

# Consumer Protection on Prepayment and Retailer Insolvency

- Review of Chargeback and Beyond



9 May 2017



# Consumer prepayment in Hong Kong

## Prepaid consumption

- Convenience and special discount
- Trade practices
  - Beauty/Fitness
  - Wedding services
  - Electric appliances/ home furniture
  - Air tickets

## Retailer insolvency

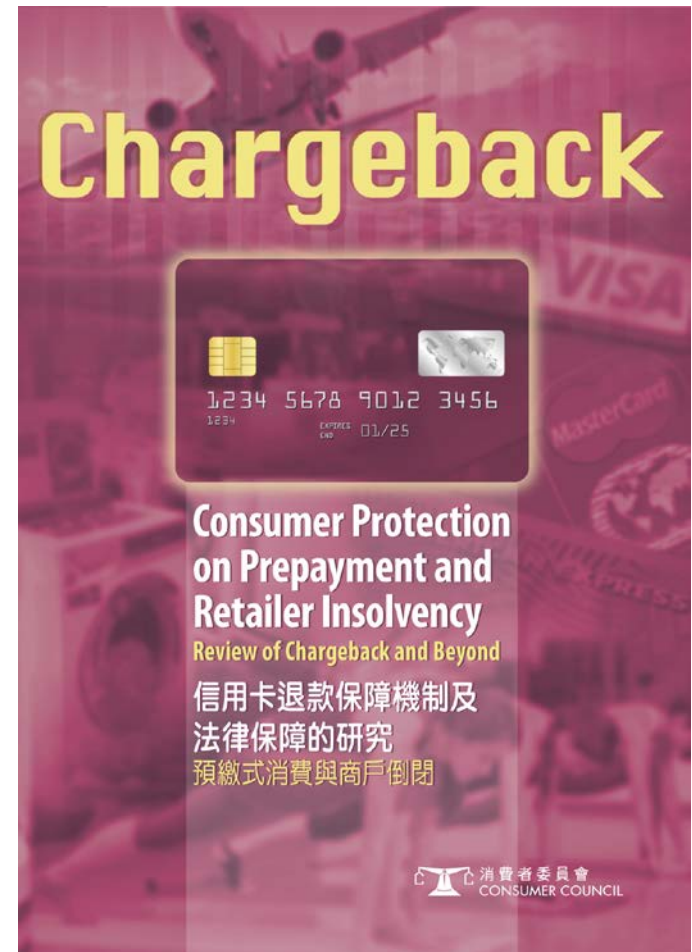
- Double loss
- Unsecured creditors
- Slim chance of recovering prepayment





# Agenda

- Background & Objectives
- Scope & Methodology
  - Chargeback mechanism
  - Credit card instalment payment plan (“IPPs”)
  - Overseas experience
- Key findings
  - Inadequate transparency of chargeback
  - Insufficient protection to IPPs
- Recommendations





# Objectives

- 1 Review the predicaments faced by consumers in retailer insolvencies
- 2 Understand how chargeback mechanism could protect consumers
- 3 Evaluate the application of chargeback in Hong Kong
- 4 Review overseas experience
- 5 Recommend measures to strengthen consumer protection

# Major retailer insolvencies

- 1998
  - Maria's bakery
  - KPS Video
- 2008
  - Oasis Airlines
- 2010
  - Planet Yoga
- 2015
  - DSC
- 2016
  - California Fitness





# Consumer Complaints and Claim Involved

Major examples:

Retailer	Year of closure	No. of complaints received by the Council	Amount of claim involved
Maria's Bakery	1998	2,600	\$3.5 million
KPS Video Express	1998	2,400	\$1.5 million
Oasis Airlines	2008	1,478	\$15 million
Planet Yoga	2010	228	\$2.4 million
DSC	2015	1,350	\$3.8 million
California Fitness	2016	1,119	\$27.37 million

Source: Consumer Council





# Case study

- 3 major retailer insolvencies
  - California fitness
  - DSC
  - Oasis Airlines
- Not all consumers knew about chargeback
- Some card issuers refused to handle consumers' chargeback requests
- Some hotline staff of card issuers failed to provide consistent and accurate information about chargeback



