such circumstances, the consumer may contact the card issuer and request a chargeback be raised. The card issuer will ask

for supporting documents and examine the request. If the request is accepted, the card issuer will raise a chargeback claim against the acquirer pursuant to the scheme rules. Upon acceptance of the chargeback claim, the acquirer will reimburse the card issuer which will in turn refund the amount at stake to the consumer.

Under the scheme rules, the acquirer may dispute the validity of chargeback claim and the matter would be referred to arbitration for determination. The outcome of the arbitration is legally binding on both the card issuer and the acquirer.

As administrative costs and fees would inevitably be incurred in handling a chargeback claim, the card issuer may, where the transaction amount is small, make refund to the consumer at its own expense for the sake of cost efficiency without invoking chargeback. It is more so when the card issuer wishes to maintain an amicable relationship with the cardholders.

On the other hand, unless the acquirer can successfully recover the sum from the insolvent retailer, the loss will ultimately fall upon them. In order to mitigate the financial risks arising from retailer insolvency or other incidents, acquirers can defer credit card payment to retailers.

As mentioned, chargeback is enshrined in scheme rules which are contractual arrangements among the business entities. Consumers as a non-party are often unaware of the details, and can only rely on the information and assistance provided by card issuers.

Credit Card Instalment Payment Plans (IPPs)

It has to be noted that not all transactions in which credit cards are used are protected by chargeback mechanism. Unlike direct debit authorization instructions arranged through credit cards, credit card instalment payment plans (“IPPs”) is a loan agreement between the bank and the cardholder, under which the bank advances a one-off loan to the cardholder and pays the full amount to the retailer, while the cardholder undertakes to repay the amount to the bank by instalments through the credit card applied. This payment method is commonly used in the purchase of electrical appliances and subscription of beauty/fitness club membership.

As IPPs is by nature a loan provided by card issuers, rather than a typical credit card transaction, chargeback protection is generally not available. For example, a retailer of home appliances closed down after a consumer had purchased from it a high

performance TV set by IPPs, the consumer is still bound to make the repayments to the card issuer until the loan amount is paid off even though the TV set has never been delivered.

Key findings

Lack of clear and consistent application requirements and procedures

According to the Survey, all the respondent card issuers do provide chargeback protection to their cardholders in the event of retailer insolvency. However, there is a lack of clear and consistent application requirements and procedures for raising a chargeback request. For example, some card issuers require consumers to first resolve the dispute with traders or liquidators before submitting a chargeback request, while others do not appear to have such a requirement. Discrepancies were also found in the prescribed time limit for raising a chargeback by cardholders. For example, some card issuers require cardholders to submit chargeback request within 60 days from statement, instead of 120 days from expected delivery date usually required by scheme rules.

Lack of transparency

The Council finds that no clear information about chargeback is provided in the cardholder agreements and card issuers' websites. Although it is mentioned in the cardholder agreements that cardholders may submit any disputed transaction within a certain period of time, there lacks specific provision regarding chargeback protection or guideline for application. Meanwhile, there is also a lack of service pledge from card issuers in handling consumers' chargeback request. Another example is some card issuers require cardholders to submit a designated dispute form for the purpose of raising a chargeback application, but the form is not readily available on the card issuer's website which is inconvenient to consumers.

Uncertainty in the outcome of application

As scheme rules are contractual arrangements among business entities, it is difficult for consumers being a non-party to know the details and latest content of the scheme rules. In the absence of any express provision in the cardholder agreement, even if the consumer has a valid ground of chargeback, the card issuer is under no contractual obligation to raise a chargeback claim for the consumer. In gist, it depends on the discretion of card issuers. As such, unless the card issuer is handling the chargeback

requests in accordance with a set of guidelines which are publicly available, consumers would be uncertain about the circumstances under which the card issuer would raise the chargeback claim for them, not to mention whether they are protected by chargeback mechanism.

Some of the above problems were reflected in the insolvency of California Fitness, DSC and Oasis Airlines. Although there were successful cases to recover prepayment by making use of chargeback, some card issuers refused to handle the consumers' chargeback requests. Some complainants indicated that when they approached the card issuers for enquiries, hotline staff of card issuers failed to provide consistent and accurate information about chargeback to them. They therefore missed the opportunity to recover their prepayment through chargeback.

Overseas experiences – chargeback and connected lender liability

The above research findings indicate that the transparency of chargeback in Hong Kong has room for improvement. Although the Code of Banking Practice, issued by the Hong Kong Association of Banks and the DTC Association and endorsed by the HKMA, has set out recommendations with respect to credit card services of card issuers, at present there is no specific legislative or regulatory provision requiring card issuers to handle cardholders' chargeback request. To ensure cardholders are aware of the risk of using IPPs, the HKMA has issued a circular setting out the regulatory measures for banks to follow if they offer IPPs which are not subject to chargeback protection. Such measures include a written confirmation by consumer with regard to the important terms of the IPPs, for example the provisions stating that consumer could not enjoy chargeback protection and he/she will not be able to cease payment to the bank even if the goods or service is not delivered by the retailer.

This Report examines the laws and regulations regarding chargeback in the USA, EU, the UK, Australia, Singapore, Mainland China and Taiwan. The Council finds that inadequate transparency of chargeback is a problem commonly encountered by many jurisdictions. The UK Law Commission recommended different measures to improve the transparency of chargeback which require the collaboration of various stakeholders. For example, it proposed card issuers to formulate an industry code of practice and issue a chargeback guide for consumers; and liquidators to provide more chargeback information to consumers. In Australia, the Code of Banking Practice and the Guidance Note on Chargeback issued by the Australian Bankers' Association and Code Compliance Monitoring Committee provide detailed guidance to the banks on how to handle

chargeback requests and inform consumers of the availability of chargeback protection. For instance, banks are required to provide in their cardholder agreements general information on chargeback.

Apart from chargeback protection, this Report also looks into a legal concept having an important bearing on consumer protection, namely the connected lender liability. Essentially, it means that a credit provider will be held jointly liable to the consumers for the retailer's breach of contract and/or misrepresentation. In the context of credit card transactions, card issuers, as credit providers, use attractive offers to invite consumers to apply for credit card, and encourage credit card consumption by launching promotion campaigns with traders. Under this concept, card issuers shall be jointly liable with the retailers.

Connected lender liability has been applied to different types of consumer credit consumption under the consumer protection legislation in the USA, EU, the UK and Australia. Among these jurisdictions, the Consumer Credit Act in UK applicable to credit card spending with no geographical constraint, offers the most comprehensive protection to consumers allowing them to recover loss from the card issuer direct in the event of retailer insolvency. Early in 1965, a committee was established in the UK to study the consumer credit law. The committee recommended that connected lender should be jointly liable for consumers' loss in the event of retailer insolvency. Subsequently, the UK Government implemented the recommendation and introduced connected lender liability by the Consumer Credit Act in 1974.

The Council is of the view that the UK and Australia's experiences provide very useful reference to Hong Kong in formulating measures to improve the transparency and operation of the chargeback mechanism. Furthermore, in order to strengthen the protection to consumers using IPPs, it is advisable for the Government to consider introducing connected lender liability by legislation with reference to the practices of the UK.

Recommendations

The study concluded that there is an imminent need to improve the chargeback mechanism in Hong Kong to better protect prepayment by consumers. Besides, existing legal protection for consumers who make purchase by IPPs is clearly not adequate. Looking forward, the Council proposes the following recommendations to the relevant stakeholders:

(1) Card Issuers

1. Supply cardholders with clear and easy-to-understand chargeback information in the cardholder agreements and card issuer's website;
2. Provide a chargeback guide to assist consumers in raising a chargeback claim;
3. Provide training to ensure that frontline staff are knowledgeable enough to explain the chargeback mechanism and its procedures to cardholders; and
4. Upon receiving a consumer's request for chargeback, exercise the right of chargeback against the acquirer under the scheme rules as soon as practicable.

(2) The HKMA

Since most of the card issuers in Hong Kong are banks and subject to the supervision of the HKMA, it is recommended that the HKMA should issue regulatory guidance to card-issuing banks to ensure that they consistently implement the above improvement measures to enhance the transparency of chargeback and its service pledge.

(3) Liquidators

The Official Receiver's Office and Hong Kong Institute of Certified Public Accountants shall provide guidance to insolvency practitioners, encouraging them to provide consumer creditors with more information about chargeback in the course of liquidation, including:

1. Remind consumers who have made prepayment by credit cards to request their card issuers to submit a chargeback claim;
2. Remind consumers that further information on chargeback can be found in the chargeback guide provided by the card issuers;
3. Posting a notice on the retailer's website that the retailer is in liquidation together with hyperlinks to the card issuers' chargeback website; and
4. Making available to consumers other evidence or information which may be required for chargeback application.

(4) The Government

Even if the above recommendations are in place, consumers who made purchase by IPPs are still unprotected. To further enhance the interest of consumers, the Council urges the Government to follow the practices of the UK and introduce connected lender liability by

legislation, allowing consumers (including those who use IPPs) to recover credit card prepayment from card issuers in the event of retailer insolvency. Without resorting to the winding-up process, consumers may claim their credit card issuers for retailer's breach of contract and recover their credit card prepayments. However, to strike a balance between consumer protection and maintaining business competitiveness, it is proposed that the extent of liability may be limited to the amount of the credit provided to the consumers.

Although connected lender liability would require card issuers to bear the loss of consumers in the event of retailer insolvency, card issuers could recover its loss from the acquirer through chargeback under the scheme rules to mitigate their exposure. This may also encourage card issuers to utilize chargeback protection for consumers in appropriate circumstances.

Conclusion

Retailer insolvency is a common hidden hazard of consumer prepayment. Consumers may suffer "double loss" - being not able to enjoy the goods or services purchased and failing to recover the payment. Under the current insolvency law, Hong Kong consumers do not enjoy any special protection as unsecured creditors. Very often, it is extremely difficult for them to obtain redress from the winding-up process.

Chargeback is a long-established mechanism intending to provide effective and practical protection to consumer credit card prepayment. By virtue of this Report, the Council wishes to generate public discussion and call for the concerted efforts of card issuers, the HKMA, liquidators and the Government to improve protection for consumer prepayment by credit card.

Having said that, chargeback is generally not applicable to IPPs. The introduction of connected lender liability can establish consumer rights in retailer insolvency. It is a direction worth exploring. Given the use of credit card plays a predominate role in the local consumption activities, improving credit card prepayment protection will definitely be beneficial to both consumers and the economy as a whole.

In case of any inconsistency between the English and Chinese versions, the English version shall prevail.

摘要

引言

在收取貨品或享用服務前，先付按金、貨價或費用，在香港是一種十分普遍的消費支付形式，涵蓋不同行業，常見於購買機票、美容套票、健身中心會籍、手機和家具電器等產品。消費者預繳可能純粹是因應行業的慣常做法（如訂購傢俬一般須先付按金）或特定的經營模式（如網上零售），亦可能是受預購所帶來的方便和優惠所吸引。然而，預繳消費潛在一定風險，尤其當提供貨品或服務的商戶倒閉，在公司破產法例下消費者列為沒有優先權的無抵押債權人，能夠討回預繳款項的機會渺茫，在未能享用所購產品或服務之餘，又可能蒙受金錢損失。當有具規模的企業倒閉，大量預繳的消費者受到影響，而當中涉及金額可以是很龐大，消費者面對的窘境及在這情況下的保障，亦會成為社會的討論焦點。

信用卡是現時香港最受歡迎的支付方式之一。根據香港金融管理局（「金管局」）的統計數字，2016 年以香港發行的信用卡作為支付方式佔本地零售銷售總值達到 4,744 億港元，當中不少應用於預繳式消費。要增加對消費者的保障，其一辦法是改變公司破產法例下的償付次序，但此舉會涉及不易解決的問題，所以較實際可行的消費者保障方案是改善以信用卡預付的消費者在商戶倒閉時的保障，因為使用信用卡付款的消費者可要求發卡機構運用信用卡退款保障機制，好讓他們有機會取回已付款項；故此消費者委員會（「本會」）就現存的信用卡退款保障機制如何在商戶倒閉時更有效地保障消費者進行了深入研究。

研究範圍

這專題研究的重點包括：

- (1) 探討信用卡退款保障機制在商戶倒閉時，作為保障消費者的途徑，其應用、運作和限制；
- (2) 就加強信用卡退款保障機制對消費者的保障提出建議；及
- (3) 探討立法引入「關連貸款人責任」的概念，以加強商戶倒閉時對消費者的法律保障。

研究方法

本會於 2016 年進行了一項問卷調查（「問卷調查」），向 20 間發卡機構和 2 間信用卡機構發出問卷，並收到 15 間發卡機構和一間信用卡機構的回覆。同時，本會亦審視了 15 間受訪發卡機構的網站和信用卡協議，以及搜集海外關於信用卡

預繳保障的資料。此外，本會亦對涉及加州健身、DSC 德爾斯和甘泉航空三宗較大型的商戶倒閉事件進行分析。綜合上述研究，本會查找出現行信用卡退款保障機制不足之處，並作相應建議以改善消費者在預繳消費及商戶倒閉方面的保障。

信用卡交易流程與所涉各方的關係

瞭解信用卡退款保障機制須首先明白信用卡交易的流程與所涉各方的關係。一個典型的信用卡交易通常涉及五個實體，分別是持卡人、商戶、發卡機構(例如銀行)、信用卡機構(例如 Visa 和 Mastercard)和收單機構(例如銀行)。發卡機構與消費者訂立合約提供信用卡服務；消費者使用信用卡，支付貨品或服務的費用；然後，收單機構按它與商戶簽訂的合約處理付款，而信用卡機構則負責交易的結算。另一方面，消費者則在結單上的還款到期日前清還有關款項給發卡機構。收單機構和發卡機構一般都是信用卡計劃的成員，在合約上受信用卡機構的操作規則（「計劃規則」）約束。相反，商戶和持卡人都不是信用卡計劃的成員，所以不受計劃規則約束。下圖介紹五個實體的相互關係和交易過程。

信用卡交易流程



信用卡退款保障

信用卡退款保障是一個在計劃規則下，信用卡機構為持卡人提供的保障機制，具體來說，是在符合計劃規則所訂的情況下，包括當商戶在消費者付款後未能交付貨品或提供服務時，將有關信用卡交易撤銷，並把透過信用卡支付的款項或款項耗用所剩的餘款退回給持卡人。

舉個例子：消費者使用信用卡向商戶訂購一部電視，但消費者在接收貨品前，商戶已經倒閉，消費者既得不到所購之物，又不獲退款，而透過清盤程序討回款項，機會亦不容樂觀。在這種情況下，消費者可以向發卡機構提出退款申請，發卡機構會要求消費者提供相關證明文件，並就消費者的申請作出審核。如果發卡機構接納申請，便會根據計劃規則向收單機構提出退款申索。若收單機構接納申索，便向發卡機構作出退款，再由發卡機構退款給消費者。

根據計劃規則，若收單機構與發卡機構就退款申索有所爭議，雙方可通過仲裁解決，而仲裁的結果對發卡機構和收單機構均有法律上的約束力。

由於使用信用卡退款保障涉及一定的行政成本和費用，發卡機構可能考慮到有關交易金額偏小，進行申索不符成本效益，因此有情況自行直接向消費者作出退款，尤以發卡機構希望與持卡人保持良好客戶關係為然。

另一方面，除非收單機構能成功向已倒閉的商戶討回退給發卡機構的金額，否則它將承擔因退款而產生的損失。因此，收單機構有權利延遲將交易款項發放給商戶，從而減低商戶倒閉或其他事故所引起的財務風險。

由於信用卡退款保障來自計劃規則，而計劃規則屬於商業機構之間的合約安排，因此消費者作為非合約方往往無法接觸和了解具體內容及細節，只能倚賴發卡機構提供的訊息及支援。

信用卡分期付款計劃

然而，並非所有使用信用卡的消費交易都受到退款機制的保障。有別於以信用卡自動轉賬每月向商戶付款的支付模式，信用卡分期付款計劃其實是發卡銀行與持卡人之間的一項貸款協議。根據協議，發卡銀行向持卡人提供一筆過的貸款以直接支付持卡人與商戶之間的交易，而持卡人承諾以分期方式向發卡銀行償還貸款。這個支付模式常見於購買電器和健身美容會藉等的消費活動。

由於信用卡分期付款計劃是一種貸款安排，而非一般的信用卡交易，所以信用卡退款保障一般都不適用。舉例說，消費者使用信用卡分期付款計劃向商戶訂購一部高性能電視機，但在收到貨物前商戶已倒閉，即使並未能享用該部電視機，消費者仍然須向發卡機構定期還款，直至清還全部貸款。

主要研究結果

退款申請方法及程序有欠明確和一致

根據問卷調查，所有受訪發卡機構均確認會在商戶倒閉的情況下，向持卡人提供信用卡退款保障。然而，本會發現發卡機構就持卡人退款申請的方法及程序均缺乏明確和一致的要求。例如部份發卡機構要求持卡人在提出退款申請前先嘗試與商戶或其清盤人解決糾紛；而其他的則似乎沒有這樣的規限。另外，持卡人提出退款申請的時限也有差異。例如部份發卡機構要求持卡人於月結單日期起 60 天內提出退款申請，而不是一般計劃規則規定的貨品或服務之預期交付日起 120 天。

資訊透明度不足

本會發現各受訪發卡機構的網站，以及採用的信用卡協議文本均沒有向消費者提供有關於信用卡退款保障的明確資訊。雖然信用卡協議有提及持卡人可在指定期間內就信用卡交易提出爭議，但欠缺針對信用卡退款保障的特定條文或申請指引。與此同時，發卡機構也未有提供關於處理消費者退款保障的服務承諾。另一例子是一些發卡機構要求持卡人在提出退款申請時提交指定的表格，但該表格未能於網上下載，對消費者帶來不便。

退款申請會否成功不易確定

計劃規則既然是商業機構間的合約安排，消費者作為非合約方難以確知當中的細節。此外，正如前述，信用卡協議內並無退款保障的相關條文，即使消費者具有充份理據，發卡機構在合約上亦沒責任為消費者提出退款申請，而提出與否純屬發卡機構單方面的決定。因此，除非發卡機構就如何處理消費者的退款申請設有一套公開的準則，否則消費者無從得知發卡機構會在什麼情況下為他們向收單機構提出退款申索；更遑論可以確定自己是否會受到這機制的保障。

加州健身、DSC 德爾斯和甘泉航空的倒閉個案反映出部分上述問題，研究發現雖然有個別消費者透過信用卡退款保障獲得退款，但部分發卡機構卻拒絕消費者提出的退款申請。某些投訴人表示當他們向發卡機構查詢信用卡退款保障時，前線人員未能向他們提供一致和準確的訊息，導致損失了向發卡機構申請退款保障的機會。

海外經驗 - 信用卡退款保障及關連貸款人責任

上述的研究結果反映香港的信用卡退款保障在透明度方面仍有改善空間。雖然由香港銀行公會及存款公司公會發布，並獲金管局認可的《銀行營運守則》已就信用卡的服務向發卡銀行提供原則性的建議，但目前香港仍缺乏針對信用卡退款保障的法例或監管規則要求發卡機構為持卡人處理退款申請。為了確保持卡人清楚了解使用信用卡分期付款計劃的風險，金管局制定了監管措施並向銀行發出通告，要求銀行向客戶提供沒有信用卡退款保障的分期付款計劃時，必須遵守有關的監管措施，包括確保客戶簽名確認分期付款計劃的各項重要條款，例如不會享有信用卡退款保障，以及不論商戶有否向客戶提供有關產品，客戶將無法向銀行停止付款等。

本報告檢視美國、歐盟、英國、澳洲、新加坡、中國大陸和台灣有關信用卡退款保障的法例及規則，發現信用卡退款保障的透明度不足是多個地區共通的問題。所以，英國法律委員會建議採取不同措施以提高信用卡退款保障在英國的透明度，當中需要不同持份者的配合，例如發卡機構制定行業守則和供消費者參閱的退款保障申請指南；及清盤人向消費者提供信用卡退款保障的資訊等。在澳洲，銀行家協會和守則監察委員會發出銀行業自願守則和信用卡退款保障指引，就銀行如何處理退款申請及讓消費者得知信用卡的退款保障機制，作出具體指導，包括銀行須在信用卡協議中明確信用卡退款保障的資訊等。

