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

- Review the predicaments faced by consumers in retailer insolvencies
- Understand how chargeback mechanism could protect consumers
- Evaluate the application of chargeback in Hong Kong
- Review overseas experience
- 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:**

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

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

1. Credit card transaction
2. Presentment of sales
3. Clearing & Settlement
4. Billing to cardholder
5. Repayment
6. Reimbursement

Cardholder agreement

Card issuer (e.g. Bank A)

Card Association (e.g. Visa/Mastercard)

Acquirer (e.g. Bank B)

Merchant agreement

Scheme rules
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

1. Disputed transaction
2. Chargeback
3. Chargeback
4. Refund
5. Refund
6. Refund

Cardholder

Card issuer (e.g. Bank A)

Card Association (e.g. Visa/ Mastercard)

Acquirer (e.g. Bank B)

Retailer

Refund (if applicable)
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

<table>
<thead>
<tr>
<th>Card issuer</th>
<th>Time limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>60 days from statement</td>
</tr>
<tr>
<td>B</td>
<td>120 days from the delivery date or the transaction date</td>
</tr>
<tr>
<td>C</td>
<td>According to scheme rules</td>
</tr>
<tr>
<td>D</td>
<td>120 to 540 days from the transaction date</td>
</tr>
<tr>
<td>E</td>
<td>120 days from the delivery date or 120/540 days from the transaction date, depending on scheme rules</td>
</tr>
</tbody>
</table>
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
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 prepaid 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

Cardholder

Action for breach of contract

Insolvent trader

Business relationship

Card issuer (Connected lender)

Joint liability

Action for breach of contract
## Connected Lender Liability

<table>
<thead>
<tr>
<th></th>
<th>USA</th>
<th>UK</th>
<th>Australia</th>
<th>EU</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Applicable to credit card but not foreign transactions</td>
<td>Applicable to credit card and foreign transactions</td>
<td>Not applicable to credit card</td>
<td>Not applicable to credit card</td>
</tr>
<tr>
<td>Consumer has to resolve the dispute with trader first</td>
<td>Can sue the card issuer directly</td>
<td>Unless traders has been dissolved, consumer has to resolve the dispute with trader first</td>
<td>Consumer has to resolve the dispute with trader first</td>
<td></td>
</tr>
</tbody>
</table>

**“Due diligence” defence is available to credit provider**

**Best protection**
## Comparison

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