# Consumer protection measures

## Insolvency Law

- No specific protection to consumers
- Consumers as unsecured creditors hardly could get any compensation

## Sector specific protection

- Travel Industry Compensation Fund

## Chargeback protection

- A long established protection mechanism provided by credit card associations which may allow consumers to recover prepayment in retailer insolvency



# Scope and Methodology

## Questionnaire survey

- Questionnaires were sent to 20 major card issuers and 2 major card associations in Hong Kong
- Received replies from 15 card issuers and 1 card association

## Desktop research

- Review the websites and cardholder agreements of 15 responding card issuers

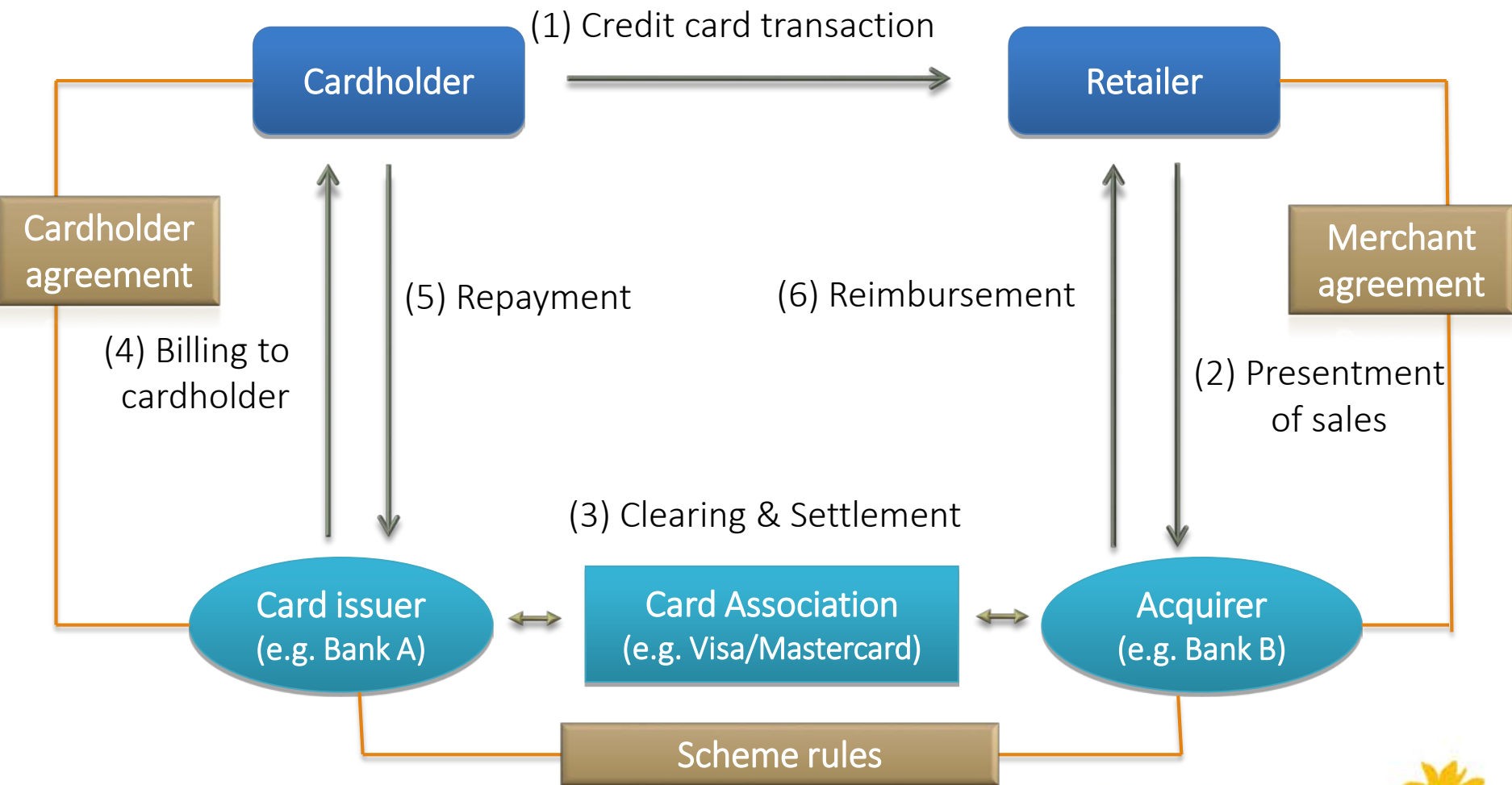
## Literature review of measures to strengthen consumer protection