此外，報告亦探討「關連貸款人責任」這個重要的消費者保障法律概念。它是指貸款提供者，須為與其有夥伴關係的商戶之違反合約和/或虛假陳述的行為，向消費者負上共同法律責任。就信用卡交易而言，發卡機構作為貸款人以各種優惠吸引消費者申請和使用信用卡，又與商戶合作推出不同優惠鼓勵信用卡消費，在這概念下發卡機構應負上共同的法律責任。

美國、歐盟、英國和澳洲均應用此概念於不同類型的消費信貸交易的消費者保障法例上。當中英國的「消費者信貸法」適用於信用卡消費，並不設地域限制，為消費者提供最全面的保護，讓消費者在商戶倒閉時可向發卡機構追討有關損失。英國早於大約 1965 年已成立委員會研究關於消費者信貸的法律。該委員會發表報告指出關連貸款人應與商戶共同承擔因商戶倒閉而對消費者造成的損失。於是

英國政府在 1974 年訂立《消費者信貸法》並引入關連貸款人責任的原則。

本會認為上述澳洲和英國在自我規管措施這方面的建議，對改善香港信用卡退款保障機制的透明度和運作安排，具有重要的參考價值。此外，為了進一步加強使用分期付款計劃購物的消費者的保障，政府應考慮效法英國，立法引入關連貸款人責任。

展望將來

綜合以上的研究，本會認為本港的信用卡退款機制實有不足之處，極需改善。此外，使用分期付款計劃購物而在商戶倒閉時還未取貨或耗用服務的消費者，在現行法律的保障並不足夠。所以展望將來，本會向相關的持份者提出以下建議：

(1) 發卡機構

1. 透過信用卡協議和網頁向持卡人提供清晰和容易明白的信用卡退款保障資訊；
2. 制定一份信用卡退款保障的申請指南協助持卡人申請退款保障；
3. 培訓前線職員，確保他們具備充份能力和知識，向持卡人清楚講解信用卡退款保障及其申請程序；及
4. 當收到持卡人具備合理成功機會的退款申請時，盡快按照計劃規則向收單機構提出退款申索。

(2) 金管局

由於香港的發卡機構大部分是銀行，受到金管局的監管，金管局可向發卡銀行發出監管指引，確保銀行持續推行上述改善措施，提升信用卡退款保障的透明度和服務承諾。

(3) 清盤人

破產管理署及香港會計師公會應向清盤人及相關專業從業員發出指引，鼓勵他們在處理涉及消費者債權人的清盤事宜時：

1. 提醒使用信用卡付款的消費者可向發卡機構提出退款申請；
2. 提醒消費者參閱由發卡機構提供的信用卡退款申請指南；
3. 在倒閉商戶的網站上表明該商戶已結業或進入清盤程序和提供各發卡機構關於信用卡退款保障的網頁連結；及
4. 為消費者提供發卡機構處理退款申請時所需的其他證據或信息。

(4) 政府

然而，即使上述三項建議得到落實，使用分期付款計劃購物的消費者也是不能受惠於信用卡的退款保障。為進一步改善消費者的權益，本會促請政府研究效法英國立法引入關連貸款人責任的原則，允許使用信用卡付款的消費者（包括參與分期付款計劃的）在商戶倒閉時，向發卡機構追討有關損失。這樣，遇上商戶倒閉，消費者可毋須訴諸討回機會渺茫的清盤程序，而向發卡機構提出申索，追討以信用卡支付的款項。為了在消費者保障和維持商業競爭力之間取得平衡，本報告建議為關連貸款人責任設立最高限額，上限是消費者在該項信用卡交易所支付的金額。

雖然關連貸款人責任會令發卡機構在商戶倒閉時承擔消費者的損失，但發卡機構可運用信用卡退款保障機制，根據計劃規則向收單機構提出退款申索，以分擔風險，此舉可鼓勵發卡機構在合適的情況下使用信用卡退款保障機制，加強對消費者的保障。

結語

商戶倒閉是預繳式消費的一項常見潛在風險，消費者可能因此而蒙受「既享用不到所購的，又不獲退款」的雙重損失。現時香港的破產法沒有給予消費者任何特殊的保護，消費者作為無抵押債權人往往難以獲得任何補償。

信用卡退款保障機制存在已久，原意在商戶倒閉時為預付消費者提供有效率及實際的保障。本會希望藉此報告促請發卡機構、金管局、清盤人和政府協力改善有關使用信用卡作預繳消費的保障，以及就相關課題引發社會討論。

然而，始終信用卡退款保障機制一般都不適用於信用卡分期付款計劃。立法引入關連貸款人的責任，可確立在商戶倒閉的情況下的消費權益，甚具探討價值。基於信用卡消費在本地消費活動佔着舉足輕重的位置，加強使用信用卡作預繳消費的保障，對消費者和整體經濟皆有裨益。

如中文版與英文版文義上有差異之處，以英文版為準。

Chapter 1

Introduction

Key Points

- In many industries, consumers pay for goods and services in advance of receiving them. However, if a retailer after receiving the prepayment becomes insolvent, consumers will be at risk of losing the money. Under the existing insolvency regime in Hong Kong, consumers are unsecured creditors. The chance of recovering the prepayment is very slim.
- However, this does not mean that consumers would always lose out. There is a long established protection mechanism provided by credit card associations, known as chargeback, which may allow consumers to recover prepayment made by credit card in the event of retailer insolvency. In view of the popularity of credit card and the potentially high monetary value of the transactions involved, this Report will focus on chargeback and enhancement of consumer protection for prepayment made by credit card.

1.1 Default Risk in Consumer Prepayment

Consumer Prepayment

Consumer prepayment refers to the situation in which consumers pay for goods or services before receiving them from the *retailers*¹. Depending on the nature and contractual terms of each transaction, consumers have to wait for a couple of days, weeks, months or even several years before the goods or services paid for are delivered. In some situations, prepayments are full payment of the entire purchase price while in others they may be a partial payment of the purchase price, often labelled as “deposits”, “instalment” or “payment term”.

One can easily think of a wide range of retail businesses for which prepayment is common or a trade usage. For example:-

Beauty

- Facial and body treatments are often sold in the form of discounted “*package*” which means that payment for dozens or up to hundreds of treatments to be provided at later dates is made in one go.

Fitness

- Gym and yoga centres offer personal training or yoga classes for sale at discounted bundles which take at least several months or years to use up. Membership plans for consumers’ subscription commonly last for over a year while some are even lifelong.

Home appliances and Furniture

- In most situations, consumers are required to make prepayment for home appliances and furniture which will be delivered at a future date. For those made-to-order furniture, it may take several weeks or months for the goods to be produced and delivered.

¹ In this Report, the term “*retailer*” is used in a wide sense to cover all suppliers which sell goods or services to consumers.

Home Decoration

- To engage service providers for home renovation work, consumers usually have to pay deposits representing a substantive part of the total service fee before commencement of work which may take some months to be completed.

Travel

- Flight tickets, hotel rooms and car rentals, etc. are booked and, in many cases, fully paid by consumers weeks or months in advance of the travel.

Leisure & Entertainment

- Consumers often buy admission tickets several weeks or months ahead of the live performances, sport or other events.

Wedding

- Banquets, car and costume rental and so on usually require consumers to make a substantial prepayment when booking, in some cases even over a year before the day of wedding.

With the growing popularity of online purchase, prepayment becomes more common than ever before. The practice of seeking prepayment from consumers and delivering products at a later date is indispensable for online transactions. It has encroached into retail businesses which did not necessarily involve prepayment in the past, such as those selling apparel and cosmetic products in a shop.

Default Risk

As the exchange of the payment vis-à-vis the delivery of goods or services do not take place simultaneously, chances are that consumers, who have prepaid in full or in part, may not receive from retailers goods or services in the quantity or condition so agreed, or not even receive any goods or services at all. When the retailer who has received the prepayment becomes insolvent or suddenly closes down, the problem of non-delivery would arise and consumers may lose part of or the whole prepayment sum. In this Report, such potential loss of prepayment is termed *"default risk in consumer prepayment"* or, in short, *"default risk"*.



For some cases, the default risk in consumer prepayment may be relatively insignificant, say for example a prepaid cake coupon costing around HK\$50 for a dozen pieces of cake. However, prepayment in a large amount of money ranging from several thousands to hundreds of thousands of dollars for a single transaction can easily be found in some industries such as those providing beauty services, fitness training and facilities, travel services, home renovation.

The impacts of insolvency of retailers on consumers would vary depending on the sizes of their business. There have been cases where a large group of consumers were affected. Below are examples of some retailer insolvencies since 1998 in Hong Kong that have attracted much public attention:-

Retailer	Year of closure	No. of complaints received by the Consumer Council ²	Amount of claims involved (HK\$) ³
Maria's Bakery (超群西餅)	1998	2,600	\$3.5 million
KPS Video Express ⁴ (金獅影視)	1998	2,400	\$1.5 million
Oasis Hong Kong Airlines (甘泉航空)	2008	1,478	\$15 million
Planet Yoga	2010	228	\$2.4 million
DSC (德爾斯)	2015	1,350	\$3.8 million
California Fitness (加州健身)	2016	1,119	\$27.37 million

² The complaint statistics are approximated figures based solely on complaints received by the Consumer Council.

³ *Ibid.*

⁴ These complaints were relating to the unilateral change of the terms and conditions by KPS Video Express shortly before the collapse.

In Chapter 3, the Council will use the collapse of (i) a major fitness chain, California Fitness, (ii) a home furniture and home appliances store, DSC, and (iii) a local airline, Oasis Airlines, to illustrate the extent of loss suffered by consumers and the difficulties in recovering the prepayment in the event of retailer insolvency.

Winner Takes All

In a consumer prepayment situation, while the consumer runs the default risk (knowingly or not), the retailer enjoys the security of payment as well as the benefit of having new money injected as a source of working capital. As the principle of time value of money suggests, all things being equal, it is always better to have money now rather than later⁵. Besides, the longer the time lag between prepayment and delivery of goods and services, the higher is the default risk consumers facing and the greater is the benefits being enjoyed by retailers.

1.2 Current Position of Consumers in Retailer Insolvency

Retailer Insolvency

In view of the prevalence of consumer prepayment nowadays and the disadvantaged position of consumers in prepayment transactions as mentioned above, the Consumer Council (“**the Council**”) has been studying on how to better protect consumers from the default risk in the event of retailer insolvency and publishes this Report to arouse public attention and generate discussion.

After making prepayment, consumers may not receive the goods and services in the agreed manner for many reasons. The retailer may fail to deliver the products on time due to excessive orders. The products delivered may be faulty or fall below the consumers’ expectation. This Report is not intended to deal with these situations which are very diverse and can be dealt with by way of either consumer complaint handling or other dispute resolution processes (e.g. litigation, mediation).

Instead, this Report aims to tackle the situations where the retailer becomes insolvent and thus fails to deliver the goods or services and/or return the prepayment. In such situations, the chance of successful recovery of the prepayment is slim or it is impracticable to conciliate or negotiate with the retailer who may have even absconded.

⁵ Shauna Carther, *Understanding The Time Value Of Money*, Investopedia, 20 October 2016, <http://www.investopedia.com/articles/03/082703.asp>.

Therefore, retailer insolvency in this Report refers to the status in which a retailer, whether being a sole proprietorship, partnership or limited company, is unable to pay its debts. Depending on the circumstances, the retailer may cease its operation (with or without consumers' knowledge) and/or go into liquidation. Hence, the Council is concerned with the unfortunate situation in which a retailer becomes insolvent and can neither provide the goods or services nor return the unused prepayment to its customers.

One may ask whether consumers can recover the debts by seizing personal assets of the owners, i.e. shareholders of the insolvent retailer. If the retailer is a limited company (which appears to be the most common type of companies in Hong Kong), it has separate legal personality, independent from the persons or members who make up the company. Therefore, consumers cannot hold a shareholder liable for the debts owed by the insolvent company and have to pursue their claims in the liquidation process.

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Priority of Claims

When an insolvent retailer goes into liquidation, its liquidator would collect and pool together all available assets for distribution among creditors if the retailer cannot be restored to profitable trading. Prepayments are debts owed by the retailer to consumers who have made them. It follows that these consumers are regarded as the retailer's unsecured creditors (i.e. the debt is without security or collateral). To recover the prepayments, consumers have to file proof of debt with the liquidator since dividends of the retailer's assets would be distributed only among those creditors

whose proofs have been lodged and admitted⁶. This exercise alone may require some basic knowledge about insolvency law and procedures.

Amongst creditors, those who are fully secured (i.e. the debt is secured by a fixed charge over the debtor's assets e.g. mortgage loan) can resort to their security for recovery of the debts outside the liquidation process. After deduction of liquidation costs and expenses, proceeds from realization of other assets would be distributed amongst other creditors. Priority will be given to preferential creditors, such as employees for unpaid wages and government for unpaid taxes. The creditors next in line are floating charge holders whose loans are secured by a floating charge on a class or all of the retailer's assets which crystallizes upon the event of insolvency⁷.

One can imagine that what still remains in the insolvent retailer's pool of assets would be very limited. Distribution of such residual assets among unsecured creditors is governed by the principle of *pari passu* distribution, i.e. proceeds will be distributed to all creditors in proportion to the size of their admitted claims. Apart from consumers, unsecured creditors may include suppliers, landlords, shareholders who had made shareholder loan to the insolvent company, and their claims may be substantive. Whilst the chance of recovering the prepayment is rather slim, the whole process of distribution may take up to several years.

As an example, in the collapse of Farepak⁸ in the United Kingdom ("UK") in 2006, consumers had less than 15% of their prepayment returned as unsecured creditors. It was only with charity donations and an additional voluntary payment from the merchant bank that the affected consumers could eventually recover about half of their prepayment after years of waiting⁹.

It is noted that in certain limited circumstances, consumers may be able to obtain redress by asserting ownership of goods¹⁰. If established, the undelivered goods will not form part of the general asset pool of the retailer and the liquidator has to make available the goods to the consumers. However, in usual consumer

⁶ R.M. Goode, *Principles of Corporate Insolvency Law*, 2nd Edition, Sweet & Maxwell, p. 163.

⁷ It is not uncommon for banks to lend with a combination of a fixed charge on certain assets and a floating charge on all other assets.

⁸ Farepak was a Christmas savings club receiving prepayments weekly or monthly from consumers and delivering gift vouchers and goods in November to them for giving away Christmas gifts. 114,000 consumers were affected with an average claim of GBP400 each and most of them were more vulnerable people.

⁹ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency – A Consultation Paper*, 2015, para. 1.38.

¹⁰ This could happen if consumer purchases a display item which is identified and agreed upon at the time a contract is made.

transactions, it is very difficult for consumers to establish a valid claim of ownership over the undelivered goods.

Disadvantaged Position of Consumers

Consumers often unknowingly bear the default risk at the time of making the prepayment. Prepayment amount and schedule are often dictated by retailers or prescribed by standard form consumer contracts. Further, consumers have little means or in fact are unable to assess the default risk in prepayment and take risk-control measures. They can have little or no idea as to whether the traders they are dealing with are financially sound and viable. Unlike banks or suppliers, consumers are not in a position to inspect or review the retailers' financial information and trading records for making a proper assessment of the underlying default risk. Furthermore, it is also practically infeasible for consumers to get insured against such risk.

Whilst prepayment provides a source of working capital for retailers, consumers bear the entire default risk which in many cases is incommensurate with the benefit from making prepayment to retailers, if any at all. The difficulty of recovering prepayments from insolvent retailers may become more acute in the context of cross-border transactions. With different legal systems and languages and communication barrier, it would be even more difficult for consumers to pursue their claims if the retailers are foreign companies and the liquidation process takes place overseas. In general, consumers may be required to file proof of debt in the foreign jurisdiction where the liquidation process takes place.

Inadequate Protection

All in all, consumers are put in a very disadvantaged position in the event of retailer insolvency. Although there are currently some sector-specific schemes to protect consumers from losing out prepayment in case of retailer insolvency, the scope is highly limited and piecemeal in nature.

For instance, the Federation of Beauty Industry (HK)¹¹ has introduced a prepayment protection scheme under which in the event of closure of a beauty salon, consumers who have made prepayment can receive the unused beauty treatments at no additional cost from another beauty salon under the scheme. The Travel Industry

¹¹ It is a trade association set up in 2004 to, among other things, promote self-regulation and quality assurance in the beauty services industry.

Compensation Fund (“TICF”), funded by levy collected from travel agents¹², provides protection to outbound travelers who may claim up to 90% of the outbound fare paid if a licensed travel agent patronized defaults. The protection is limited to outbound packaged tours only and does not apply if only flight tickets or hotel accommodation alone are purchased¹³. Yet, as far as the Council is aware, this is the only institutional sector-specific mechanism offering compensation in cash for consumers who lost their prepayment in the event of retailer insolvency.

Whilst there may be some sectors holding more sizeable amounts of prepayment and posing higher risk, the default risk in fact arises from the practice of receiving prepayment and protection is required across all sectors¹⁴. As mentioned above, the current insolvency regime offers no specific protection to consumers. Foreign jurisdictions like the UK share the same problem. The UK Law Commission recognized that the question whether the law should be changed to give consumers a more favorable status on insolvency involves value judgment and is ultimately a political decision about how to allocate losses between equally innocent parties¹⁵. However, if a decision is taken to provide greater protection to consumers, one way to do this would be to give a limited preference to consumers who has made a prepayment of £250 or more during the six months immediately prior to the insolvency and did not have a chargeback remedy, and the prepayment is not protected in any other way¹⁶.

Similarly in Hong Kong, the Council has been voicing out the need for a more preferential status for consumers in the insolvency hierarchy to enhance prepayment protection in general¹⁷. However, it remains a controversial issue in foreseeable future and will inevitably affect the interests of other creditors.

Nevertheless, default risk in consumer prepayment on retailer insolvency is a crucial topic for consumer rights. Such risk will become more obvious at the time of economy downturn when retailers face tougher business environment and stricter

¹² The rate of the levy was in the range of 0.15%-0.35% of the outbound fare but collection of levy had been suspended since 2009.

¹³ Travel Industry Compensation Fund Management Board, *Application for Ex Gratia Payment from TICF*, <http://www.ticf.org.hk/eng/legal.htm>.

¹⁴ Exceptions may be those businesses which are being heavily regulated, e.g. insurance and banking service.

¹⁵ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency Report*, 2016, paras. 8.4–8.6.

¹⁶ *Ibid.*, para. 8.109.

¹⁷ See Consumer Council’s views on Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill (2015). See also Consumer Council’s views on the Consultation Document of the Legislative Proposals on Improvement of Corporate Insolvency Law (2013).

credit control. It is also the time when consumers, or the general public, encounter financial difficulties. Without any protection mechanism in place, the incidence of retailer insolvency (maybe involving several retailers at a time) will cause considerable financial loss and misery to consumers, particularly those in the lower income group. With the current murky economy outlook, the Council considers that it is high time that options to enhance consumer protection against prepayment risk on retailer insolvency be explored.

1.3 Focus and Terms of Reference

Our Focus

The Council aims to explore options and generate informed public debate about how to provide better protection for consumer prepayment on retailer insolvency across different sectors. This is by no means a simple task that can be achieved with leaps and bounds. This Report will focus on a long established (but not so well known locally) prepayment protection mechanism voluntarily provided by credit card associations, namely, *chargeback*, details of which will be explained in Chapter 2 of this Report.

Of course, by narrowing the focus on chargeback, other means of prepayment such as cash or cheque, would be outside the scope. The volume of consumer prepayment by credit card is significant and will further increase with the growth of online shopping. According to the statistics of the HKMA, the total value of local retail sales spending for credit cards issued in Hong Kong in 2016 amounts to HK\$474,422 million¹⁸, constituting about 19% of the GDP in the same year¹⁹. Enhancement of the protection for prepayments made by credit cards will have a significantly positive impact on consumer protection and the local economy as a whole. In view of the popularity, versatility and high transaction value usually involved with the use of credit cards in making prepayments, the benefits that may be brought by recommended consumer protection measures with focus on credit cards would be material and applicable across a majority of retail businesses.

