

LCQ3: Protecting consumers who make prepayment for services

Following is a reply by the Acting Secretary for Commerce and Economic Development, Mr Gregory So, to a question by Hon James To Kun-sun in the Legislative Council today (June 2):

Question:

At present, quite a number of providers of personal services (e.g. beauty care and slimming centres and yoga centres, etc.) lure customers to make pre-payment for services by offering discounts. Some banks have extended private loans through service providers to their customers to enable them to make pre-payment for services with the loans, and the amounts of money involved range from several thousand dollars to tens of thousands of dollars. In the past one-odd year, a number of large-scale service providers closed down suddenly and their customers who had made pre-payment for services could not recover the pre-paid amounts. Under the existing system, when service providers are put into liquidation, their customers often become unsecured creditors and it is difficult for them to recover their pre-paid money. In this connection, will the Government inform this Council whether:

(a) the practice of banks offering private loans through service providers to their customers is subject to the regulation of the Hong Kong Monetary Authority; when the staff of service providers, when handling the formalities for securing loans for their customers, have not clearly explained to their customers the potential loss to them and related risks in case the service providers close down, whether banks have breached any guideline and are required to shoulder responsibilities as a result;

(b) reference will be made to the practice adopted in Taiwan to introduce legislation to require that when service providers receive pre-payment for services, performance bond in full amount in respect of the contracts must be provided by financial institutions; and

(c) the Government has any plan in the short-term to enhance its publicity and education efforts to let the public know the legal rights and obligations of consumers in respect of pre-payment for services, so as to prevent the recurrence of the above problems; if so, how the plan will be implemented?

Reply:

President,

(a) Where customers have made pre-payment for goods or services, if the merchant goes out of business before delivering the goods or services, they will face the situation of not being able to claim back the prepaid amount. Customers will have to bear credit risk if pre-payment for goods and services is involved. Credit risk arises no matter whether the pre-payment is made in cash, lump sum payment upfront by credit card or payment by instalments.

Recent incidents indicate that consumers who made lump sum pre-payment upfront by credit card may enjoy better protection than those who have pre-paid by cash or those who make re-payment of loans used for the purchases by instalments. In general, where consumers use credit card to make lump sum payment upfront, if the merchant goes out of business, consumers may request the card issuers to claim back part of pre-paid amount relating to goods or services which have not been delivered. However, where consumers have entered into loan agreements involving re-payment through instalments, they may not be able to stop re-payment to banks as the latter usually have advanced the whole transaction amount to the merchant upfront. The banks will then charge the consumers by instalments through their credit cards. Therefore, when a merchant goes out of business, consumers may still need to continue their loan re-payments to banks.

The Hong Kong Monetary Authority (HKMA) understands consumers' concerns over the recent incidents. The HKMA has urged the banks to deal with customers' complaints and chargeback requests reasonably and pragmatically, and will continue to discuss with the banking industry to find ways to strike a fair balance between better protecting consumers from pre-payment risks and avoiding cashflow problems which may be encountered by small and medium enterprises (SMEs).

(b) To our knowledge, the relevant authority in Taiwan has imposed a requirement on providers of certain goods and services (such as those in general retail business and the hair styling industry) to provide a performance bond when they receive pre-payment from consumers. The performance bond can take the form of an undertaking of an adequate amount issued by a financial institution, which should be valid for at least one year starting from the date on which the provider receives the pre-payment.

Honourable James To suggests that similar measures as those adopted in Taiwan

be introduced into Hong Kong. A host of policy, regulatory and implementation issues are involved, which would have a bearing on the operation of traders and financial institutions. For instance, what are the yardsticks for determining the amount of the required bank guarantee and the amount of capital required by a service provider to discharge its contractual obligations? How to identify industries or traders which are accepting pre-payment? How can the relevant requirements be enforced and who would shoulder the administrative costs?

Besides, we believe that the proposed measures would bring drastic changes to the current mode of operation (including cashflow) of traders accepting pre-payment. For example, banks are likely to charge a price for the guarantees they may provide according to the assessed default risk, and small businesses may need to shoulder a higher premium. New establishments may find it difficult to obtain bank guarantees if they do not have past performance records or collaterals. In the long run, such requirements may alter the industry structure, thereby reducing the choices available to consumers or raising prices. These are issues calling for careful consideration.

Our current priority is to consult the public as soon as possible on legislative proposals to tackle common unfair trade practices and then proceed with the legislative work. One of our legislative proposals is to prohibit the practice of "accepting payments without the intention or ability to supply the contracted goods or services". The proposal should help tackle the problem of unscrupulous traders continuing to accept pre-payment notwithstanding the knowledge that their businesses are not sustainable. In the meantime, as mentioned in the reply to part (a) of this question, the HKMA has urged the banks to deal with customers' complaints and chargeback requests reasonably and pragmatically, and will continue to discuss with the banking industry to find ways to strike a fair balance between better protecting consumers from pre-payment risks and avoiding cashflow problems which may be faced by SMEs.

(c) While it is necessary to impose legislative controls to prohibit unfair trade practices, we consider it equally important to raise consumer awareness through publicity and consumer education. Since late 2009, we have broadcast announcement in public interest on TV and the radio relating to the pre-payment mode of consumption. We have also published articles in newspapers to remind consumers of the need to consider the risks arising from this mode of consumption. Another announcement in public interest will be launched soon on TV and the radio. We will also continue our efforts in exploiting other publicity channels (such as newspapers and the web) and work together with the Consumer Council, the Police and other

organisations (including major chambers of commerce, schools and the media) to enhance consumers' awareness and knowledge of the pre-payment mode of consumption and unfair trade practices.

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