- Review overseas experience (EU, the UK, the USA and Australia)
- Explore other legal protection measures to strengthen protection for credit card prepayment

# Chargeback mechanism



# Credit Card Transaction Cycle





# Credit Card Transaction Cycle

- Three contractual relationships

## Consumer and Card Issuer

- Cardholder agreement (Bank A and the Consumer)

## Card Issuer, Card Association and Acquirer

- Scheme rules (Bank A, Bank B and Card Association)

## Acquirer and Retailer

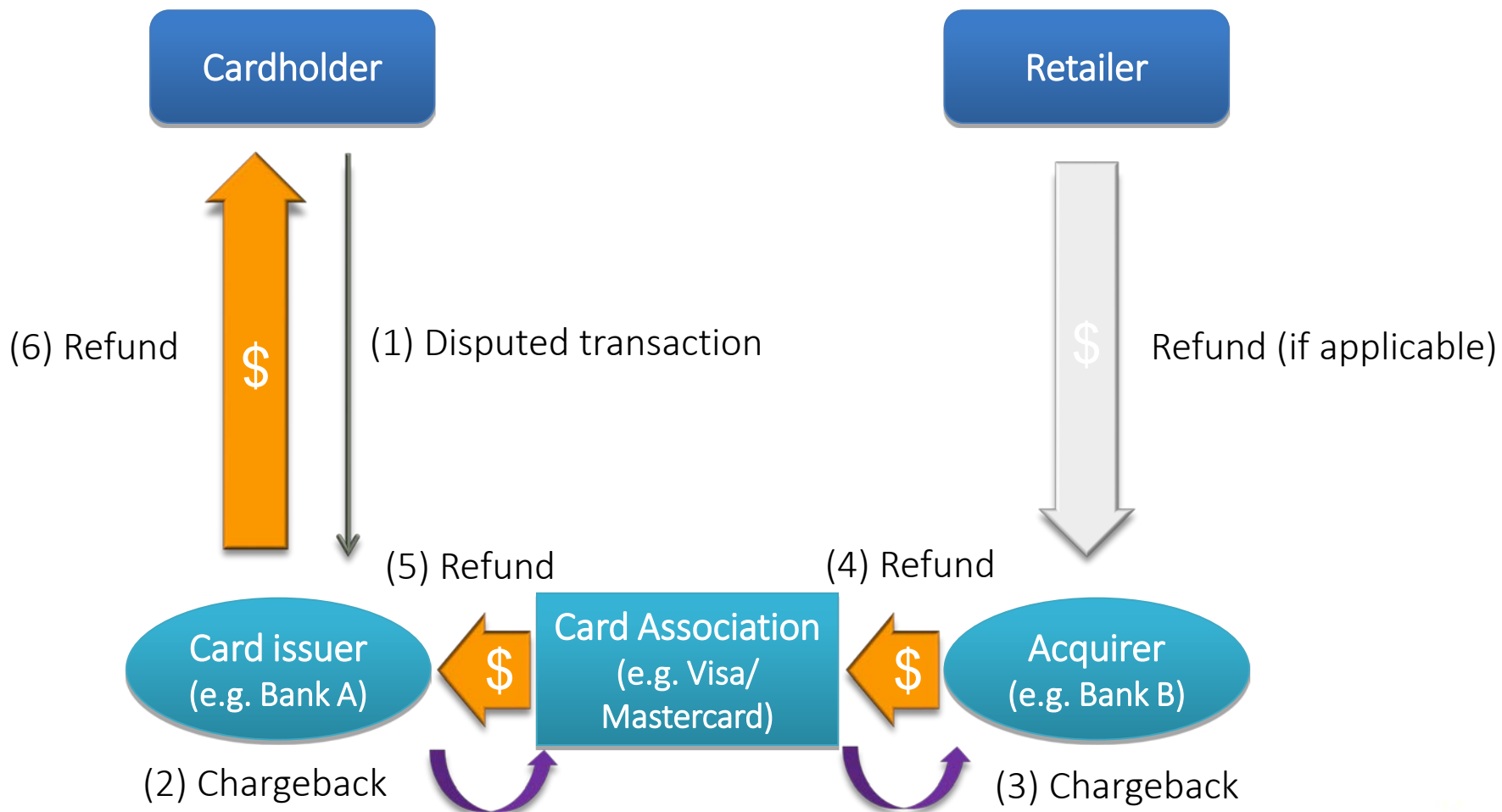
- Merchant agreement (Bank B and the Retailer)