¹⁸ Hong Kong Monetary Authority, *Statistics of Payment Cards Issued in Hong Kong for Second Quarter 2016*, 21 September 2016, <http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2016/20160921e3a1.pdf>. See also Hong Kong Monetary Authority, *Statistics of Payment Cards Issued in Hong Kong for Fourth Quarter 2016*, 24 March 2017, <http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2017/20170324e5a1.pdf>.

¹⁹ See Census and Statistics Department, *National Income*, , <http://www.censtatd.gov.hk/hkstat/sub/sp250.jsp?tableID=030&ID=0&productType=8>.

Terms of Reference

The terms of reference of our present study is (i) to investigate the availability, operation and limitation of chargeback as a means to protect consumers in the event of retailer insolvency; (ii) to recommend measures to strengthen the protection of chargeback to the interest of consumers; and (iii) to explore the option of legislative change to provide more comprehensive consumer protection on retailer insolvency by introducing the concept of connected lender liability. With the enhancement of consumer protection for credit card transactions, it is hoped that protection can be further strengthened and widened over the years to cover other kinds of prepayment methods in the long run.

1.4 Methodology and Structure of this Report

Methodology

The Council has researched on the availability of chargeback in Hong Kong by first conducting a questionnaire survey targeted on various card issuers and credit card associations. Cardholder agreements and other relevant documents were further examined to study the certainty and transparency of chargeback protection from consumers' perspectives. In general, credit card may be issued by a bank alone or in conjunction with an institution or commercial body as approved by the bank. It is common for card issuing banks to offer different categories of credit cards depending on the financial position of an applicant. Each type/category of credit card may be governed by a separate cardholder agreement or a master cardholder agreement. For the purpose of this Report, only cardholder agreements applicable to the bank's own-brand credit card were reviewed for reasons of representativeness and simplicity. Based on the results of our survey, together with legal research and literature review of other jurisdictions, this Report will identify the inadequacies of the existing chargeback protection in Hong Kong, and make recommendations to improve consumer protection on prepayment and retailer insolvency.

Structure

This Report is divided into 5 chapters. Chapter 2 of this Report will provide an overview of chargeback covering its function and operational mechanism as well as its fundamental nature. It will also examine how chargeback may protect consumers from loss of prepayment in the event of retailer insolvency.

This is followed by our survey findings and observation of the practical application of chargeback in Hong Kong in Chapter 3. Apart from the question of whether chargeback is available in case of retailer insolvency, its transparency, accessibility and certainty will also be assessed. There is also a case study on 3 high-profile retailer insolvencies in Hong Kong, namely, California Fitness, DSC and Oasis Airlines.

In Chapter 4, the Council will make reference to the operation of chargeback and consumer protection regulations relating to prepayment by credit cards in other jurisdictions. For the purpose of this Report, the Council will look at the position in the United States of America (“USA”), the UK, European Union (“EU”), Australia, Singapore, Mainland China and Taiwan.

In Chapter 5 of this Report, the Council will recommend measures to strengthen the function of chargeback in protecting consumers who made prepayments by credit cards. To provide more comprehensive consumer protection to complement the function of chargeback, the option of legislative change by introducing the concept of connected lender liability will also be explored.

Chapter 2

Understanding about Chargeback

Key Points

- A typical credit card transaction usually involves not only a cardholder (consumer), a retailer and a card issuer but also the credit card association and the retailer's acquirer (hereinafter referred to as "*acquirer*"). In some operational model, the card issuer, the credit card association and the acquirer may be the same entity.
- Chargeback was introduced into credit card association rules to enable reversal of a payment transaction as between the card issuer and the acquirer under certain circumstances, including failure of the retailer to supply the goods or services. By allowing the card issuer to charge back the acquirer in case of default by the retailer, this mechanism can strengthen cardholders' confidence and encourage the use of credit cards.
- In the event that a retailer becomes insolvent and fails to deliver the goods or services, the cardholder may ask the card issuer to charge back the acquirer which, if the chargeback claim is valid, has to provide refund to the card issuer and in turn the cardholder can recover the prepayment made. Hence, chargeback not only increases the likelihood of recovering prepayment on retailer insolvency but also incentivizes the acquirers to implement risk control measures in its dealings with retailers.

2.1 What is Chargeback?

Credit Card Transactions

Although consumers' use of credit cards has been phenomenal nowadays, few have thought about how their cards work and what or how business entities are involved in a single transaction. On the business-to-consumer side, it is obvious that the transaction involves the retailer in question and the card issuer, which extended credit and provided the cards to consumers for making purchases (without cash) and settling the bill later in time.

On the business-to-business side, there exists another key institution in the transaction, known as "*acquirer*", which, together with credit card association (e.g. Visa, Mastercard), serves as the communications and transactions link²⁰ between the retailer and the card issuer. The acquirer recruits retailers to accept credit cards. Upon the retailer's acceptance, the acquirer will sign a merchant agreement with the retailer and handle the transaction authorization as well as payment flow between the point of sale and the network established by the credit card association²¹.

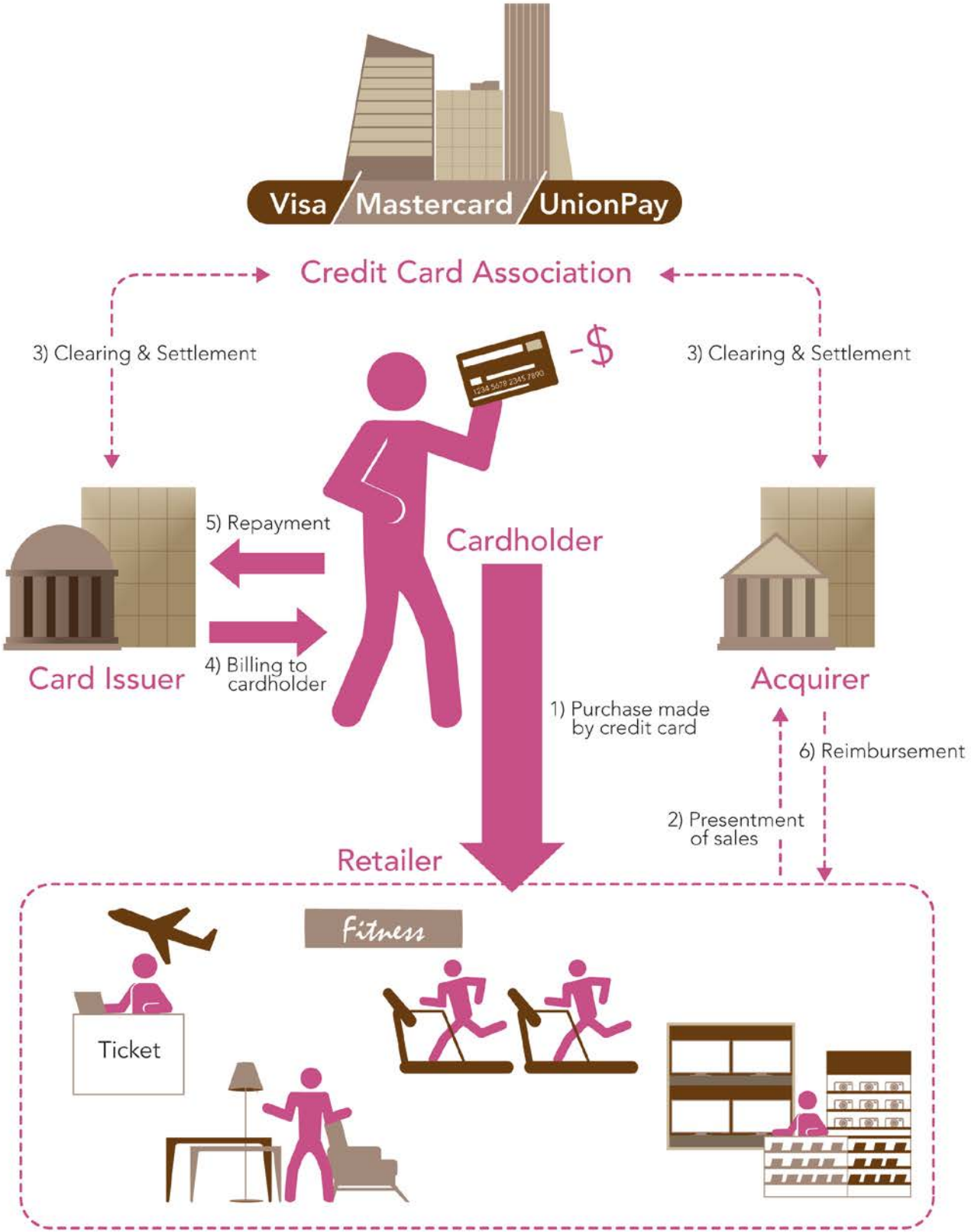
Below is an illustration of a 5-party credit card transaction. As shown in the diagram, the following steps are involved in a 5-party credit card transaction:-

- (1) The cardholder makes a purchase by credit card;
- (2) The retailer presents an authorized sale to the acquirer for payment;
- (3) The acquirer passes the transaction details to the card issuer through the card association. The card issuer then settles the amount through card association according to its operational rules.
- (4) The card issuer will bill the cardholder pursuant to the cardholder agreement;
- (5) The cardholder pays the bill;
- (6) The acquirer reimburses the retailer pursuant to the acquirer's agreement with the retailer.

²⁰ It is a simplified description of the operational model. In reality, other business institutions may be involved, such as payment processors.

²¹ Ramon P. DeGennaro, "Merchant Acquirers and Payment Card Processors: A Look inside the Black Box", *Federal Reserve Bank of Atlanta Economic Review*, 1st Quarter 2006, pp. 27-42.

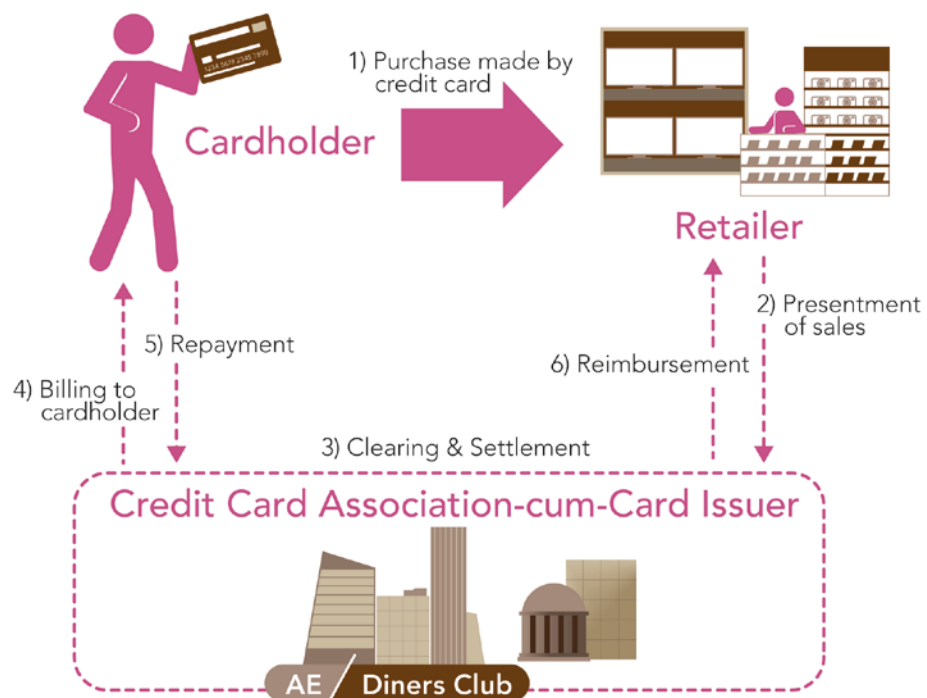
A 5-party Credit Card Transaction



Both the acquirer and the card issuer are members of the credit card association and are bound by operational rules of the respective credit card association which are contractual in nature (referred to as “**scheme rules**” in this Report). However, neither the retailer nor the cardholder is a member of the credit card association or is bound by the scheme rules.

There is, however, another operational model adopted by different credit card associations, such as American Express and Diners Club²². This group of credit card associations takes up the role of the card issuer as well as that of the acquirer. While they sign up retailers to accept their cards for payment, they also issue cards to and collect payment from consumers directly.

Under such operational model, there are only three parties involved in the credit card transaction, namely, the retailer, the credit card association-cum-card issuer and the cardholder. In this Report, this group of credit card associations is referred to as “*credit card association-cum-card issuer*” where distinction from the 5-party operational model is necessary. Below is an illustration of a 3-party credit card transaction:-



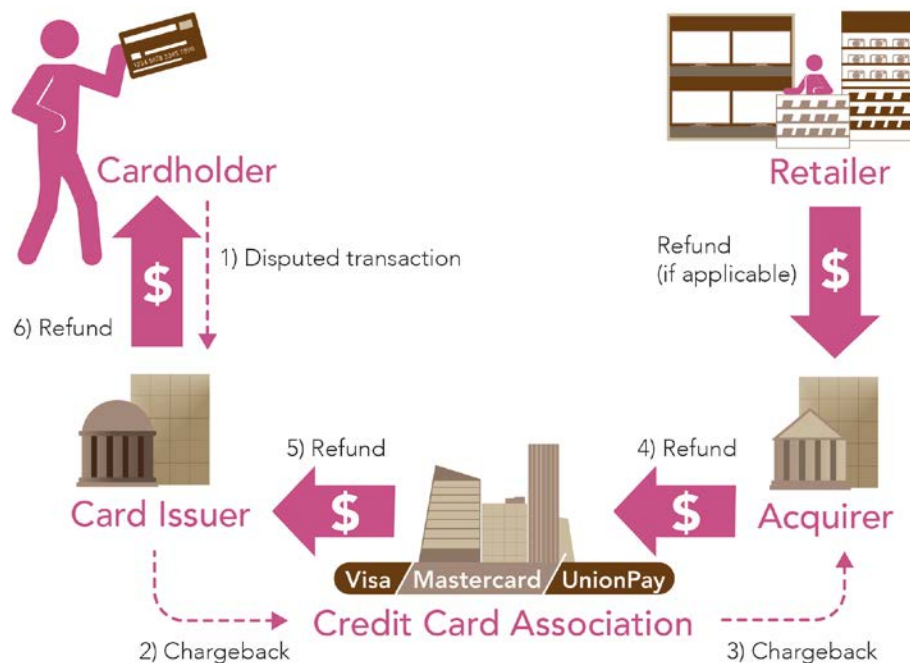
²² That said, in some situations, this group of credit card associations may also cooperate with other institutions, such as banks, which may take up the role of the card issuer and handle the customer relationship with consumers.

The steps in a 3-party credit card transaction are similar to the 5-party credit card transaction. Under the 3-party operational model, the retailers sign an agreement with the credit card association-cum-card issuer, which sets out scheme rules. On the consumer side, cardholders are not a party to the scheme rules but will sign a cardholder agreement with the credit card association-cum-card issuer.

Chargeback

Regardless of the operational model, the scheme rules laid down by the credit card associations are aimed to govern the business dealings between the credit card associations and all members in respect of numerous issues, for instance transaction processing, settlement, data security, fraud prevention, fees, etc. The focus of this Report, namely chargeback, is also enshrined in the scheme rules²³.

Under the scheme rules, after a consumer has purchased some goods or services through a credit card transaction with a retailer, the retailer's acquirer will present the sale bill to the credit card association which will in turn request the card issuer to settle and clear the bill. Normally, the card issuer will collect repayment from the cardholder after issuance of the monthly credit card statement. Chargeback is the reversal of the said money flow as illustrated below:-



²³ Which?, *How do I use Chargeback?*, 2016, <http://www.which.co.uk/consumer-rights/advice/how-do-i-use-chargeback>.

Chargeback is the mechanism by which the card issuer, via the credit card association and in accordance with the scheme rules, charges back the transaction to the acquirer. A valid chargeback would oblige the acquirer to pay back the card issuer the transaction amount. On the other hand, the acquirer may dispute the validity of chargeback and present the transaction to the issuer again for payment.

Each credit card association has its own scheme rules providing for, among other things, a chargeback mechanism with detailed regulation and procedures. Let's take Visa, Mastercard and American Express, being some of the key players in the industry, as examples.

The Visa Core Rules (15 October 2016) ("**Visa Rules**")²⁴ entitles card issuers to initiate chargeback under the applicable reason code. Further, it provides that "*a Member must attempt to offer mutual assistance to other Members to resolve disputes between both its Cardholder and another Member's Merchant (and) its Merchant and another Member's Cardholder*"²⁵. Accordingly, where a cardholder disputes a transaction with reason, its card issuer (being a member of the Visa network) may charge back the transaction and the acquirer (also a member) must cooperate to resolve the disputed transaction. If the acquirer finds the chargeback to be valid and does not present the transaction to the card issuer again for payment, the issuer will be able to reimburse its cardholder or write off the payment bill in respect of the disputed transaction. In case there is dispute as to the validity of the chargeback, either the card issuer or the acquirer may refer it to arbitration under the scheme rules.

Likewise, the Chargeback Guide of Mastercard (10 May 2016)²⁶ provides that a card issuer may initiate a chargeback when the circumstances of the transaction meet the requirement of a chargeback reason code described in the guide.

The Merchant Reference Guide of American Express (October 2016)²⁷ ("**AE Rules**") provides that the American Express has the right to charge back the retailer if the cardholder disputes a charge. While the retailer may request a "*chargeback reversal*"

²⁴ Visa, *Visa Core Rules and Visa Product and Service Rules*, 15 October 2016, <https://usa.visa.com/dam/VCOM/download/about-visa/visa-rules-public.pdf>.

²⁵ *Ibid.*, Part 11.

²⁶ Mastercard, *Chargeback Guide*, 10 May 2016, <https://www.mastercard.us/content/dam/mccom/en-us/documents/rules/chargeback-guide.pdf>.

²⁷ This guide only contains general information about the policies and procedures of American Express. The merchant regulations or agreement which have contractual effect are not publicly available. American Express, *American Express Merchant Reference Guide – U.S.*, October 2016, https://icm.aexp-static.com/Internet/NGMS/US_en/Images/merchantpolicypdfs/US_RefGuide_NS.pdf.

and submit evidence to prove that the chargeback is invalid, American Express has the power to decide whether to charge back in favor of the cardholder²⁸.

The above documents are published online by credit card associations but either in the section dedicated to its business partners or in the USA website only. In making this report, the Council has made enquiries with the major card associations concerning the operation of chargeback in Hong Kong but only one of them did provide a copy of the scheme rules to the Council. As a whole, it may be difficult for consumers to get access to the scheme rules and fully understand the operation of chargeback.

2.2 Why Chargeback was Introduced?

Although the scheme rules of different credit card associations may differ, they all provide chargeback and the grounds upon which chargeback may be exercised are of two major kinds. The first kind is related to irregular, unauthorized and fraudulent transactions whereas the second concerns situations in which cardholders are dissatisfied with some aspect of the purchase.

It follows that chargeback which enables reversal of the payment transaction where a cardholder disputes a credit card transaction²⁹, not only rectifies irregular or fraudulent transactions but also strengthens consumers' confidence in using credit cards, particularly for purchase of goods or services to be delivered at later time.

With the chargeback protection and greater confidence, it is likely that consumers will be incentivized to make purchase by using credit cards rather than other payment methods, like cash. Card issuers, credit card associations and acquirers would welcome this situation as they will be able to generate more revenue associated with increased transaction volume.

2.3 Application in Retailer Insolvency

As this Report is concerned with prepayment and retailer insolvency, the relevant question to ask is whether a valid chargeback may be exercised in the event of retailer insolvency. The answer is positive.

²⁸ The chargeback mechanism in a 3-party credit card transaction is similar to the one in a 5-party credit card transaction.

²⁹ Chargeback is also available for debit cards. Since debit cards are not commonly used by Hong Kong consumers, discussion in this Report will be focused on credit cards only.

Although different scheme rules may adopt different terminology and procedures for the chargeback mechanism, they all include "*non-delivery of goods or services*" as one of the circumstances giving rise to chargeback. This broad category would fall squarely within the scenario in which the retailer becomes insolvent or suddenly closes down, and fails to supply the goods or services already paid for, no matter whether the retailer has entered into winding up process or not.

Assuming you purchased a product, say a television, from a retailer by credit card and the retailer closed down shortly after. You failed to receive the television on the agreed delivery date and you are unable to contact the retailer to seek either refund or delivery of the television. As there is chargeback under the scheme rules, you may inform your card issuer of the situation and provide all relevant documents or information to prove that there had been non-delivery of the television bought with its card. The card issuer, if so satisfied, may exercise its right to charge back under the scheme rules and credit you for the transaction amount. Depending on the circumstances, the acquirer may accept the chargeback for its validity or simply for commercial reason and you would be able to recover the prepayment expediently despite the closure of the retailer.

It is, of course, possible that the card issuer may directly credit the transaction amount to your account without exercising chargeback, i.e. out of its own pocket, for the sake of client relationship or cost efficiency. There is a certain fee for exercising chargeback under the scheme rules which, together with the administrative cost, may not justify doing so especially where the transaction amount is small³⁰.

In the unlikely event that the acquirer disputes the chargeback, the matter may be referred to arbitration (e.g. Visa) or the credit card association for determination (e.g. American Express). The result of the arbitration or determination under the scheme rules is final and binding on both the card issuer and the acquirer.

Although acquirers usually require retailers to indemnify them for providing chargeback by contractual arrangement, recovery action may be futile where the retailers become insolvent. Even if the acquirer fails to recover the transaction amount from the retailer, it would not constitute a defence to chargeback under the scheme rules and the acquirer would have to bear the loss if the card issuer wins the

³⁰ European Commission, *Payment card chargeback when paying over Internet*, First Sub-group meeting of the PSTDG and PSULG held on 4 July 2000, MARKT/173/2000, p. 3, http://ec.europa.eu/internal_market/e-commerce/docs/chargeback_en.pdf.

case. The risk of suffering financial loss due to the retailer's failure is an operational risk for the acquiring business and is commonly known as "*acquiring risk*".

The acquiring risk incentivises acquirers to adopt risk management measures. First of all, they have to undertake credit assessments of their customers, i.e. the retailers, before signing them up and thereafter on a regular basis. If it happens that the acquirer or its group companies provides corporate banking facilities to the retailer, it will be easier to monitor the financial health of the retailer and to identify unusual activity or pattern.

Besides, since there is delay between transaction (between a retailer and a consumer) and settlement (between a retailer and its acquirer), the acquirers are, in effect, withholding funds which may be used to set off the potential claims of chargeback³¹. Also, the acquirers may require a certain portion of the monthly turnover to be held as collateral or reserve in which the retailers would have no interest or right at all³². If the retailers later become insolvent or fail to indemnify them for providing chargeback for any other reason, the acquirers can use such collateral or reserve to pay for the chargeback and avoid paying out of their own pockets. When a British low-cost airline, Flyglobespan, entered into administration in 2009, its acquirer was holding about GBP35 million of collateral to satisfy potential chargeback claims. The amount of collateral or reserve depends on the commercial agreement between each retailer and its acquirer. The acquirers may require a larger amount of collateral from retailers of higher risk³³.

2.4 Strengths and Limitations of Chargeback in Recovering Prepayment during Retailer Insolvency

In the event that a retailer becomes insolvent before delivering the goods or services, chargeback enables a card issuer (for the benefit of the cardholder) to charge back the acquirer on the ground of non-delivery of goods or services, thereby allowing the consumer to recover the entire prepayment (less chargeback fees perhaps) without going through the liquidation process. There have been a number of successful stories of making use of chargeback to recover consumer prepayments during retailer insolvency. For instance, in the insolvency of MFI, which was then a UK retailer of home fittings and furniture, a total of GBP19.3 million was refunded to consumers

³¹ Grant Thornton, *Technical briefing, Understanding and managing merchant acquiring risk*, 2008, <http://docplayer.net/6174099-Technical-briefing-understanding-and-managing-merchant-acquiring-risk.html>.

³² The UK Law Commission, *Consumer Prepayments on Retailer Insolvency – A Consultation Paper*, 2015, paras 5.40-43.

³³ *Ibid.*

through chargeback. Approximately GBP15.3 million was related to non-delivery of customer orders and the remainder concerned claims for part-delivered orders and extended warranties³⁴. In the case of Comet, a UK electrical retail chain which closed down in 2012, chargeback claims in the sum of GBP2.1 million had been paid off by the acquirer. In the collapse of Land of Leather, a furniture retail store operated in the UK and Ireland, a total amount of GBP1.1 million has been successfully charged back from the acquirer³⁵. Some other successful stories of making use of chargeback to recover consumer prepayments in Hong Kong will be discussed in Chapter 3.

Instead of competing with other creditors for a share of the bankruptcy estate, chargeback reallocates default risk from consumers to acquirers who should be in a better position to assess and manage such risk. As the one to sign up retailers to accept credit card payments, the acquirers have the means and every reason to conduct a diligent assessment of the retailers' financial position and trustworthiness. As a business entity specialized in providing financial services, the acquirers have developed different measures to mitigate and manage their risk exposure as discussed in section 2.3 above. By reallocating default risk, chargeback encourages the business sector to implement risk control or management measures and protects consumers from suffering the entire prepayment loss on retailer insolvency.

The protection afforded by chargeback can be particularly helpful for consumers to recover their prepayments made in cross-border (usually online) transactions. As pointed out in Chapter 1, prepayment is indispensable for online transactions since the goods or services are always delivered at a later date. In the event that the foreign retailer collapses before the delivery date, the prepayment would be at risk. Consumers may have to file a claim through court proceedings or liquidation process in a foreign jurisdiction which will, most likely, involve a lot of practical difficulties arising from, for instance, the differences in terms of language or legal system. Consumers may have to instruct foreign lawyers or advisors in order to recover the prepayments, which may not be practical as the costs involved would usually be disproportionate with the amount of claim. Chargeback may, however, enable cardholders to recover the prepayment without the hassles since the scheme rules relating to chargeback in case of non-delivery of goods or services apply to members in all countries/regions. In case a foreign retailer becomes insolvent, the affected consumers may request their card issuers to file a chargeback claim against the acquirers under the scheme rules.

³⁴ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency – A Consultation Paper*, 2015, para. 9.7.

³⁵ *Ibid.*, para 5.44.

Although chargeback is a useful tool in protecting consumer prepayments on retailer insolvency, its application is not without limitation. Different scheme rules may lay down different restrictions or procedures, e.g. time limits for card issuers to submit chargeback claims. In general, card issuers are required to file the claim within 120 days from the date on which delivery of the goods or services was expected. There may be different time calculation basis for different kinds of goods or services which is far from simple and may be revised by the credit card associations from time to time. However, chargeback is enshrined in scheme rules which are contractual arrangements among the business entities only. Consumers, being an outsider, may not easily access the scheme rules in order to understand the applicability and procedures of chargeback. In this Report, measures to strengthen the role that chargeback may play in protecting consumer prepayments on retailer insolvency will be recommended.

Chapter 3

Chargeback in Hong Kong

Key Points

- The Council has conducted a questionnaire survey to investigate the availability, transparency, accessibility and certainty of chargeback in Hong Kong. All responding card issuers indicated that they will provide chargeback protection to cardholders. However, findings of our survey and research revealed that the transparency, accessibility and certainty of chargeback protection are unsatisfactory and there is room for improvement.
- From time to time, retailer insolvencies happen in Hong Kong and the impact on consumers can be substantial. The Council has chosen the collapse of California Fitness (in 2016), DSC (in 2015) and Oasis Airlines (in 2008) as the illustrative examples. Based on the complainants' experience, some card issuers would provide chargeback in the event of retailer insolvency while some would refuse to handle their requests for chargeback without valid justifications.
- While consumers may recover prepayments by requesting their card issuers to exercise chargeback, they should beware of a distinctive type of prepayment which also involves the use of credit cards, i.e. instalment payment plans (usually referred to as "IPPs"). IPPs are, in essence, loan agreements between the cardholder and the card issuer and do not involve the credit card association. Therefore, chargeback is generally not applicable to IPPs.
- There is a lack of clear and specific guidance from the card issuers to the consumers on how to file a chargeback application and subsequent steps in assessing their requests for chargeback.

Chapter 2 explains how consumers who pay by credit card may, by way of chargeback, seek recourse from their card issuers if the goods or services are not delivered. It is considered that chargeback can be an important and powerful protection tool for consumers in case of retailer insolvency. This Chapter looks into the position and real-life application of chargeback protection in Hong Kong. By conducting a survey, research and a case study of major retailer insolvencies, the Council has assessed the availability, transparency, accessibility and certainty of chargeback with regard to consumer protection in Hong Kong.

3.1 The Survey

In order to understand the real-life application of chargeback in Hong Kong, the Council has sent a questionnaire survey to 20 major card issuers and 2 major card associations³⁶ in Hong Kong. Essentially, the said questionnaires were designed to ascertain the following issues:-

- (1) Whether a cardholder is entitled to chargeback protection for lump sum payment³⁷ in the event of retailer insolvency?
- (2) What steps should the cardholder take and what documents should he/she provide to make the chargeback request?
- (3) What is the time limit for cardholder to raise a chargeback request?
- (4) Which entity shall determine whether to provide chargeback?
- (5) Whether Instalment Payment Plan is protected by chargeback?

The Council has received replies from 15 card issuers³⁸ and one card association. Summary of their replies are shown in Appendix 1 on an anonymous basis. The results of the survey as at 20 May 2016 and our further research findings are summarized as below and will be discussed in the following paragraphs.

³⁶ One of the card issuers is acting as both card issuer and card association and for the purpose of this Report, it is classified under the category of card issuers.

³⁷ In this Report, a lump sum payment refers to the situation in which the prepayment for goods or services is to be settled by consumers at one go, usually in the same or the month following the transaction date. This is in contrast with instalment payment plan in which the prepayment is to be repaid by way of monthly instalments for a relatively longer period of time, e.g. 1 or 2 years.

³⁸ Save for 2 card issuers, all other responding card issuers are licensed banks in Hong Kong.

Availability

- All the major card issuers in the survey do provide chargeback protection to their cardholders but according to some feedbacks from consumers, staff of call centres contended that they did not provide chargeback
- No clear and consistent application procedures and requirements for raising a chargeback request in the context of retailer insolvency
- Discrepancies were found among the practices of card issuers in terms of the prescribed time limit for chargeback

Transparency & Accessibility

- No general information about chargeback is provided in the cardholder agreements and card issuers' websites
- No express provision in the cardholder agreements mentions the availability of chargeback protection
- The designated dispute form (if so required by the card issuer) is not readily available on the card issuer's website

Certainty

- Chargeback is not a consumer right. Scheme rules may be revised at any time and there is no system for communicating these changes to the public
- Chargeback depends on the discretion of card issuer who is not legally obliged to raise a chargeback claim
- Lack of service pledge from card issuers on how to handle a consumer's chargeback request

3.2 Availability of Chargeback

Basically, all the responding card issuers replied that chargeback protection was available to their cardholders in the event of retailer insolvency. However, their replies in respect of the application procedure, evidential requirement and time limit of chargeback differed to a certain extent. The availability of chargeback in the event of retailer insolvency was also confirmed by one responding credit card association.

Application Procedure

According to the results of our survey, 7 out of the 15 responding card issuers require their cardholder to first resolve the dispute with the retailer and/or liquidator (as appropriate) before raising a chargeback request, whereas the remaining 8 card issuers do not appear to have such a pre-condition. In the context of insolvency, the appointment of liquidator or provisional liquidator may take weeks or months and it may not be easy for consumers to contact them. The right to dispute a transaction may eventually be lost if consumers encounter difficulty in contacting the retailer and/or liquidator and thereby fail to report to the card issuers within the prescribed time.

Insofar as the method of application is concerned, 7 out of 15 card issuers require cardholders to lodge a particular form in writing when disputing a transaction. In practice, the use of standardized form may save time and facilitate the process of seeking chargeback.

Evidential Requirement

Based on the results of the survey and the Council's own research, there is no clear and consistent evidential requirement for raising a chargeback request in the context of retailer insolvency. It is understandable that each case would depend on its own facts and it would be inflexible and indeed impracticable, to provide an exhaustive list of the required documents. However, the absence of clear and consistent guidance from the card issuers may make it very difficult for consumers to prepare the necessary evidence for a valid claim of chargeback.

Time Limits

As mentioned in Chapter 2, chargeback is enshrined in the scheme rules, and is not a legal right conferred on consumers. The scheme rules prescribe certain time limits for card issuers to submit chargeback claims. The details, such as the length of time limit or when the time limit should start, are different among different card associations. However, it seems that the general rule is 120 days from the date when the goods or service are expected to be delivered³⁹.

³⁹ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency Report*, 2016, paras. 7.21.

On the other hand, the cardholder agreement is a contract between the consumer and the card issuer and is, therefore, binding on both parties. The cardholder agreement will always prescribe the time limit for cardholder to dispute a transaction. In general, the time limit is 60 days from the date of the credit card statement.

As regards the prescribed time limit for cardholder to raise a chargeback request, the replies obtained in our survey suggested that the time limit ranged from 60 days to 540 days. Broadly speaking, the card issuers' responses show that their prescribed time limits are fixed in two manners, namely (i) a certain period of time from the date of statement (6 out of 15 respondents), usually 60 days; and (ii) a certain period of time from the transaction date or expected delivery date (8 out of 15 respondents) in accordance with the applicable scheme rules. One respondent did not specify the time limit but encouraged cardholder to request promptly.

On the card association side, one card association replied that the time limit ranges from 120 to 540 calendar days from the transaction processing date, depending on the circumstances. For instance, if the goods are to be provided after the date of transaction, the time limit is 120 calendar days from the last date that the cardholder expected to receive the goods or the date that the cardholder was first made aware that the goods would not be provided, but in any event, not to exceed 540 calendar days from the transaction processing date.

The above shows that inconsistencies exist among the card issuers on the prescribed time limit for cardholder to apply for a chargeback. Some card issuers apply the time limit provided in the cardholder's agreement for disputing a transaction to the case for chargeback, whereas the others apply the time limit provided in the respective scheme rules. It is not impossible that a card issuer may decline a cardholder's request for chargeback by reason of lapse of time prescribed by the cardholder's agreement when the time limit under the scheme rules has not yet expired. In such a case, chargeback mechanism is not fully utilized.

3.3 Transparency and Accessibility

Although the questionnaire survey indicates that all responding card issuers would provide chargeback protection to consumers on retailer insolvency, the Council takes the view that the transparency and accessibility of chargeback protection so provided are important issues which warrant further investigation.

Call Centres

Putting the insolvent retailer aside, call centres of card issuers are often the first point of contact for consumers in the event of retailer insolvency. Consumers may reasonably expect the staff at call centres to provide accurate information about chargeback and other assistance. In our questionnaire survey, card issuers often suggested consumers to contact their respective customer service hotline for assistance. Consumer's experience in requesting chargeback will be discussed later in this Chapter.

Cardholder Agreements and Card Issuers' Official Websites in Hong Kong

The Council has perused the respective official websites and cardholder agreements of 15 responding card issuers to see if there is any written material for their cardholders to, first, know the availability of chargeback and, further, to understand the procedural rules for making a valid chargeback claim.

Upon reviewing the terms and conditions of the cardholder agreements and the official websites of the 15 card issuers, the Council has the following observations:-

- (1) First and foremost, there is no general information about chargeback provided in the cardholder agreements and card issuers' websites;
- (2) Secondly, notwithstanding it is common for cardholder agreements to provide that cardholder shall submit any disputed transaction and report any alleged error or omission within a certain period of time, there is no express or clear provision mentioning the availability of chargeback protection⁴⁰, how to raise a chargeback request and how the card issuer will handle such request;
- (3) Thirdly, the designated dispute form (if so required by the card issuer) is not readily available at the card issuer's website⁴¹. The Council understands that consumers are usually advised to contact the card issuers to obtain a dispute form; and

⁴⁰ In one cardholder agreement, it is expressly provided that the cardholder is liable for any transactions where bank could otherwise has exercised chargeback rights if cardholder fails to notify the bank of the transactions and provide any required documents or information within the prescribed time periods required. But no further information about chargeback is provided in the cardholder agreement and the official website of the bank.

⁴¹ One respondent replied that card members may inform the respondent of their intention to apply for chargeback via online banking system.

- (4) Last but not least, there is no provision under the cardholder agreements mandating or requiring the card issuer to raise a chargeback claim (even if a valid ground exists under the scheme rules).

Scheme Rules

Scheme rules are supposed to govern the business relationship among the card issuer, the credit card association and the acquirer only. They are for the exclusive use of the members of credit card association, and therefore are not easily accessible by the public⁴². For instance, it is noted that in refusing the request for disclosure of the scheme rules, Visa Europe informed the UK Law Commission that "*it was not in a position to provide the relevant sections of the Visa Europe Operating Regulations as they are confidential*"⁴³. In any event, given the length⁴⁴ and complexity of the scheme rules, most consumers would have found it difficult to understand the chargeback mechanism by reading the scheme rules even if they had the chance to read them.

Notwithstanding the above, it should be borne in mind that chargeback was initially implemented by the credit card associations as a means to protect consumers (being the end users) and strengthen the public's confidence in using credit cards. Besides, in most situations, the circumstances giving rise to a chargeback claim are simply not within the knowledge of the card issuers. It is only when the cardholders (who fail to receive the goods or services purchased) notify the card issuers of their intention to apply for chargeback that the latter would be able to activate this built-in protective mechanism. Hence, chargeback is raised in most cases only at the request of the cardholders. In order for such mechanism to function effectively, the mechanism should be made as transparent and accessible as possible to consumers so that they are aware of chargeback as a redress option in the circumstances that warrant so and can conveniently use it to recover the money paid.

Given the general lack of information about chargeback provided by the card issuers, the Council considers that the transparency and accessibility of the chargeback mechanism in Hong Kong are highly unsatisfactory. Consumers may not know when and how they may benefit from the chargeback mechanism.

⁴² Similar position was noted in the UK. See the UK Law Commission, *Consumer Prepayments on Retailer Insolvency – A Consultation Paper*, 2015, para. 5.61.

⁴³ *Ibid.*, Appendix E, para E.1.

⁴⁴ For example, the scheme rules of one major credit card association is more than 800 pages.

3.4 Certainty

Apart from the "*transparency and accessibility*" issues, certainty of chargeback is also an area of concern from the consumers' perspective.

It is understandable that even if the card issuer files a claim of chargeback, it would not guarantee a refund to the cardholder since the acquirer may dispute the claim. The card issuer and/or the acquirer may refer the dispute to arbitration or adjudication by the credit card association depending on the scheme rules.

The major concern is whether a consumer, not being a party to the scheme rules, may enforce the chargeback right or require the card issuer to file a claim of chargeback. It is trite that a contract cannot (as a general rule) confer rights or impose obligations arising under it on any person except the parties to it⁴⁵. However, the Contracts (Rights of Third Parties) Ordinance (Cap. 623) created an exception and, in particular, section 4 provides that:-

- (1) A third party may enforce a term of contract (including a term that excludes or limits liability) if:-
 - (a) the contract expressly provides that the third party may do so; or
 - (b) the term purports to confer a benefit on the third party.
- (2) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description.
- (3) Subsection (1)(b) does not apply, if, on a proper construction of the contract, the term is not intended to be enforceable by the third party.

Hence, a third party may enforce a term of contract if he/she is expressly identified in the contract (section 4(2)) and the contract expressly provides that he/she may do so (section 4(1)(a)).

Alternatively, even if the contract does not expressly provide that a third party may enforce the term, he/she may still do so if he/she is expressly identified in the contract and the term purports to confer a benefit on him/her (section 4(1)(b)). However, by virtue of section 4(3), the third party will lose such right if, on a proper construction of the contract, the term is not intended to be enforceable by the third party.