# What is Chargeback?

- Reversal of a credit card transaction from the retailer to the consumer
- A mechanism set out in the credit card scheme rules
- Allows transactions to be reversed under specified circumstances. For instance, where the retailer fails to deliver goods or services after payment, due to insolvency
- Applicable to credit card transactions
- Irrespective of location of retailers



# Chargeback





# Time limit of Chargeback

- Different scheme rules have different time limits
- In general, card issuers are required to file the claim within 120 days from the expected date of delivery of the goods or services

Card issuer	Time limit
A	60 days from statement
B	120 days from the delivery date or the transaction date
C	According to scheme rules
D	120 to 540 days from the transaction date
E	120 days from the delivery date or 120/540 days from the transaction date, depending on scheme rules

# Who bears the loss?

- Chargeback shifts the risk from the consumer to the Acquirer
- Unless the Acquirer can successfully recover the sum from the insolvent retailer, the loss will ultimately fall on the Acquirer's shoulder







## How to mitigate the risk by Acquirer?

- Acquirer could assess and monitor the financial position of retailers
- Acquirer may take various measures to mitigate the loss arising from large number of chargeback claims as result of retailer insolvency:
  - Withholding payment to retailer
  - Requiring security deposit from retailer



# Major Observations (1)

## Availability

- All the responding card issuers do provide chargeback to cardholders in the event of retailer insolvency
- Lack of clear and consistent application procedures and requirements
  - Hotline enquires and accessibility of application form
  - Required to resolve with retailer or liquidator first
- Discrepancies in the time limit for raising a chargeback by cardholders

# Major Observations (2)

## Transparency

- No general information about chargeback in the cardholder agreements or card issuers' websites
- No express provision in the cardholder agreements mentions about the availability of chargeback protection

## Certainty

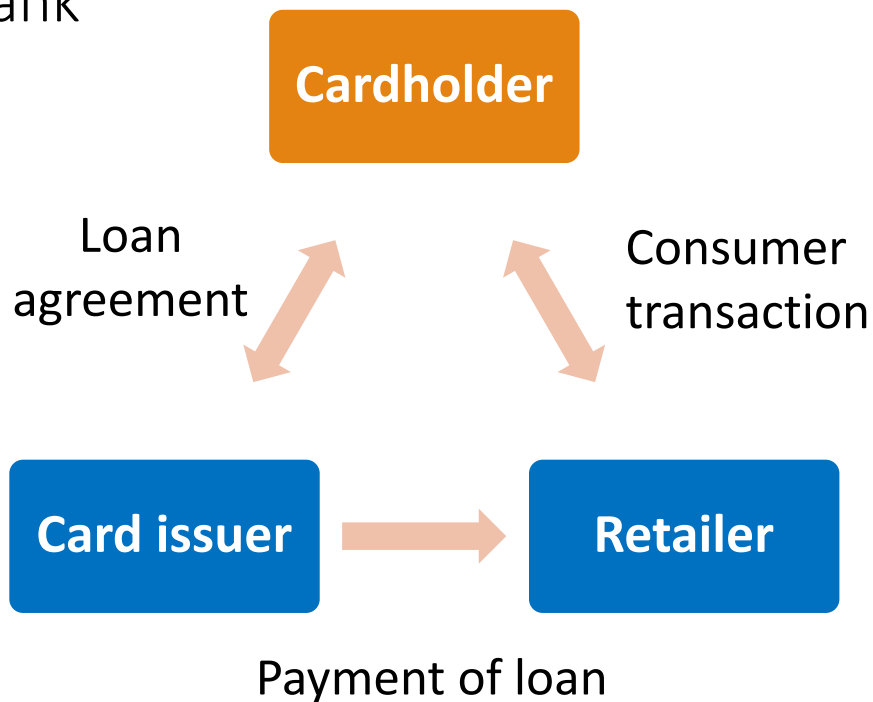
- Difficult for consumers to know the details and latest content of scheme rules
- Card issuer is under no contractual obligation to raise a chargeback claim for the consumer
- Consumers could not ascertain if the card issuer would raise the chargeback claim for them

# Credit Card Instalment Payment Plan (IPPs)



# What is IPPs?

- **Loan agreements** between the bank and the cardholder
- The bank advances the pre-paid amount to the cardholder, while the cardholder undertakes to repay the amount to the bank by instalments through his/her credit card





# Risk of IPPs

- Chargeback is **not** applicable
- Consumers is required to make repayments to the card issuer until the loan amount is paid off even if the goods/services purchased have never been delivered



# Existing Regulations

- No specific legislation or adequate regulatory guidance requiring card issuers to chargeback upon cardholders' request
- HKMA circular requiring banks to:
  - Inform cardholder that there is no chargeback protection for IPPs
  - Even if the goods and services are not delivered, he/she will not be able to stop payment to the card issuer
  - Have written confirmation by consumer with regard to the important terms of the IPPs



# Overseas experiences

- European Union
- United Kingdom
- USA
- Australia





# Common problems

- Chargeback in the USA, EU, the UK, Australia and some Asia countries (Mainland China and Singapore) is very similar to Hong Kong and is provided by the scheme rules
- Lack of transparency is a common problem
- The UK & Australia: increase transparency via industry code of practices (e.g. banks and liquidators)