⁴⁵ *Chitty on Contracts*, 32nd Edition, Vol. 1, para. 18-003.

As the scheme rules govern the business relationship among the credit card associations, card issuers and acquirers, it is unlikely that they would expressly provide that cardholders or consumers (not being a party to contract) may enforce the chargeback right. Besides, even if it is arguable that the scheme rules purport to confer a benefit on the cardholders by creating the chargeback mechanism, the third party's right to enforce may be barred if it is construed from the contract that the chargeback right is not intended to be enforceable by cardholders. It appears to be common for scheme rules to contain an express provision to make it clear that no term is intended to be enforceable by any third party. For instance, it is noted that the Visa Rules expressly states that "*The Visa Rules govern the relationship between Visa and its Members and their agents. The Visa Rules do not constitute a contract, promise, or representation or confer any rights, privileges, or claims of any kind as to any third parties*"⁴⁶. As such, even if the said statutory provisions apply to the scheme rules (which may be governed by foreign law or were made before commencement of the said Ordinance), it is unlikely that consumer will be able to enforce the right of chargeback as a third party.

As chargeback is not an enforceable right conferred on the consumers, the decision whether or not to raise a chargeback claim pursuant to the scheme rules rests squarely on the card issuers. However, as mentioned, in the absence of any express provision in the cardholder agreement, the card issuer is under no legal obligation to raise a chargeback right (for and on behalf of the consumer) even if a valid ground exists under the scheme rules. Besides, there is a lack of service pledge from card issuers on how to handle a consumer's chargeback request.

In other words, while there is a readily available consumer protection mechanism under the scheme rules, whether consumers can in fact be protected by it is entirely at the discretion of the card issuers. A consumer would be uncertain about the circumstances under which the card issuer would raise the chargeback claim for him, unless the card issuer's discretion is made in accordance with a set of guidelines which is made known to the consumer. In the circumstances, the Council considers that the certainty of chargeback protection is insufficient and there is room for improvement.

⁴⁶ Visa, *Visa Core Rules and Visa Product and Service Rules*, 15 October 2016, <https://usa.visa.com/dam/VCOM/download/about-visa/visa-rules-public.pdf>, para. 1.1.1.5.

3.5 Case Study

In order to have a glimpse of the real-life application of chargeback from consumers' perspectives and to better understand the predicament of consumers in retailer insolvency, the Council has examined the complaint cases received in 3 major insolvencies in Hong Kong, namely, California Fitness, DSC and Oasis Airlines.

California Fitness

California Fitness was one of the major chain fitness clubs in Hong Kong and had 9 fitness centres⁴⁷ in operation before it closed down in July 2016. Established in 1996, it had been offering consumers with fitness club membership under which they acquired the right to use the gym and wellness facilities at its fitness centres during the membership that may range from 1-2 years to lifelong. In addition, it provided club members with group or individual personal training service at extra charge. Whilst some club members paid the membership fee by way of autopay on monthly basis, many others made full payment to California Fitness for the club membership and/or personal training service well before the service could be consumed.

California Fitness had been operated by a corporate entity known as J.V. Fitness Ltd. ("J.V. Fitness"), which operated two other fitness centres, namely, *mYoga and Leap*. On 28 June 2016, a winding up petition was filed against J.V. Fitness by its creditor on the ground that it was unable to pay debts. After that, California Fitness closed down its fitness centre in Whampoa on 4 July 2016 and then all the other centres on 12 July 2016. It was estimated that the number of existing club members reached 100,000⁴⁸ and their potential claim amounts exceeded HK\$100 million⁴⁹. The incident generated extensive media attention and aroused public concern about consumer prepayment in the event of retailer insolvency.

On 23 November 2016, a winding up order was made against J.V. Fitness which entered into liquidation process since then⁵⁰. It was reported that the company

⁴⁷ California Fitness is one of the fitness clubs operated by the group which had run another fitness club and another yoga centre under different trading names of "*Leap*" and "*mYoga*" respectively. For the purpose of this Report, reference is only made to California Fitness which affected the largest number of consumers.

⁴⁸ See Wikipedia, <https://zh.wikipedia.org/wiki/加州健身>.

⁴⁹ RTHK, *California Fitness 會籍債務逾億元*, 15 August 2016, <http://news.rthk.hk/rthk/ch/component/k2/1279205-20160815.htm?spTabChangeable=0>.

⁵⁰ South China Morning Post, *Hong Kong court orders winding up of California Fitness' parent company*, 23 November 2016, <http://www.scmp.com/news/hong-kong/law-crime/article/2048629/hong-kong-court-orders-winding-california-fitness-parent>.

has been heavily indebted to a number of creditors apart from consumers, e.g. employees, landlords, etc. The provisional liquidators indicated that club members, as unsecured creditors, were unlikely to get a refund⁵¹.

As at 28 October 2016, the Council had received 1,119 complaints relating to the insolvency of J.V. Fitness. The aggregate amount of payments involved was up to around HK\$27.37 million, being the retailer insolvency incident that involved the largest aggregate amount of payments in the Council's experience.

According to the Council's record, over half of the complainants had made prepayment by credit cards, demonstrating its prevalence as a prepayment method. 68 complainants had raised a request for chargeback and 1 of them was able to receive refund through chargeback. However, 37 complainants' requests were rejected and some were rejected on the ground that they had made the payment by instalment payment plans (to be discussed in later part of this chapter).

DSC

DSC (Direct Sale Centre or 德爾斯) was a chain retail store selling home furniture, household goods, electrical and electronic appliances, etc. Established in 1997, it had opened up to 18 outlets and employed about 900 staff in Hong Kong. It bought the merchandise directly from suppliers and manufacturers instead of wholesalers or distributors. Hence, it managed to sell the goods at competitive prices and attract a wide sector of consumers⁵².

In early August 2015, DSC ceased trading and closed down all its outlets due to financial distress. On 28 October 2015, a winding up order was made by the Court against four companies of the DSC Group. In addition, a number of its creditors, e.g. landlords and suppliers, filed lawsuits against DSC for unsettled bills⁵³. Since home furniture is usually delivered several days or weeks after payment is made, many consumers had not yet received the goods when DSC closed down and their prepayments (as unsecured debts) were at risk.

⁵¹ *Ibid.*

⁵² See Wikipedia, <https://zh.wikipedia.org/zh-hk/DSC%E5%B7%B7%E7%88%BE%E6%96%AF>.

⁵³ South China Morning Post, *Failed Hong Kong retail chain DSC obtains winding-up order*, 29 October 2016, <http://www.scmp.com/news/hong-kong/law-crime/article/1873523/failed-hong-kong-retail-chain-dsc-obtains-winding-order>.

By the end of 2015, the Council received about 1,350 complaints relating to the collapse of DSC. The complainants did not receive the goods from DSC despite prepayment had been made at the time of purchase. The prepayments made by most complainants ranged from a few hundred dollars to more than HK\$30,000 for each transaction and the aggregate amount involved exceeded HK\$3.8 million. However, since DSC had already closed down, the Council could not establish contact and conduct conciliation. This reflects one of the typical difficulties that consumers would face in the event of retailer insolvency.

According to the Council's record, 3 of the complainants indicated that they made the prepayment by credit cards and asked the card issuers to reverse the payment, i.e. to raise chargeback claim for them. However, their requests were all declined by the card issuers. One of them was told by the card issuer that chargeback was impossible since a month had passed since the payment date. The card issuer of another complainant stated that it would not provide any chargeback for lack of power to do so.

Oasis Airlines

Oasis Airlines (Oasis Hong Kong Airlines or 甘泉航空) was an airline company based in Hong Kong. It started operation in 2006 and purported to provide long-haul flights at more affordable prices.

However, due to substantial loss and lack of fund, it ceased operation in April 2008 and was subsequently wound up by the Court on 11 June 2008. It is obvious that numerous consumers who had previously booked flight tickets and prepaid (in full) to Oasis Airlines would be adversely affected. Not only that their travel schedule was disrupted but also their prepayments amounting to at least several thousand dollars were at risk.

Within a few months, the Council received altogether 1,478 complaints relating to Oasis Airlines' cessation of business. The total amount of prepayments involved in these complaints exceeded HK\$15 million.

According to the Council's record, 10 complainants had the experience of being refused by their card issuers in providing chargeback. Some card issuers advised the complainants that chargeback was impossible since the transaction had been completed.

On the other hand, as far as the Council was informed, 43 complainants recovered their prepayments through the card issuers but it was unclear whether the fund was paid by the card issuers themselves or charged back against the acquirer pursuant to the scheme rules.

Soon after the collapse of Oasis Airlines, it was reported that HSBC and Hang Seng Bank had assisted some cardholders to recover the prepayments. In that case, they respectively confirmed that as a commercial arrangement, the card issuer may charge back against the acquirer where the retailer became insolvent and failed to deliver the service⁵⁴. During our present study, the Council was told by a card issuer that, in the collapse of Oasis Airlines, its acquirer provided the refund out of its own pocket since it was unable to seek contribution from Oasis Airlines.

Besides, according to the last update by the liquidators of Oasis Airlines, the proof of debt forms received totaled approximately HK\$1.3 billion and the estimated dividend rate for ordinary creditors was approximately 1.5% to 2%. Although the major creditors were lenders and suppliers/vendors of Oasis Airlines, there were approximately 20,000 passengers who had paid for flight tickets but were unable to obtain refunds via their credit card companies⁵⁵.

Our Observations

From the above thousands of complaint cases, the Council has 3 observations. First of all, when a sizable retailer becomes insolvent and ceases trading, a large group of consumers will be affected and the loss for each individual consumer could be of a wide range and the impact would depend on each individual's financial position. For instance, the prepayment made to DSC for home furniture may amount to several thousand dollars which can be a substantial part of monthly income for a less well-off family. Worse still, in the case of California Fitness, the prepayment loss suffered by an individual consumer may be several hundred thousand dollars.

Secondly, the Council has seen successful recovery of prepayments by making use of chargeback. Consistent with our findings in Chapter 2, in the event that a retailer closes down, the card issuer may charge back the acquirer on the ground of

⁵⁴ Apple Daily, "簽卡購甘泉機票滙豐客獲退款 恒生有同樣安排消委會籲其他銀行也幫手", 16 April 2008, <http://hk.apple.nextmedia.com/news/art/20080416/10994012>.

⁵⁵ A letter dated 22 June 2012 issued by Patrick Cowley, Joint and Several Liquidator, for and on behalf of Oasis Hong Kong Airlines Limited (In Liquidation).

non-delivery of goods or services and the acquirer is liable for the loss. However, chargeback is merely a commercial arrangement between the card issuer and the acquirer under the scheme rules. In other words, it is not a contractual right enforceable by consumers.

Thirdly, and most importantly, it entirely depends on the card issuer's initiative as to whether chargeback will be exercised in each and every individual case. According to the experience of some complainants, two particular problems may arise. First, not all the consumers know about chargeback; or know it well enough so that they may seek assistance from their card issuers. That is why, in the event of retailer insolvency, the Council would remind consumers who made purchase with credit cards to contact their card issuers and try to get redress by way of chargeback.

Secondly, even if the consumers know about chargeback, if the hotline staff of card issuers failed to provide consistent and accurate information about chargeback to the consumers, it could create a lot of confusion, even worse is that some hotline representatives even refused to handle their requests for chargeback. Their refusal may have been driven by management decisions or simply due to their own ignorance of the availability or operation of chargeback, for instance, chargeback cannot be exercised after completion of transaction. While some card issuers have been willing to exercise chargeback on behalf of their cardholders, a significant number of consumers were unable to recover the prepayments via their card issuers and could only place their hopes in the slim chance of recovery in the liquidation process as unsecured creditors. This differential practice across the industry may cause a lot of uncertainty and confusion as well as grievance for consumers.

All in all, it reinforces our observations, based on the questionnaire survey and desktop research, that transparency, accessibility and certainty of chargeback are unsatisfactory in Hong Kong.

3.6 Instalment Payment Plans

Another issue worth addressing in the context of chargeback is instalment payment plans ("IPPs"). For the purpose of this Report, IPPs refer to prepayment by credit card which would be repaid by the cardholder to the card issuer by way of monthly instalments. They usually involve goods or services to be delivered by the retailer at a later date or over a considerable period of time and at a relatively substantial transaction amount. Common examples include purchase of electrical appliances and subscription of fitness club membership. In respect of consumer complaints

relating to the closure of California Fitness aforesaid, at least 26% of the complainants who used credit cards to make prepayments indicated to the Council that they had used IPPs. A majority of them had their requests for chargeback rejected.

According to the circular from HKMA to all authorized institutions (“AI or AIs”) dated 16 August 2010 (“**IPPs Circular**”)⁵⁶:-

“The terms and conditions of IPPs vary among AIs. IPPs are loan agreements between the bank and the customer, under which the bank advances the pre-paid amount to the customer and pays the full amount to the retailer, while the customer undertakes to repay the amount to the bank in instalments through their credit card... Some AIs offer the chargeback mechanism for IPPs while others do not. Where the AI does not offer the chargeback mechanism, the pre-paid amount is paid to the retailer more or less immediately or with limited withholding. It is particularly in this type of arrangement that disputes have arisen where merchants have gone out of business before the services contracted for have been fully delivered.”

According to our questionnaire survey, not all card issuers provide IPPs. Four card issuers replied that they did not provide IPPs to consumers. For the remaining 11 card issuers which did provide IPPs, all of them confirmed that cardholders were not entitled to chargeback protection for IPPs. That said, two of them supplemented that in exceptional circumstances, they may arrange refund to cardholders on a discretionary basis without resorting to chargeback⁵⁷.

As a general observation, IPPs are not normal credit card transactions and do not involve credit card associations. They are usually not subject to chargeback protection which is enshrined in scheme rules prescribed by credit card associations. Hence, in the event of retailer insolvency, there is no channel for the card issuer to charge back the acquirer so as to provide refund to the cardholder in respect of the prepayment made, as opposed to the case of lump sum payment. As the card issuer has already transferred the entire prepayment to the retailer shortly after the purchase, the cardholder is liable to repay the outstanding monthly instalments to the card issuer under the IPPs agreement whether or not the goods or services contracted for are delivered.

⁵⁶ Hong Kong Monetary Authority, *Marketing through Third Parties of Instalment Payment Plans involving Pre-payment for Goods or Services*, 16 August 2010, <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2010/20100816e2.pdf>.

⁵⁷ From the consumer’s perspective or in a loose manner, “chargeback” may mean refund from the card issuers to the cardholders. In this report, chargeback refers to the reversal of a credit card transaction pursuant to the scheme rules.

For example, if a retailer of home appliances closed down after a consumer purchased a high performance TV set by IPPs (without chargeback), the consumer still has to make the monthly repayments to the card issuer until the whole purchase price is paid off even if the TV set is never delivered.

The unavailability of chargeback protection for IPPs in usual circumstances poses a greater risk of losing out in the event of retailer insolvency for cardholders. It gives rise to consumer protection issues that warrant particular attention and further discussion.

3.7 Existing Regulatory Framework

As mentioned, chargeback is a right vested with card issuers under the scheme rules to which consumers are not a party. Card issuer's undertaking (by means of contract) to exercise chargeback on behalf of cardholders is also nowhere to be found. Whether consumers are able to recover prepayments on retailer insolvency via chargeback largely relies on their own knowledge on chargeback and the initiative of card issuers.

This section discusses the existing regulation regarding consumer protection in credit card transactions involving IPPs and the existence of regulation or guidance on whether or how card issuers should offer chargeback protection to cardholders for credit card transactions in general.

IPPs

As the IPPs Circular suggests, whether to provide chargeback for IPPs or not is voluntary and at the option of card issuing banks. However, in order to ensure that cardholders are aware of the underlying default risk, the IPPs Circular laid down various requirements for banks to follow if they offer IPPs which are not subject to chargeback protection⁵⁸.

Firstly, the IPPs agreements should be separately and clearly documented and made readily available to customers at the premises where the transactions take place. The following points should be made clear:-

- that the IPP is a loan agreement;
- that the customer is agreeing to pay for goods or services which may be delivered at a later date;

⁵⁸ *Ibid.*

- that the instalment amount will be counted against the customer's credit limit;
- the repayment obligations of the customer, in particular whether he or she will be able to stop payment to the bank if the goods or services contracted for are not delivered by the merchant; and
- that the customer will not enjoy chargeback protection.

Unless the customers sign separately against each clause to confirm that he/she has read and understood, the IPPs application should not be processed by the banks. There should also be a channel for the customer to call the banks from the point of sale for enquiries, e.g. a 24-hour hotline if possible.

Secondly, banks should be prudent in approving new merchants (i.e. retailers) and monitoring their accounts on an ongoing basis. They should also require the merchants to undertake to:-

- make available the terms and conditions of IPPs to the customer at the point of sale and encourage customers to read them carefully before signing the agreement; and
- remind customers that they may contact the bank for explanation and defer signing the agreement until they have been able to speak with the bank.

Thirdly, banks should be able to audit the compliance of the merchants with the undertakings mentioned above and any other contractual obligations. If a merchant is not fulfilling the undertaking, banks should follow up and require it to take remedial measures or even terminate the business relationship.

Chargeback

According to our research, there is no specific legislative or regulatory provision requiring card issuers to provide or exercise chargeback upon cardholders' request. It follows that little guidance on how card issuers should handle such requests can be found.

HKMA has issued a supervisory policy manual for credit card business (CR-S-5)⁵⁹ ("Manual"). Although the Manual does not require banks to provide chargeback to cardholders or recognize such duty on the part of card issuers, it highlights the credit risk and liquidity risk for acquirers in the event that retailers fail to reimburse them for

⁵⁹ Hong Kong Monetary Authority, *Supervisory Policy Manual*, 5 January 2016, <http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CR-S-5.pdf>.

chargeback and suggests risk control measures, e.g. prudent approval of new merchants, merchant account management and withholding funds to suspicious merchants. Nevertheless, they are largely guidance on how to manage business relations and operational risk rather than customer relation or protection.

The Council has also seen the regulator's efforts in educating the public about the availability of chargeback. For instance, in the HKMA's webpage of "*Consumer Corner*", there is a leaflet titled "*Smart Tips on Using Credit Cards*"⁶⁰ which, among other things, suggests that "*If a merchant fails to deliver the goods or services you paid for by credit card, or the goods delivered are damaged or do not comply with the product specifications, check with your bank if you can get a refund through the credit card chargeback mechanism*". In the webpage of "*Frequently Asked Questions*"⁶¹, there is a question about what is chargeback. It says "*Generally speaking, consumers using credit cards to make lump-sum payments upfront are eligible to apply for a refund of their payments, or a "chargeback", in accordance with the credit card association's rules, for services that they have not enjoyed because the merchant has gone out of business... (omitted)*".

Further, after the closure of California Fitness, HKMA issued "*Smart tips on using autopay services*" to advise consumers on how to cancel direct debit authorization to stop making future payment to an insolvent retailer and how to utilize chargeback to recover prepayment already made by credit cards⁶². That said, these are not regulation or guidance to card issuers who are the key players in making use of the chargeback mechanism.

As to self-regulation in the banking industry, one of the general principles under the Code of Banking Practice⁶³ includes "*Institutions and their authorized agents should have as an objective, to work in the best interest of their customers and be responsible for upholding financial consumer protection*". In respect of credit card business, paragraph 26.5 of the Code of Banking Practice further provides that,

⁶⁰ Hong Kong Monetary Authority, *Smart Tips on Using Credit Cards*, <http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/consumer-corner/pe2.pdf>.

⁶¹ Hong Kong Monetary Authority, *Frequently Asked Questions - Banking Stability*, 21 April 2016 <http://www.hkma.gov.hk/eng/other-information/pws-faq/banking-stability.shtml#credit-cards>.

⁶² Hong Kong Monetary Authority, *Smart tips on using autopay services*, 7 July 2016, <http://www.hkma.gov.hk/eng/key-information/insight/20160707.shtml>.

⁶³ The Hong Kong Association of Banks, *Code of Banking Practice*, February 2015, http://www.hkma.gov.hk/media/eng/doc/code_eng.pdf.