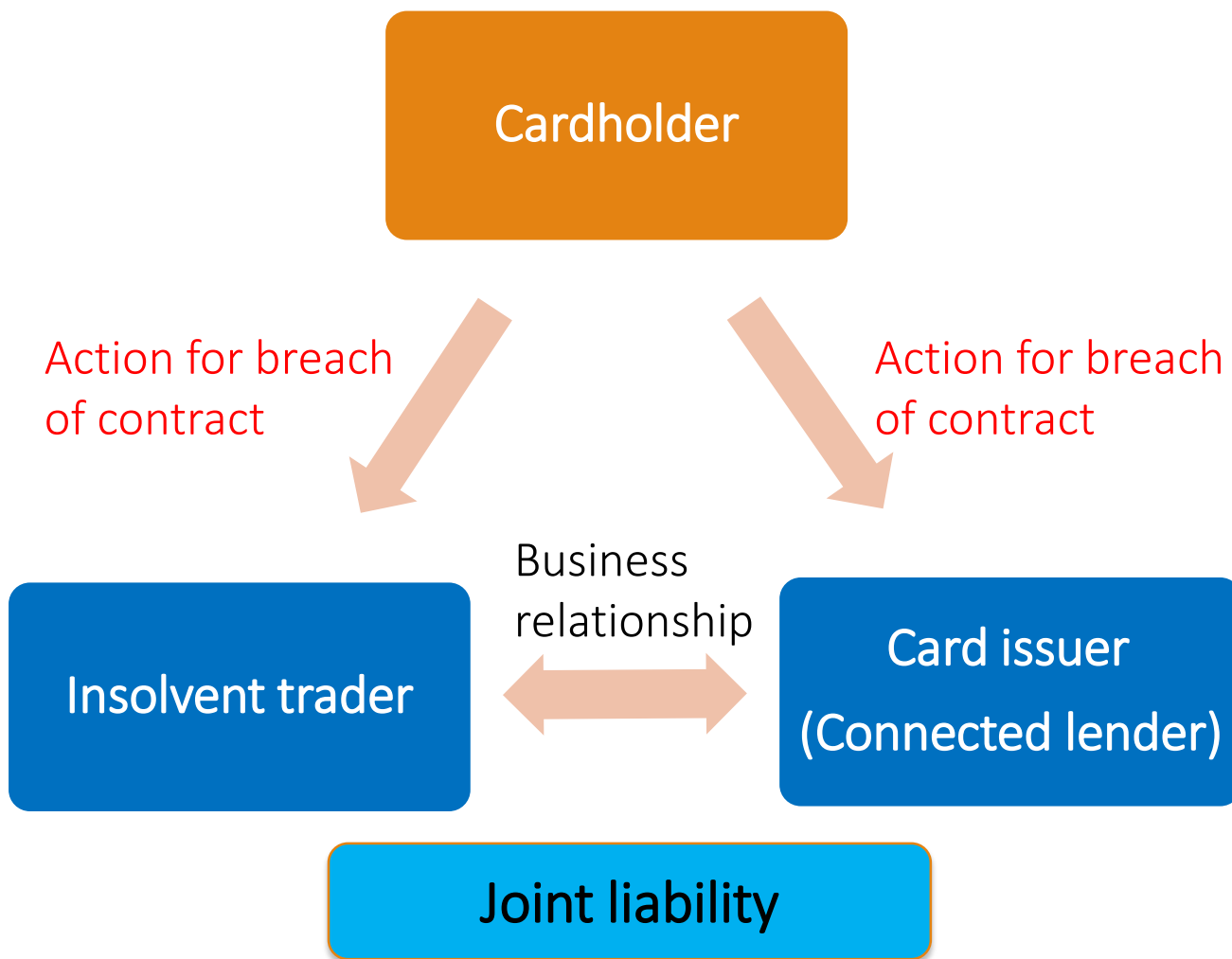


# Connected Lender Liability

- A consumer protection concept provided for under legislation
- Card issuers use attractive offers to invite consumers to apply for credit card, and encourage credit card consumption by lodging promotional campaigns with traders
- Card issuers have responsibility to ensure that traders with whom they have business collaboration are able to provide the goods/services to consumers



# Connected Lender Liability



# Connected Lender Liability

USA	UK	Australia	EU
<p>Applicable to credit card but not foreign transactions</p> <p>Consumer has to resolve the dispute with trader first</p>	<p>Applicable to credit card and foreign transactions</p> <p>Can sue the card issuer directly</p>	<p>Not applicable to credit card</p> <p>Unless traders has been dissolved, consumer has to resolve the dispute with trader first</p> <p>“Due diligence” defence is available to credit provider</p>	<p>Not applicable to credit card</p> <p>Consumer has to resolve the dispute with trader first</p>

 **Best protection**

# Comparison

	Chargeback	Connected Lender Liability (UK)
Nature of right	Scheme rules (Non statutory)	Consumer Credit Act
Monetary limits	Depending on Scheme rules, generally no upper limit	Value of goods/service must be over £100 and less than £30,000
Amount which can be recovered	Amount paid by card	No upper limit
Time limit	Generally 120 days	6 years
Loss	Acquirer	Card issuer

# Recommendations and Way forward



## 4 Recommendations to enhance protection for credit card prepayment

Improve  
transparency of  
chargeback

- Card issuers
- The HKMA
- Liquidators

Enhance  
protection for  
credit card  
prepayment

- Government



# Recommendations to Card Issuers

- Supply cardholders with clear and easy-to-understand chargeback information in the cardholder agreements and card issuer's website
- Provide a chargeback guide to assist consumers in raising a chargeback claim
- Provide training to ensure that frontline staff are knowledgeable enough to explain the chargeback mechanism and its procedures to cardholders
- Raise a chargeback claim against acquirer in accordance with the scheme rules as soon as practicable