"In addition to the detailed terms and conditions, card issuers should make readily available to cardholders general descriptive information on the use of cards. Such information should include:–

...(omitted)

- (g) the procedures for making complaints against outlets arising from the use of the card;*
- (h) how to use the card issuer's error/dispute resolution processes (including the procedure for querying entries on a periodic statement);*
- (i) the procedures for cancelling recurring payments;...(omitted)"*

Whilst chargeback provides a readily available channel for consumers to seek redress on retailer insolvency, clear assurance of consumers' right/entitlement to chargeback protection is absent in the industry regulations and standard card member agreements. Despite the above-mentioned industry guidelines, our questionnaire survey and desktop research showed that excessively generic wording, e.g. cardholder shall submit any disputed transaction and report any alleged error or omission, rather than direct mention of chargeback is adopted in the card member agreements and may not be helpful and reader-friendly for layman consumers to appreciate the possibility of recovering prepayments via chargeback. The case study also indicates that in a real-life case of major retailer insolvencies, consumers' requests for chargeback may be declined by some card issuers with invalid reasons or even no reason at all. Opportunities for recovering prepayments via chargeback may be wasted, possibly due to a card issuer's inertia or even its business concern in preserving relationship with an acquirer.

To a large extent, card issuers are given a free hand in deciding whether and how they should file a claim of chargeback against acquirers on a case by case basis. Without regulatory control and contractual obligation, the decision will be discretionary and even arbitrary.

Chapter 4

Chargeback in Other Jurisdictions

Key Points

- Similar to Hong Kong, chargeback is provided by the scheme rules in the USA, the UK, EU and Australia. The UK Law Commission considered that the lack of transparency was the major problem of chargeback in the UK and recommended non-legislative measures to improve the transparency of chargeback. In Australia, the Code of Banking Practice and the Guidance Note on Chargeback issued by the Code Compliance Monitoring Committee provide detailed guidance to banks on how to handle chargeback requests and inform consumers of the availability of chargeback protection.
- The concept of connected lender liability has been introduced, to different extent, by legislation in the USA, the UK, EU and Australia. Essentially, it means a credit provider will be held liable to the consumers for the retailer's breach of contract and/or misrepresentation. Among these jurisdictions, section 75 of the Consumer Credit Act in the UK applies to credit card and offers the most comprehensive protection to consumers. It allows consumers to recover his/her loss from the card issuer and/or the retailer in the event of retailer insolvency.

In this Chapter, the operation of chargeback in the USA, the UK, EU, Australia, Singapore, Mainland China and Taiwan, and the concept of connected lender liability will be discussed. For Australia and the USA which have multiple jurisdictions, the focus stays on their respective federal regimes only. Connected lender liability essentially means the connected credit providers (e.g. card issuers) will be held liable to the consumers for the retailer's breach of contract (which happens in retailer insolvency) and/or misrepresentation. It confers a private legal right enforceable by consumers against the connected lender. These overseas examples provide reference for improving the operation of chargeback and strengthening the protection for consumer prepayment on retailer insolvency in Hong Kong.

4.1 United States of America

Chargeback

In the USA, apart from the scheme rules⁶⁴, the implementing regulation of the Truth in Lending Act, Regulation Z⁶⁵ ("**Regulation Z**"), has laid the statutory foundation for the chargeback mechanism.

Section 226.13 of the Regulation Z⁶⁶ deals with billing error resolution. For the present purpose, the meaning of billing error covers a reflection on statement of goods or services not accepted by the consumers, or not delivered to the consumers⁶⁷. Hence, it covers the situation of retailer insolvency where goods/services are not delivered.

To handle a billing error, the card issuer shall mail or deliver written acknowledgement to the consumer within 30 days of receiving a billing error notice, unless the problem is resolved within that 30-day period⁶⁸. Furthermore, within 2 complete billing cycles (but in no event later than 90 days) after receiving a billing error notice from the cardholder, the issuer must take either one of the following two actions⁶⁹. If it is determined that a billing error occurred as asserted, the card issuer shall correct the billing error and credit the cardholder's account with any

⁶⁴ Mark Furletti & Stephen Smith, *The Laws, Regulations, and Industry Practices that Protect Consumers Who Use Electronic Payment Systems: Credit and Debit Cards*, January 2005, p.37, https://philadelphiafed.org/consumer-credit-and-payments/payment-cards-center/publications/discussion-papers/2005/ConsumerProtectionPaper_CreditandDebitCard.pdf.

⁶⁵ Code of Federal Regulations, Title 12, Chapter II, Part 226

⁶⁶ §226.13 of the Regulation Z

⁶⁷ §226.13(a)(3) of the Regulation Z

⁶⁸ §226.13(c)(1) of the Regulation Z

⁶⁹ §226.13(c)(2) of the Regulation Z

disputed amount and related finance or other charges, as appropriate, as well as sending a correction notice to the cardholder⁷⁰. Alternatively, if the card issuer determines after conducting a reasonable investigation that no billing error occurred, it shall notify the cardholder in writing the reasons for refusal⁷¹.

It is noted that the time limit of raising a chargeback claim under the scheme rules (usually within 120 days from the date that consumer expects to receive the goods or service) would go beyond the statutory requirement under Regulation Z, which is 60 days after the card issuer sent the statement where the alleged error appeared.

Connected Lender Liability under Regulation Z

The concept of connected lender liability is introduced by legislation in the USA. Section 226.12(c)⁷² provides that *"when a person who honors a credit card fails to resolve satisfactorily a dispute as to property or services purchased with the credit card in a consumer credit transaction, the cardholder may assert against the card issuer all claims (other than tort claims) and defences arising out of the transaction and relating to the failure to resolve the dispute"*.

The application of section 226.12(c) is, however, subject to two important limitations. First, the cardholder has made a good faith attempt to resolve the dispute with the person honoring the credit card, i.e. the retailer. Secondly, the disputed transaction occurred in the same state as the cardholder's current designated address or, if not within the same state, within 100 miles from that address⁷³. Hence, its scope of application is more restrictive than section 75 of the Consumer Credit Act 1974 in the UK, which will be discussed below.

4.2 United Kingdom

In the UK, there are two main ways in which payment made by credit card are protected:-

- (1) The scheme rules provide a system of chargeback, which allows the card issuer to ask the acquirer to reverse a credit card transaction under certain circumstances.

⁷⁰ §226.13(e) of the Regulation Z

⁷¹ §226.13(f) of the Regulation Z

⁷² §226.12(c) of the Regulation Z

⁷³ §226.12(c)(3)(i) of the Regulation Z

- (2) Section 75 of the Consumer Credit Act 1974 renders a connected credit provider (i.e. credit card issuers) jointly and severally liable for the retailer's breach of contract and/or misrepresentation.

Chargeback

In the UK, chargeback is provided by the scheme rules instead of legislation. In other words, chargeback is not a statutory right. In case the paid goods or services are not delivered, the consumer can contact the card issuers and request that a chargeback be raised. The card issuer will ask for supporting documentation and investigate the request. Depending on the outcome of the investigation, the card issuers may or may not accept the consumer's request. Consumers who are not happy with their card issuer's decision are entitled to raise a complaint with the Financial Ombudsman Services⁷⁴ ("FOS").

On its website, the FOS describes its view on how a card issuer should handle a chargeback request from a cardholder and its approach in addressing a cardholder's complaint regarding chargeback as follows⁷⁵:-

"We consider that, as a matter of good practice, the card issuer should attempt a chargeback if the card holder has challenged a transaction and – taking account of the relevant card scheme rules – there appears on the face of it to be a fair chance that a chargeback request may succeed.

So we normally expect the card issuer to identify whether the potential exists for a successful chargeback request. And if so, to ensure that a request is processed in the right format and within any time limits that apply.

If it does not do that, then we can consider a complaint from the card holder. And we will decide in our opinion the chargeback would have succeeded, if had been properly made."

⁷⁴ The Financial Ombudsman Service in the UK was set up by law as an independent public body with an aims to resolve individual disputes between consumers and financial businesses. It has the power to require banks to pay up to £150,000 in compensation.

⁷⁵ Financial Ombudsman Service, *online technical resources, disputed transactions*, http://www.financial-ombudsman.org.uk/publications/technical_notes/disputed-transactions.htm.

If the FOS upheld a complaint against the card issuer, it can generally provide the cardholder redress in two ways. It may order the card issuer to pay monetary compensation to the consumer. This may happen if the time limit of chargeback expires. Alternatively, it may direct the card issuer to make a chargeback claim for the consumer.

Indeed, protection for consumer prepayments has been a long standing concern. In 2014, the Department for Business, Innovation and Skills asked the UK Law Commission to examine the existing protections for consumer prepayments and to consider whether such protections should be strengthened⁷⁶. In 2015, the UK Law Commission published a consultation paper on “Consumer Prepayments on Retailer Insolvency”. Among other things, a comprehensive review of the chargeback system in the UK was conducted.

In the consultation paper, whilst the Law Commission recognizes the importance of chargeback as a consumer protection measure in insolvency situations where the consumer is unlikely to have redress against the retailer, it finds that the lack of information about how chargeback works is the main problem with this protection in the UK⁷⁷. This coincides with our findings in Chapter 3 indicating that the transparency and accessibility of chargeback in Hong Kong are unsatisfactory. The Law Commission takes the view that chargeback arrangements should be transparent and puts forward the following 3 proposals to improve dissemination of information about how the chargeback system works⁷⁸.

Proposal 1

Insolvency practitioners should give information to consumer creditors about chargeback claims and make available on the retailer’s website a confirmation that the company is in administration or liquidation.

Proposal 2

All card issuers should give consumers a brief explanation of how to raise a chargeback. This should include:-

⁷⁶ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency – A Consultation Paper*, 2015, para 1.9.

⁷⁷ *Ibid.*, para 9.8

⁷⁸ *Ibid.*, p.130

- (1) *Contact details (including a phone number and website address);*
- (2) *Details of situations in which consumers may raise a chargeback, including when a retailer enters administration, and what documentation needs to be provided to the bank;*
- (3) *A statement that consumers who think they have met with an unreasonable refusal may complain to the Financial Ombudsman Service.*

Proposal 3

Card schemes should provide a publicly available authoritative guide on how chargeback works.

In July 2016, the Law Commission published the report of the said consultation. Insofar as chargeback is concerned, the Law Commission made the following major recommendations based on the above 3 proposals⁷⁹:-

- (1) A best practice guidance for insolvency practitioners should be produced by Insolvency Service⁸⁰ on:-
 - (a) Advising consumer creditors who have paid by credit card to contact their card issuer to raise a chargeback;
 - (b) Advising consumers that further information on chargeback can be found in a chargeback guide (see (4) below);
 - (c) Providing on the retailer's website a confirmation that the company is in administration or liquidation, in a form which consumers can provide to their card issuer as evidence of the same;
 - (d) Making available to consumers other evidence or information which a card issuer may reasonably require.

⁷⁹ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency Report*, 2016, para 7.106.

⁸⁰ The Insolvency Service is an executive agency of the Department of Business Innovation and Skills in the UK which administers compulsory company liquidations and personal bankruptcies and deals with misconduct through investigation of companies and enforcement.

- (2) Insolvency practitioners and card issuers (through appropriate representative bodies) should agree the form and content of a document which the insolvency practitioner will put on the website of an insolvency retailer and which the card issuer will accept from the consumer as evidence of insolvency.
- (3) A code of best practice for card issuers should be produced concerning the provision of information to consumers about chargebacks and the evidential requirements for raising a chargeback.
- (4) A chargeback guide should be produced. It should include greater information on time limits and complaints. Card issuers and card schemes should link to this document, which should be kept up to date.

The Council considers that the above recommendations can serve as a good reference for addressing the issues of accessibility and transparency of chargeback in Hong Kong and deserve serious consideration.

Connected Lender Liability under Section 75 of Consumer Credit Act 1974

Under the UK Consumer Credit Act 1974 (“CCA”), credit card transaction is regarded as a type of “connected lending” where a loan is made under pre-existing arrangements between a bank and a retailer, and the bank knows that the loan will be used to finance the purchase of goods or services⁸¹. Although the contract for goods or services is between the retailer and the consumer, the CCA imposes a connected lender liability on the card issuer (as creditor).

Section 75 of the CCA⁸² (“Section 75”) renders a connected credit provider (i.e. card issuer) jointly and severally liable for the retailer’s breach of contract and/or misrepresentation. The purchase must be more than £100 and not more than £30,000. In the scenario of retailer insolvency, a consumer who has a claim for misrepresentation or breach of contract against the retailer may sue the creditor or the supplier or both.

The legislative history and policy objective of Section 75 is succinctly summarized in the above-mentioned consultation paper on “Consumer Prepayments on Retailer Insolvency” published by the UK Law Commission⁸³:-

⁸¹ Section 12(b) and (c) of the Consumer Credit Act 1974

⁸² Section 75 of the Consumer Credit Act 1974

⁸³ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency – A Consultation Paper*,

"Section 75 of the Consumer Credit Act 1974 implements a recommendation of the Committee on Consumer Credit, chaired by Lord Crowther. The Crowther Committee looked at "connected credit" arrangements, where a lender provided credit to buy specific goods or services and had a connection with the supplier of those goods and services. The Committee thought that if there was any misrepresentation or breach of contract by the supplier, then both the lender and the supplier should be liable to the borrower for the breach. In most cases, the lender would pay the borrower and recover the loss from the supplier. However, if the supplier was unable to pay (for example, for reasons of insolvency), the Committee thought that the loss should fall on the lender:-

In considering which two of the relatively innocent parties should bear the greater loss, it is much easier for the business creditor to do so than the individual debtor.

The first credit card in the United Kingdom was launched by Barclays in 1966; in 1971, when the Crowther Committee reported, credit cards were still a new idea. The Committee was mainly thinking in terms of credit arrangements arranged directly between retailers and finance companies. For example, where a retailer offers a finance deal (such as "pay nothing for your sofa for 2 years"), this will be a consumer credit agreement which will therefore attract section 75 protection.

However, the Committee thought that similar reasoning should apply to credit cards. The Committee commented:-

There is in fact a close business relationship between an issuer and the suppliers who have agreed to accept the issuer's credit cards. The issuer, through provision of the card, swells the turnover of the supplier, and for conferring this benefit usually receives by way of discount an agreed percentage of the invoice price of the goods or services supplied. Moreover, a cardholder dealing with a reputable issuer has every reason to assume that the issuer will list only reputable suppliers."

2015, paras. 5.13 - 5.15.

The table below summarized the respective features of chargeback and Section 75 protection in the UK regarding consumer protection in a retailer insolvency⁸⁴:-

	Section 75	Chargeback
Nature of right	Statutory right of consumer	Non-statutory right contained in the scheme rules
Type of payment card	Credit cards only	Credit and debit cards
Monetary limits	The price of the goods/service (not the value of transaction) must be over £100 and less than £30,000, though the amount paid by card may be less ⁸⁵	Variable minimum amount ⁸⁶ and no maximum limit
Amount which can be recovered	Unlimited, including amount paid plus any consequential loss (if any)	Amount paid by card
Time limit	6 years from the non-delivery of goods or service	Variable, but generally 120 days from the date on which delivery of goods or service was expected
Where retailer is insolvent, the loss falls on	Card issuer (unless offset by chargeback claim against acquirer)	Acquirer
Jurisdiction limit	Apply to UK credit card agreement	Not applicable

In 1994, the Director General of Fair Trading conducted a review on Section 75. Various arguments were advanced by card issuers in support of the proposition that credit card transactions should be excluded from the scope of Section 75. They include⁸⁷:-

⁸⁴ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency – A Consultation Paper* 2015, para. 5.74.

⁸⁵ Section 75 applies where the consumer has made a partial credit card payment of less than £100, provided the price was more than £100.

⁸⁶ There is a minimum chargeback amount for travel and entertainment. See Visa rules, para. 11.1.4.2.

⁸⁷ Connected Lender Liability, *A review by the Director General of Fair Trading of section 75 of the*

- (1) The significant expansion of the use of credit cards was barely envisaged by the Crowther Committee in 1970s;
- (2) There was little difference, in effect, between the use of credit card and debit card or charge card, as many people would pay off the balance in full every month. But Section 75 does not apply to the latter;
- (3) The rationale for imposing connected lender liability might no longer be applicable to the existing credit card arrangements, which is a five-party structure involving retailer, acquirer, credit card association, card issuer and consumer; and
- (4) Credit card issuers may not have a close relationship with retailers.

On the other hand, there were some strong counter-arguments. They include⁸⁸:-

- (1) The advent of five-party structure is more a change of practice, not of principle. Although the presence of acquirers has led to evolution in the relationship between retailers and card issuers, it does not follow that real business relationship do not continue to exist between them. The five parties remain as inter-connected, inter-related and co-dependent in their arrangements as the three parties were;
- (2) It may be true that those who pay their credit card balances in full each month may well perceive no real difference between credit card and debit card or charge card. The fact remains, however, that the person who uses a credit card, has, at his own discretion, the option of an extended period of payment;
- (3) Section 75 may be seen as a form of insurance which would facilitate the growth of credit card industry. This would ultimately benefit the consumers, card issuers, acquirers and retailers;
- (4) If the market is working effectively, card issuers should be able to recover most costs incurred as a result of Section 75 through chargeback arrangements. To this extent, Section 75 does not seem to impose an undue additional liability on the card issuers.

Consumer Credit Act 1974, March 1994, para. 4.2.

⁸⁸ *Ibid.*, para 4.4.

Having considered all the arguments carefully, the Director General concluded that the then developments in the market of credit cards did not alter the case put forward by the Crowther Committee for a special level of consumer protection in connected lender transactions⁸⁹.

After review, the Director General did not find a case to exclude credit card transactions from Section 75. The scope of application of this statutory provision had been challenged; and issues have been raised regarding (1) whether it should extend to foreign transactions; and (2) whether the creditor's liability should be unlimited.

Foreign Transactions

The issue of whether Section 75 is applicable to foreign credit card transactions has been determined by the House of Lords. In *OFT v Lloyds TSB Bank and Ors*⁹⁰, the Office of Fair Trading ("OFT") brought proceedings seeking declarations relating to the scope of application of Section 75. The defendant banks argued that Section 75 did not cover transactions which took place and performed abroad, and were governed by foreign law. The House of Lords rejected the argument and decided that it did cover. In delivering his judgment, Lord Hope gave a strong endorsement of the policy behind Section 75. As His Lordship put it:-

"The creditor is in a better position than the debtor, in a question with a foreign supplier, to obtain redress. It is not to be assumed that the creditor will always get his money back. But, if he does not, the loss must lie with him as he has the broader back. He is in a better position, if redress is not readily obtainable, to spread the cost. He is in a better position to argue for sanctions against a supplier who is not reliable. For his part, the debtor is entitled to assume that he can trust suppliers who are authorized to accept his credit card."

According to an evaluation report published by the OFT in 2009⁹¹:-

"The main benefits of intervention arose from clarification of a point of law and as a result consumers being better informed and making more use of their rights under S75. This occurred in three broad fashions:-

⁸⁹ Connected Lender Liability, *A review by the Director General of Fair Trading of section 75 of the Consumer Credit Act 1974*, March 1994, para. 4.7.

⁹⁰ [2007] UKHL 48

⁹¹ Office of Fair Trading, *Evaluation of a sample of consumer enforcement cases*, October 2009

- *If a problem arose with a purchase, credit card users were able to deal with the credit card company rather than with a distant overseas supplier(s);*
- *As a result consumers were more likely to use credit cards than another form of payment and;*
- *Consumers were more confident about purchasing from abroad at cheaper prices."*

The OFT estimated (from an economics perspective) that there was a reduction of consumer detriment of £99 million a year⁹². Whilst this benefit was a result of merely confirming that Section 75 is applicable to foreign transactions rather than the implementation of Section 75, the Council submits that proportionate benefits, albeit on a smaller scale due to smaller affected market size and population in Hong Kong, would likely be achieved if statutory protection similar to Section 75 is available to Hong Kong consumers.

Unlimited Liability

Under Section 75, the creditor's liability may extend beyond the amount of the credit. Take a case in which the consumer spends \$1,000 on a sofa, paying a \$300 deposit by credit card and the rest by cash. If the retailer goes into liquidation without delivering the sofa, the card issuer can be liable for the full price of \$1,000.

It was argued that this was unfair to the card issuer which would be held liable for the whole purchase price. In the review conducted by the Director General in 1994, it was recommended that the liability of card issuers should be limited to the money lent (plus interest)⁹³. Subsequently, upon the consultation with stakeholders on the scope of Section 75, the Department of Trade and Industry took the view that the suggested reduction in connected lender liability could lead to a significant reduction in consumer protection⁹⁴. As such, the said recommendation was not implemented⁹⁵.

⁹² *Ibid*

⁹³ Office of Fair Trading, *A second report by the Director General of Fair Trading on Section 75 of the Consumer Credit Act 1974* (1995)

⁹⁴ *Connected Lender Liability in United Kingdom Consumer Credit Law: A Consultation Document*, DTI, London, December 1995, Chapter 5, para. 7.

⁹⁵ DTI press release on 28 October 1996 stating that the Government believed that the law required no clarification and that the law should not be changed.

Although there does not seem to be much quantitative information available relating to the effectiveness of connected lender liability in protecting consumers' prepayment in retailer insolvency, overall speaking, it is beyond dispute that Section 75 is an important and effective provision for consumer protection⁹⁶. The consumer groups and trading standard officers⁹⁷ in the UK had emphasized that "the protection afforded by section 75 has been, and remains, of considerable value to consumers"⁹⁸. Each year, the FOS received a significant number of complaints involving Section 75⁹⁹, reflecting wide range of purchases that people make using credit cards: from solar panels, timeshare and holiday clubs, to concert tickets and household appliances. But no exact complaint figures were provided by the FOS. Nevertheless, this still reflects the importance of section 75 in protecting consumers.

Similarly, the UK Law Commission, despite recognizing the controversy of Section 75, stated that "*trust is particularly important in the modern context due to prevalence of online retail. [The Law Commission] thinks that Section 75 underpins consumer trust in this practice. Without it, consumers would be much less confident, particularly for distance sales from smaller retailers*"¹⁰⁰. It is noted that the UK Government has asked the Financial Conduct Authority to conduct a further review on Section 75, but this would unlikely happen before 2017¹⁰¹.

Chargeback and Section 75, conferring different rights and extents of protection to consumers, can complement each other to increase the chance of recovering consumer prepayments in the event of retailer insolvency. Furthermore, Section 75 provides a strong incentive to card issuers to make use of the chargeback mechanism to recover the prepayment from the acquirer in order to cover its liability under the provision. If card issuers are more willing to use chargeback, the Council believes it would ultimately benefit consumers.

⁹⁶ However, the Council is not aware of any public data showing the total number of Section 75 claims and the amount of money involved against card issuers in the UK each year.

⁹⁷ Trading standards officers act on behalf of consumers and businesses to advise on, and enforce, laws that govern the way goods and services are bought, sold and hired. They generally work for local councils, advising on consumer law and investigating complaints. See Prospects, *Trading Standards Officer*, <https://www.prospects.ac.uk/job-profiles/trading-standards-officer>.

⁹⁸ Connected Lender Liability, *A review by the Director General of Fair Trading of section 75 of the Consumer Credit Act 1974*, March 1994

⁹⁹ See FOS annual report 12/13, 13/14 and 14/15.

¹⁰⁰ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency – A Consultation Paper*, 2015, para. 5.25.

¹⁰¹ *Ibid.*

4.3 European Union

Chargeback

The legal position in EU is essentially similar to the UK. According to a report published by the European Consumer Centres Network (“ECC-Net”) in 2014¹⁰², card schemes in most EU countries operate internal chargeback procedures. Chargeback is provided by card schemes and has no statutory basis.

In the said report, ECC-Net found that banks in EU countries often do not give information about their operating rules for chargeback. Worse still, some consumers may be given information by bank tellers that the bank has no means to assist them¹⁰³. Similar to our findings on the local situation, the study by ECC-Net also demonstrates that the lack of transparency of chargeback is a common problem in EU countries.

Connected Lender Liability under Article 15 of the Consumer Credit Directive

Article 15 of the Consumer Credit Directive¹⁰⁴ provides that where the goods or services covered by a linked credit agreement are not supplied, or are supplied only in part, or are not in conformity with the contract for the supply thereof, the consumer shall have the right to pursue remedies against the creditor if the consumer has pursued his remedies against the supplier but has failed to obtain the satisfaction to which he is entitled according to the law or the contract for the supply of goods or services. In gist, it gives consumers the right to claim against a linked creditor but only after exhausting possible remedies against the retailer.

Nevertheless, a “linked credit agreement” is defined as a credit agreement where the credit in question serves *exclusively* to finance an agreement for the supply of specific goods or the provision of a specific service, and those two agreements form, from an objective point of view, a commercial unit. Examples may include agreements for hire purchase of items such as automobiles and high value electrical goods.

¹⁰² The European Consumer Centres’ Network, Chargeback in the EU/EEA, February 2014, http://ec.europa.eu/consumers/ecc/docs/chargeback_report_en.pdf.

¹⁰³ *Ibid.*, p. 12.

¹⁰⁴ Directive 2008/48/EC of the European Parliament and of the Council on credit agreements for consumers and repealing Council Directive, 23 April 2008, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF>.

By virtue of such definition, Article 15 is more restrictive in nature than section 75 of the Consumer Credit Act in the UK. Its protection is limited to “linked credit agreement” and thus does not apply where credit has been provided for general purposes rather than for the purchase of specific goods or services. Therefore, it does not apply to typical credit card transactions. Moreover, it allows consumer to sue the creditor only if they have sought remedies against the suppliers but in vain. Consumers cannot sue both parties simultaneously.

4.4 Australia

Chargeback

In Australia, whilst chargeback is also originated from scheme rules, chargeback protection for consumers is expressly provided in the Code of Bank Practice¹⁰⁵ which is a voluntary code of conduct for member banks of the Australian Bankers’ Association and sets standards of good banking practice for banks to follow when dealing with individual and small business customers, prospective customers and guarantors.

The relevant clauses of the Code are as follows:-

“Clause 12.5 – [the bank] will include in, or with, the terms and conditions for [its] credit cards and, where relevant, debit cards (a) general information on chargeback rights; (b) a prominent statement that [the card holder] should report a disputed transaction to the bank as soon as possible (so that [it] may reasonably ask for a chargeback where such a right exists).

Clause 22.1 - If [the card holder] has disputed a card transaction with [the bank] within the required timeframe, [the bank] will, in relation to a credit card or, where relevant, a debit card transaction (including an unauthorized payment debited to the card account pursuant to a recurring payment arrangement):

- (a) claim a chargeback right, where one exists, for the most appropriate reason; and*
- (b) not accept a refusal of a chargeback by a merchant’s financial institution unless it is consistent with the relevant card scheme rules.*

¹⁰⁵ Australian Bankers’ Association, Code of Bank Practice, <http://www.bankers.asn.au/industry-standards/ABAs-code-of-banking-practice>.

Clause 22.2 – [The bank] will make available general information about chargebacks on [its] website or by electronic communication to [the card holder] and [the bank] will notify [the card holder] of the availability of this information on or with the relevant card statement of account at least once every 12 months."

It can be seen that although chargeback is not a statutory right conferred on consumers, the Code imposes obligations on the banks (i) to include in its terms and conditions of credit card the general information on chargeback rights; (ii) to handle a chargeback request in accordance with the relevant card scheme rules; and (iii) to disclose information about chargeback on a regular basis. It would not only enhance consumers' knowledge on chargeback but also facilitate the utilization of chargeback in recovering consumer prepayment.

Code Compliance Monitoring Committee

The Code Compliance Monitoring Committee ("CCMC") is an independent body established under clause 36 of the Code of Banking Practice in Australia. One of the major functions of CCMC is to monitor banks' compliance with the Code and conduct, on its own motion, inquiries into banks' compliance with the Code.

CCMC's Inquiry Reports

In 2011, the CCMC conducted a mystery shopping exercise and questionnaire survey to assess banks' compliance with the elements of the Code concerning chargeback ("2011 Inquiry"). Inconsistency was found in the responses provided by different representatives of the same bank concerning time frames or procedures associated with chargeback. The results of the 2011 Inquiry highlighted that the accuracy of information given to customers by call centre staff about their chargeback requests needed improvement¹⁰⁶.

In view of the above, the CCMC conducted a follow up mystery shopping exercise in 2013 to see whether standards had improved in call centres ("2013 Inquiry"). Regrettably, when compared with the 2011 Inquiry, the overall result suggested that there had been no significant improvement in the provision of accurate information

¹⁰⁶ Code Compliance Monitoring Committee, *Inquiry report (Jan 2012) on chargeback*, <http://www.ccmc.org.au/cms/wp-content/uploads/2013/11/CCMC-Inquiry-Report-Chargebacks-January-2012.pdf>.

to consumers about their chargeback rights¹⁰⁷. For example, some bank representatives advised that dispute had to be raised by customer in person at a branch. The bank's website, however, provided a downloadable dispute form for this purpose which could be faxed or posted to the bank.

CCMC's Guidance Note in 2014

Subsequent to the 2013 inquiry on chargeback, the CCMC issued a Guidance Note in 2014 ("**Guidance Note**"). The purpose of the Guidance Note is to share CCMC's view of good industry practice, which, in some cases, may extend beyond the strict requirements of the Code. They are divided into 3 main areas¹⁰⁸:-

Disputing Transactions

In CCMC's view, the lodgment of disputes by customers within relevant time limits can be facilitated more easily if the designated dispute form is readily available online and call centre staff are aware of its use. Many customers are unclear about their chargeback rights and look to banks to assist them to dispute transactions according to bank policies and procedures. Effective training of relevant staff can ensure that customers receive bank's advice about whether and how transaction may be disputed.

Warnings that Rights may be Lost

In CCMC's view, providing warnings in the terms and conditions that the ability to dispute a transaction may be lost if the dispute is not reported within relevant timeframes is one example of good industry practice which may help ensure customers are fully informed of their rights and responsibilities.

Provision of Accurate Information through Call Centres

As call centers are often the first point of contact for customers, these channels play an important role in providing accurate information to customers. In CCMC's view,

¹⁰⁷ Code Compliance Monitoring Committee, *Inquiry report (Oct 2013) on chargeback*, <http://www.ccmc.org.au/cms/wp-content/uploads/2013/11/CCMC-Inquiry-Report-Chargebacks-Follow-up-October-2013.pdf>.

¹⁰⁸ Code Compliance Monitoring Committee, *Guidance Note on Chargeback*, No. 11, <http://www.ccmc.org.au/cms/wp-content/uploads/2014/12/GN11-Chargebacks.pdf>.

good industry practice requires effective training of call centre staff and access to accurate information about chargebacks.

Overall speaking, the major concerns of CCMC in the 2011 and 2013 Inquiries, namely the inconsistency and inaccuracy of information provided to consumers regarding chargeback are shared by Hong Kong consumers seeking such a remedy.

To tackle similar problems of chargeback in Hong Kong, the Code of Banking Practice and CCMC's Guidance Note on Chargeback can be of considerable reference value.

Connected Lender Liability under Section 278 of the Australian Consumer Law

Section 278 of the Australian Consumer Law ("**Section 278**") imposes joint and several liability on retailers and linked credit providers where consumers suffer loss as a result of breach of contracts relating to the supply of goods or services as well as the linked credit. For example, a motor vehicle dealer under an agreement with a finance company regularly refers customers to that finance company. This finance company can be jointly liable with the car dealer under Section 278 for the loss or damage suffered when that dealer fails to comply with certain consumer warranties or deliver the vehicle at all.

The underlying concept of connected lender liability had been introduced since 1986 by amending the then section 73 of the Trade Practices Act 1974. The rationale behind was that before 1986, finance companies were absolved from all liability under the Act for breach of contract of sale. However, in some cases, the credit provider must carry some fault. Where the credit provider had an arrangement with the retailer to provide credit in respect of purchases from such retailer, the credit provider was aiding the retailer's business. He would be in a better position to know of the solvency of the retailer and, depending on the connection, he might be able to exercise some control over the retailer's business conduct. Hence, the Australian Government proposed to introduce connected lender liability against the credit provider¹⁰⁹ by enacting the then section 73 which was subsequently replaced by Section 278. Both provisions are in effect largely similar so that consumers retain the ability to pursue actions against retailers and linked credit providers jointly in prescribed circumstances.

¹⁰⁹ Explanatory Memorandum of the Trade Practices Revision Bill 1986, paras. 142 & 143.

However, the application of Section 278 is subject to some critical restrictions. Firstly, the credit should be provided specifically in relation to the supply of goods or services in question, similar to the EU situation. Secondly, it is a requirement that the consumer must bring the action against the linked credit provider and the retailer jointly unless the retailer has been dissolved or winding up of the retailer has commenced, or it is unlikely that a judgment obtained against the retailer would be satisfied¹¹⁰. Thirdly, several defences are available¹¹¹ to the linked credit provider, such as (i) the credit provided was the result of an approach made to the credit provider by the consumer and the approach was not induced by the retailer of the goods or services; and (ii) before becoming a linked credit provider, the credit provider has conducted due inquiry and was satisfied that the reputation of the retailer was good, and after becoming a linked credit provider, it had no cause to suspect that the consumer might be entitled to recover damages as a result of the retailer's breach of contract and the retailer might be unable to meet the liabilities.

4.5 Other jurisdictions

Given the similarities in culture, business environment and geographical proximity between Hong Kong, Singapore, Mainland China and Taiwan, the operation of chargeback in those jurisdictions have also been reviewed.

As a whole, the operation of chargeback in Singapore and Mainland China is very similar to Hong Kong, i.e. chargeback is provided by scheme rules and does not have statutory backup. Further, there appears to be no authoritative guide published by the relevant regulatory authorities about how credit card issuers should handle cardholders' enquiries or chargeback requests. Based on the above observation, it appears that transparency of chargeback is also a potential issue in Singapore and Mainland China, as in Hong Kong.

On the other hand, the Consumer Protection Act in Taiwan regulates the use of certain types of "standard contract". The Consumer Protection Committee of Executive Yuan promulgated the standard cardholder agreement which is intended to be consistently adopted by card issuers¹¹². Chargeback is expressly provided for in the standard cardholder agreement whereby cardholders shall be, under certain circumstances, including non-delivery of goods/services, entitled to request the card issuer to raise a chargeback against the acquirer pursuant to the scheme rules. That

¹¹⁰ Section 279 of the Australian Consumer Law

¹¹¹ Section 280 of the Australian Consumer Law

¹¹² See http://www.ey.gov.tw/Content_List.aspx?n=5279F68BA6EBB1E2

said, details regarding the application procedures and transparency are not provided for in the standard cardholder agreement.

With respect to connected lender's liability, it appears that Singapore, Mainland China and Taiwan have not yet introduced, by legislation, the concept of connected lender's liability to strengthen protection of consumers on retailer insolvency.

4.6 Conclusion

In our survey of different overseas jurisdictions, chargeback is generally provided by scheme rules. It is also enshrined in the federal law in the USA and consumer protection regulation in Taiwan. Evidence reveals that inadequate transparency of chargeback is a transnational phenomenon. Seeing that it is detrimental to consumer interests, the UK and Australia take a non-legislative approach to make improvement in this regard. The UK Law Commission has proposed measures to tackle the transparency issue whereas Australia had been regulating the practice of chargeback by way of industry's code of practice and CCMC's Guidance Note on Chargeback.

Apart from chargeback, connected lender liability provides a legal basis for another important form of consumer redress in the context of retailer insolvency. It was introduced, to different extent, by way of legislation in the USA, UK, EU and Australia with different scopes of application. Among these jurisdictions, section 75 of the Consumer Credit Act in the UK applies to credit card transactions and offers the most comprehensive protection to consumers. Although it is regarded as a controversial provision, it is widely accepted that it provides an important statutory protection to consumer in credit card transactions.

In light of the above, the UK and Australia's experience could serve as a good reference in formulating measures to improve the transparency, accessibility and certainty of chargeback in Hong Kong. To further incentivize card issuers to make use of the chargeback mechanism, it may also be necessary to impose connected lender liability against card issuers by legislation. These measures will further be explored in the next Chapter.

Chapter 5

Recommendations and Conclusion

Key Points

- In order to fully utilize the function of chargeback in protecting consumer prepayments on retailer insolvency, transparency and accessibility of the mechanism to consumers should be enhanced through greater initiatives on the part of card issuers. General information about chargeback and the related procedures should also be provided by insolvency practitioners.
- As card issuers are the one to exercise the right of chargeback under the scheme rules, industry regulation and guidance should be introduced for them to follow when handling enquiries or chargeback requests from cardholders. With consistent and clear industry approach in providing chargeback in the event of retailer insolvency, consumers are in a much better position to seek redress.
- Nevertheless, chargeback protection is generally inapplicable to credit card prepayments made by IPPs. Hence, even if the above-mentioned improvements are in place, in the event that a retailer becomes insolvent before delivery of the goods or services purchased, consumers who made purchase by IPPs are still unprotected and can only seek redress from the impecunious retailer. Such lacuna may be filled up by introducing the concept of connected lender liability to impose liability on card issuers who, in connection with the wrongful retailer, provided credit to consumers to purchase the undelivered goods or services. This concept has been introduced in the UK for more than 40 years. It will also provide a strong incentive to card issuers to make the best of the chargeback to answer its potential connected lender liability.
- To conclude, it can make the best of the chargeback mechanism by increasing its transparency and accessibility to consumers and by introducing industry guidance for card issuers to follow in handling consumers' requests for chargeback. To provide consumer protection beyond chargeback, the concept of connected lender liability should be explored and introduced to provide consumers with direct legal redress against card issuers.

As discussed in the previous Chapters, under the current insolvency law the chance for consumers to successfully recover prepayment on retailer insolvency is slim as they are ranked as unsecured creditors being the last in the queue of distribution of the insolvent assets. Chargeback provides an efficient and practical avenue for consumers to recover prepayment on retailer insolvency. Whilst it is a long standing protection mechanism afforded by the scheme rules of credit cards, its utilization hinges on both consumers' awareness and card issuers' initiative.

Based on our study of the local situation, transparency, accessibility and certainty of chargeback is unsatisfactory from a consumer's perspective. On the industry side, there is a lack of clear and specific guidance on how card issuers should handle consumers' chargeback requests. In this Chapter, the Council recommends various measures to enhance transparency and accessibility and, above all, make the best of chargeback in protecting consumer prepayment on retailer insolvency.

Besides, it is noted that chargeback is generally not available to consumers who made prepayments by IPPs. In the event that a retailer becomes insolvent before delivering the goods or services purchased, there is no channel for the card issuer to charge back the acquirer so as to provide refund to the cardholder in respect of prepayment made. Worse still, the cardholder is liable to repay the outstanding monthly instalments to the card issuer under the IPPs agreement. In view of this, it is important to go beyond chargeback and explore the option of legislative change to provide more comprehensive consumer protection by introducing the concept of connected lender liability.

5.1 Making the Best of Chargeback

Although chargeback is generally not a consumer right enshrined in law (except in the USA and Taiwan¹¹³), it is provided by credit card associations as a means to protect consumers (being the cardholders) and strengthen the public's confidence in using credit cards. Chargeback has proved a long-standing and important consumer protection mechanism to tackle the problems arising from the default risk in consumer prepayment. As discussed in Chapter 3, both the awareness of consumers and initiative of card issuers are pivotal.

Card issuers are always reactive and raise chargeback only at the request of consumers. It is doubtful whether chargeback is generally perceived as a

¹¹³ So far as the overseas examples mentioned in Chapter 4 are concerned.

recognized means of redress by consumers who fail to receive goods or services as a result of retailer insolvency. Without consumers' awareness of its availability, chargeback will only remain a protection mechanism on paper with little practical value at all. Hence, some measures have to be put in place to make chargeback transparent and accessible so that consumers would consider chargeback as a redress option and know when and how to exercise it.