## Recommendation to HKMA

- Most of the card issuers in Hong Kong are banks and subject to the supervision of the HKMA
- Issue regulatory guidance to card-issuing banks to ensure that they consistently implement the improvement measures to enhance the transparency of chargeback and its service pledge



## Recommendation to Liquidators

- The Official Receiver's Office and Hong Kong Institute of Certified Public Accountants to issue circular or guidance note to insolvency practitioners:
  - Remind consumers who have made prepayment by credit cards to submit a chargeback claim;
  - Remind consumers to make reference to the chargeback guide provided by the card issuers;
  - Posting a notice on the retailer's website that the retailer is in liquidation together with hyperlinks to the card issuers' chargeback website; and
  - Making available to consumers other evidence or information which may be required for chargeback application



## Recommendation to the Government

- Introduce connected lender liability by legislation:-
  - Consumers may have a legal claim against their card issuers for retailer's breach of contract to recover their prepayments made by credit cards
  - Consumers who made purchase by IPPs would be protected
  - The amount to be recovered is limited to the amount of transaction

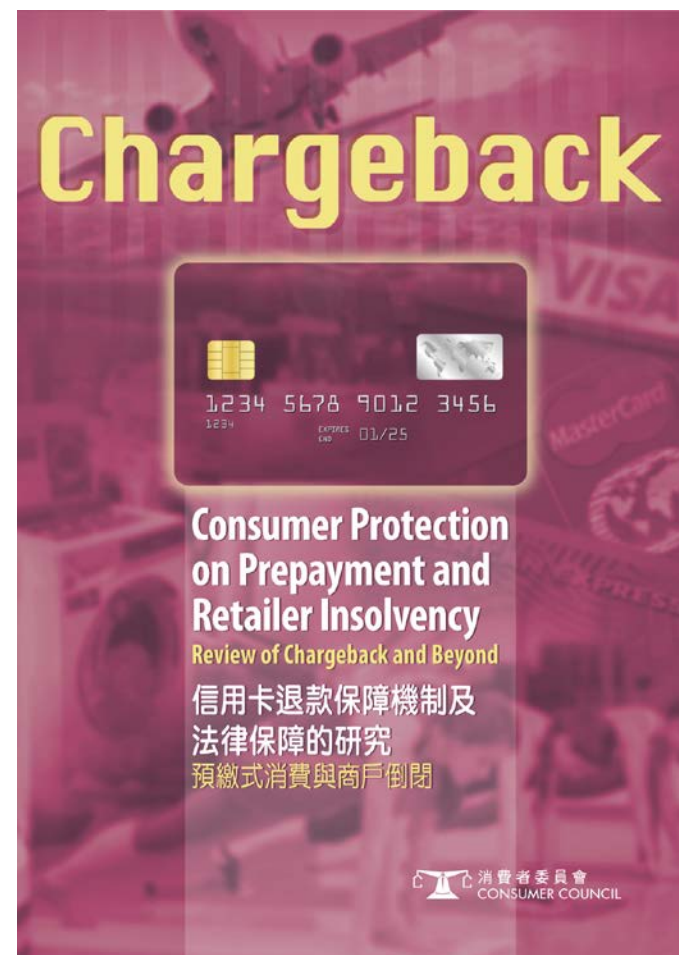
# Consumer tips



- Pay attention to the nature of transaction and terms and conditions, and keep good records
- Chargeback is generally not applicable to IPPs
- Consider your own needs and financial position before making purchase
- Be careful in making large prepayment in exchange of discounts
- Contact the card issuer for assistance in the event of retailer insolvency

# Conclusion

- Consumers may suffer huge amount of loss in retailer insolvency
- The transparency and operation of chargeback have room for improvement
- Introduce connected lender liability to enhance consumer protection in a comprehensive manner



Thank you