As discussed in Chapter 3, although HKMA and the Council have made efforts to educate consumers, transparency and accessibility of the chargeback mechanism in Hong Kong still require significant improvements in order to ensure that consumers, especially those directly affected by retailer insolvencies, know how to make use of chargeback. In Chapter 4, it is mentioned that Australia has issued industry code requiring banks to provide information about chargeback whereas there has been calling by the UK Law Commission for increased transparency of chargeback. Based on the overseas practice and proposals, the following measures are recommended to improve transparency and accessibility of the chargeback mechanism to consumers in Hong Kong.

5.2 Recommendations for Card Issuers

Card issuers, being the prominent party with direct relationship with consumers as well as the legal right to exercise chargeback under the scheme rules, can play a pivotal role in making the best of chargeback. It is appreciated that chargeback is voluntarily provided for under scheme rules to enhance cardholders' confidence in the use of payment cards. Whilst chargeback has been effectively utilized to recover consumer prepayments on various occasions, the Council agrees with the UK Law Commission that its voluntary nature should be preserved and new statutory rules would only add complexity into the mechanism with little corresponding benefit¹¹⁴. Rather than imposing a mandatory obligation on the card issuers to provide or exercise chargeback, priority should first be given to strengthening the voluntary mechanism of chargeback in protecting consumer prepayments.

As discussed in Chapter 3, card issuers often provide little information in the cardholder agreements or their official websites about chargeback or how they may

¹¹⁴ The UK Law Commission concluded that the problems with chargeback are consumer awareness and transparency and that these can be improved by non-legal means. That said, given the importance of chargeback, the situation should be kept under review and that regulation may be necessary if the card schemes took steps to remove or lessen the voluntary chargeback scheme. See the UK Law Commission, *Consumer Prepayments on Retailer Insolvency Report*, 2016,, paras. 7.29-7.40.

assist the cardholders in the event of retailer insolvencies, not to mention an undertaking or commitment to exercise chargeback on cardholders' behalf. From the Council's experience, certain frontline staff of card issuers failed to provide consistent and accurate information about chargeback to consumers affected by retailer insolvency¹¹⁵. Whilst some card issuers exercised chargeback and helped the cardholders recover the prepayments made to the insolvent retailer, some others refused to do so.

In light of the above, and based on the experience learnt from the UK and Australia, the Council recommends card issuers to take the following measures:-

- (1) Supply cardholders with clear and easy to understand chargeback information in the cardholder agreements and webpage relating to credit card services;
- (2) Provide a brief chargeback guide to assist consumers in raising a chargeback claim covering:-
 - (a) contact details for raising a chargeback with the card issuer;
 - (b) details of situations in which consumers may raise a chargeback, particularly those related to when a retailer is considered to be going into liquidation;
 - (c) documentation required to support a chargeback claim;
 - (d) a warning that a chargeback claim may fail if not raised within relevant timeframes and that cardholder should raise a chargeback as soon as possible;
 - (e) a dispute form for raising a chargeback or from where it may be obtained;
- (3) Provide training to ensure that frontline staff are knowledgeable enough to explain the chargeback mechanism and its procedures to cardholders; and

¹¹⁵ See section 3.5 of Chapter 3 of this Report.

- (4) Upon receiving a consumer's request for chargeback, exercise the right of chargeback against the acquirer under the scheme rules as soon as practicable.

5.3 Recommendations for the Hong Kong Monetary Authority

To ensure that card issuers across the industry consistently provide accurate information about chargeback and exercise the right of chargeback where the circumstances justify, service pledge, industry code or guidance on conduct is recommended. Differential practice among individual card issuers may not only lead to a confusion in market practice, but also distrust in the use of credit cards in the long run.

In the UK, the FOS has laid down a standard of good practice for card issuers to follow in handling consumers' requests for chargeback and it handles consumer complaints received accordingly. In Australia, the banks' association issued a voluntary code of conduct requiring card issuing banks to, among other things, provide information on chargeback and exercise the right of chargeback on cardholders' behalf where the scheme rules permit. Subsequently, further guidance on improving the industry practice regarding chargeback was set out under a supplementary guidance note issued by the CCMC (an independent body established under the voluntary code).

The HKMA is the government authority in Hong Kong responsible for maintaining monetary and banking stability. One of its key statutory functions is to promote and encourage proper standards of conduct and sound and prudent business practices amongst banks. The Council hopes that the HKMA, in addition to educating consumers on how to make use of chargeback, will set a standard of good practice by issuing regulatory guidance to card-issuing AIs with reference to our recommendations in section 5.2 above.

5.4 Recommendations for Liquidators

The Council has been advising consumers affected by retailer insolvencies, on an individual basis in the course of handling complaints and answering enquiries; and collectively via media or the Council's website, to request their card issuers to raise chargeback for them. Likewise, the HKMA also issues consumer tips about chargeback from time to time (as discussed in Chapter 3). But, some of the affected cardholders, especially those who do not file a complaint or make an enquiry with the

Council, or fails to notice the related messages of the Council or HKMA, may not be aware of this redress option. To ensure more affected cardholders know about chargeback, liquidators have a role to play. Consumers seeking to recover their losses would keep an eye on the liquidation process. In fact, they are required to submit proof of debt to the liquidators in making claims against the insolvent retailer's estate. Thus, liquidators are a critical contact point for cardholders in retailer insolvencies. Besides, upon making a chargeback request, cardholders may be required to provide proof of the retailer's insolvency as evidence to support the chargeback claims. As lay persons, they may not be able to provide such evidence or may not even understand the exact meaning of "insolvency" or "liquidation" from the legal perspective. Liquidators are in a convenient position to inform cardholders of the availability of chargeback as an alternative redress and facilitate them in making the chargeback request to the card issuers.

Hence, it is recommended that liquidators:-

- (1) Remind consumers who have made prepayment by credit cards to request their card issuers to submit a chargeback claim;
- (2) Remind consumers that further information on chargeback can be found in the chargeback guide provided by the card issuers (see above);
- (3) Posting a notice on the retailer's website that the retailer is in liquidation together with hyperlinks to the card issuers' chargeback website; and
- (4) Make available to consumer other evidence or information which may reasonably require for submitting a chargeback claim.

The information to be provided should be high level and restricted to "the possibility of raising a chargeback" since the liquidators are not in the position to determine the likelihood of a successful chargeback in individual cases and should not be expected to comment on differences between different scheme rules. Whilst the general information may serve as useful reminder or evidence for consumer creditors, dissemination of which will not result in undue workload or liability for wrongful advice on the part of the liquidators.

According to the UK Law Commission, some insolvency practitioners had already been providing general information about chargeback to consumer creditors. It

can be easily implemented without undue burden upon the practitioners by way of website usually set up by the liquidators upon the court appointment¹¹⁶. In the case of California Fitness, it is noticed that the provisional liquidators published announcements in the retailer's official website to club members about collection of their personal items in the lockers of the company's fitness centres and acknowledged their concerns about prepayments made. Regrettably, there is no specific information regarding chargeback provided to club members.

The Council suggests that the Official Receiver's Office, as the governmental body responsible for monitoring private insolvency practitioners in carrying out the duties as liquidators, should issue a circular or any other form of guidance note to insolvency practitioners encouraging them to take the above steps in insolvencies possibly involving consumer prepayments by credit cards. Since professional accountants are often appointed as liquidators, the Council also invites Hong Kong Institute of Certified Public Accountants, the statutory licensing body of accountants in Hong Kong, to consider stipulating the above measures in the Code of Ethics for Professional Accountants, particularly under the section relating to liquidation and insolvency practice, or any other form of guidance note.

As it can be seen in the previous retailer insolvencies, thousands or tens of thousands of consumer creditors may be affected in one single insolvency case. Obviously, handling their enquiries and claims can be administratively burdensome and time-consuming. By advising consumers of the availability of chargeback and facilitating them in making requests for chargeback, it will also facilitate the work of insolvency practitioners and save the administrative costs of the liquidation process.

5.5 Going Beyond Chargeback

As pointed out in Chapter 3, chargeback is generally not available to consumers who made prepayments by IPPs. Hence, even if the measures recommended above are in place, in the event that a retailer becomes insolvent before delivery of the goods or services purchased, consumers who made purchase by IPPs are still unprotected. Although measures have been taken to alert consumers to the inapplicability of chargeback to IPPs, the Council is still concerned with the default risk, whether wittingly or not, borne by consumers using IPPs. Presumably, prepayments made by way of IPPs are of relatively substantial amount. While

¹¹⁶ The UK Law Commission, *Consumer Prepayments on Retailer Insolvency Report*, 2016, paras 7.58-7.61.

striving to recover prepayments from the impecunious retailer, the consumer has to continue making the monthly instalments to the card issuer.

Putting aside IPPs, there may still be concerns on whether consumers making payments by standard credit card transactions can be assured of the benefit from the protection afforded by chargeback. On the premise that chargeback remains a voluntary consumer protection measure under the scheme rules embodying contractual rights and obligations among financial institutions, consumers are in no position to enforce it and the exercise of it is optional for the card issuers.

To provide more comprehensive consumer protection and in view of the growing populace of consumer credit, the Council recommends that the concept of connected lender liability be introduced to Hong Kong by way of legislation based on the UK model. In some overseas jurisdictions studied in this Report, the concept of connected lender liability has been introduced by legislation to different extent. Among these jurisdictions, Section 75 of the CCA in the UK offers the most comprehensive protection to consumers on retailer insolvency.

Firstly, the UK's concept of connected lender liability applies to credit card transactions without geographical restrictions, including those made overseas. Consumers using a credit card issued in the UK to purchase goods or services abroad are protected by Section 75. Secondly, it does not require the aggrieved consumers to bring action against the retailer before or jointly with the connected credit provider. They may go straightly to the card issuers for redress. It will save the time and legal costs for the consumer, particularly in the event of retailer insolvency. Lastly, it is applicable whether or not the provision of credit was induced by the trader or the consumer himself and whether or not the credit was provided specifically in relation to the supply of goods or services in question.

To recap, under the CCA, credit card transaction is regarded as a type of "connected lending" where a loan is made under pre-existing arrangements between a bank and a retailer, and the bank knows that the loan will be used to finance the purchase of goods or services¹¹⁷. Section 75 renders a connected credit provider (i.e. card issuer) jointly and severally liable for the retailer's breach of contract and/or misrepresentation. The purchase must be more than £100 and not more than £30,000. A consumer who has a claim for misrepresentation or breach of contract

¹¹⁷ Section 12(b) and (c) of the Consumer Credit Act 1974

(including non-delivery of goods or services in the case of retail insolvency) against the retailer may sue either the creditor or the retailer or both.

Although the contract for goods or services is between the retailer and the consumer, the CCA imposes a connected lender liability on the card issuer (as creditor) based on various policy considerations. First, the business creditors are in a better position than consumers to bear the loss arising from retailer insolvency. Besides, the credit providers, through lending to consumers, have boosted the sales of goods or services together with the retailer in return for profit (usually in the form of handling fee imposed as a percentage the transacted amount known as "*discount*"). It is also reasonable for consumers to expect that the credit provider, usually a bank or sizeable corporation, will only sign up reputable retailers¹¹⁸.

In the midst of opposition by banks, it is beyond dispute that Section 75 is widely considered (including the UK Government) to be an important and effective provision for consumer protection. With the presence of connected lender liability, consumers will have a right to claim against their card issuers for the retailer's non-delivery of goods or services to recover their prepayments made by credit cards including IPPs which are generally not subject to chargeback protection. The Council believes that card issuers, who (jointly with retailers) promote the sale of goods or services and receive the benefit of increased sales volume by offering IPPs to cardholders, are under a moral duty to ensure that the retailers have the reasonable means to deliver the prepaid goods or services to cardholders in the agreed manner. With their relatively stronger bargaining power, card issuers can also employ measures to protect the prepayments in case the retailers fail to do so, e.g. by withholding payments from the retailers.

For credit card transactions subject to chargeback protection, imposition of connected lender liability would, in turn, incentivize the card issuers to make use of the chargeback mechanism. The reason is that with connected lender liability, a card issuer has to pay for the cardholder's claim out of its own pocket. With a view to mitigate its loss, the card issuer should be more willing to exercise its contractual right under the scheme rules and raise a chargeback against the retailer's acquirer. In normal situations involving retailer insolvency, the fact that the retailer fails to deliver the goods or services is often beyond dispute and the card issuer would stand a good chance of recovering the payment by chargeback. Even if the acquirer disputes the chargeback claim, the card issuer may refer the dispute to the dispute resolution mechanism provided by the

¹¹⁸ See section 4.2 of Chapter 4 of this Report

scheme rules and reassert its entitlement to charge back by providing further evidence (if any). On this premise, provided that the card issuers duly utilize the existing chargeback mechanism, the imposition of connected lender liability is unlikely to cause substantial financial burden to them as it is perceived to be.

To make the application of the concept of connected lender liability more acceptable to the card issuers, as the credit providers, the extent of liability may be limited to the amount of the credit provided to the consumers, as opposed to the unlimited liability under the UK model. In this way, credit providers may be in better position to assess the extent of risk and deploy the appropriate risk control measures.

With their own distinct rights and scopes of application, chargeback and connected lender liability can complement each other to increase the chance of recovering consumer prepayments in the event of retailer insolvency. Furthermore, the latter provides a strong incentive to card issuers to make the best of the former to answer its potential connected lender liability, thereby enhancing the practical use and effectiveness of the former in protecting consumer interest.

Enhancing consumer protection not only protects the interest of consumers but also strengthens confidence in the use of credit cards for making prepayments. Nowadays, online shopping is becoming more prevalent and market demand for non-cash payment means is ever increasing. With the rapidly developing and increasingly competitive payment system market, the Council believes that promoting the use of chargeback and providing consumers with direct redress against card issuers, despite the likely increase in operating costs, will be beneficial for the credit card industry in the long run.

Although connected lender liability appears to be an unfamiliar concept to local credit card issuers, the Council believes its long legislative history in some overseas jurisdictions, particularly the UK and Australia, provides a strong policy reason and solid justification for introducing a similar right for Hong Kong consumers. Indeed, Hong Kong is 40 years behind the UK and 30 years behind the Australia jurisdictions on this matter. Given the impact and benefit of Section 75 to the credit card industry may not be easily quantified, it is understandable that stakeholders, particularly card issuers or consumer credit providers, would be hesitant about any change which may increase their contingent liabilities. Similar arguments to those mentioned in Chapter 4 against the imposition of connected lender liability in the UK would likely be raised by local card issuers. But it is clear from the UK experience

that there are even stronger counter arguments for such fundamental change in consumer protection law and the Council fails to see why those counter arguments are not applicable to the Hong Kong situation. It is also believed that the proposal of limiting the connected lender's liability to the amount of money lent is a reasonable and practicable way to alleviate the concern of the card issuers. It is not the purpose of this Report to come up with a concrete legislative proposal which will require the expertise of law draftsmen of the Department of Justice and should only be done upon public consensus on the matter. Instead, with this Report, the Council aims to explore options and generate informed public debate on what our society may do to better protect consumers against default risk.

5.5 Conclusion

The problem of how to protect consumer prepayment on retailer insolvency has always been an important topic in consumer protection work. It is also a problem with no simple and easy solution. In the unfortunate event of retailer insolvency and with competing claims by other creditors whose claims have a higher priority over consumers as unsecured creditors, recovering consumer prepayment from the insolvent retailer's estate is like trying to get blood out of a stone. Coupled with the failure to receive the goods or services purchased, retailer insolvency often leads to "double loss" for consumers. It is beyond dispute that the existing default risk and windfall loss faced by consumers is unsettling.

Chargeback, a long standing protection mechanism afforded by scheme rules for protecting cardholders, provides an efficient and practical avenue for consumers to recover prepayment on retailer insolvency. It also reallocates the default risk from consumers to acquirers who are in a better position to assess and manage such risk, thereby encouraging the latter to implement better risk control or management measures.

By issuing this Report, the Council hopes to call for concerted efforts of card issuers, regulators and insolvency practitioners to improve protection for prepayment made by credit cards and generate informed public debate on the topic of consumer prepayment on retailer insolvency. Above all, the HKMA, as a regulator of the banking industry, can play a vital role in taking forward our recommendation of issuing regulatory guidance to card-issuing AIs. Without the appropriate intervention by the HKMA, card-issuing AIs may be slow in implementing measures to improve the transparency and operation of chargeback. Notwithstanding such

measures, the situation remains that chargeback does not always apply to transactions made by IPPs and is not a consumer right. Hence, to provide consumers with clear legal rights and more comprehensive protection on retailer insolvency, the option of introducing legislation to imposing connected lender liability on card issuers (being lenders connected with retailers) should be explored at a later stage.

To conclude, our recommendations to improve the operation of chargeback in Hong Kong do not require legislative change and can be implemented straight away. The Council hopes that card issuers, regulators (especially the HKMA) and insolvency practitioners can cooperate with a view to provide consumers with clear, coherent and consistent information about chargeback. In a long run, the Government should consider introducing the concept of connected lender liability which provide consumer protection beyond chargeback and entitle consumers to seek direct legal redress against card issuers.

Appendix 1: Summary of the Survey Results

Card issuer/ Association	Availability of Chargeback	Time limit for application	Documentation required / other requirements	Channel/ procedure of application
Issuer A	Yes	60 days from statement	- Purchase receipt or contract	- By phone, post, fax or email
Issuer B	Yes	120 days from the transaction date or the delivery date	- Payment receipt and document	- Written notice - Request will then be sent to the acquirer via credit card associations
Issuer C	Yes	540 days from the delivery date	- Contract and receipt etc.	- Not specified
Issuer D	Yes	120 days from the delivery date or 120/540 days from the transaction date, depending on scheme rules	- Fill in cardholder transaction dispute form and submit relevant documents	- Resolve with retailer or liquidator first
Issuer E	Yes	According to scheme rules	- Details and evidence for purchase	- Resolve with retailer or liquidator first
Issuer F	Yes	According to scheme rules	- Details and evidence for purchase	- Resolve with retailer or liquidator first
Issuer G	Yes	- Not specified - Cardholder is encouraged to request promptly	- Proof of purchase may be required - Refer to cardholder agreement	- Call hotline (will advise cardholder on required documentation)
Issuer H	Yes	120 days from the delivery date or 180 days from the transaction date, depending on scheme rules	- Document relating to the transaction	- Resolve with retailer or liquidator first
Issuer I	Yes	60 days from statement	- Evidence relating to the payment and the delivery date - "Customer declaration" stating the retailer's promise, the reason for and amount of chargeback	- Not specified
Issuer J	Yes	120 days from the delivery date or 360/540 days from the transaction date, depending on scheme rules	- All information relating to the transaction and charging dispute form	- Call customer service hotline (will advise cardholder on the application)
Issuer K	Yes	60 days from statement	- Document or information relating to the purchase, delivery date, failure to deliver and attempt to resolve with retailer	- Call customer service hotline and refer to cardholder agreement

Card issuer/ Association	Availability of Chargeback	Time limit for application	Documentation required / other requirements	Channel/ procedure of application
Issuer L	Yes	60 days from statement	<ul style="list-style-type: none"> - Information relating to the transaction - "Cardholder's Declaration of Dispute" 	<ul style="list-style-type: none"> - Not specified
Issuer M	Yes	60 days from statement, or 60 days from the delivery date (no more than 480 days from the transaction date)	<ul style="list-style-type: none"> - Evidence showing closure of business - Document showing the retailer failed to deliver within agreed period (e.g. invoice, receipt) 	<ul style="list-style-type: none"> - Resolve with retailer first
Issuer N	Yes	120 to 540 days from the transaction date	<ul style="list-style-type: none"> - Cardholder dispute form/ relevant document 	<ul style="list-style-type: none"> - Resolve with retailer or liquidator first
Issuer O	Yes	60 days from statement	<ul style="list-style-type: none"> - Cardholder's declaration, sales slip copy, agreement copy 	<ul style="list-style-type: none"> - Resolve with retailer or liquidator first - Call hotline for enquiry on rules and procedures
Association A	Yes	120 to 540 days from the transaction date	<ul style="list-style-type: none"> - All available information regarding the purchased goods/services, i.e. date of purchase, date of expected delivery, date of notification of insolvency 	<ul style="list-style-type: none"> - Contact the card issuer



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