

## **Press release**

### **LCQ4: Enhancing supervision of pre-payment**

Wednesday, July 7, 2010

Following is a question by the Hon Starry Lee and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (July 7):

Question:

A large yoga centre closed down in mid-May this year, affecting more than 13,000 members. Some of the affected members have criticised that when consumers choose to make prepayment for services, they are unable to learn about the business status of the service providers, making it impossible for them to guard against any pitfalls. They have also pointed out that the banks offered private loans through merchants to customers for making prepayment for services, but as the loan formalities are handled by staff of the merchants rather than the banks, it is possible that in order to promote sales, the staff avoid mentioning to customers loan terms which may be unfavourable to them. There have been comments that as the prepayments received from members by the yoga centre amounted to nearly \$80 million but the amount of assets of the centre was only some \$4 million, it raises doubts as to whether the incident involved fraud, misfeasance or other misconduct of the directors. In this connection, will the Government inform this Council:

- (a) whether it will consider requesting companies which charge customers prepayments for services to deposit the received payments to a special bank account, so as to facilitate the Hong Kong Monetary Authority (HKMA) to monitor the money flow of such funds;
- (b) whether HKMA will consider enhancing supervision of the bank loan procedures handled by merchants for their customers, so as to ensure that consumers fully understand the credit risks to be borne by them; and
- (c) whether the Financial Secretary will consider appointing an inspector under section 143 of the Companies Ordinance (Cap. 32) to investigate whether the above incident involved fraud, misfeasance or other misconduct of the directors?

Reply:

President,

Pre-payment for goods or services is becoming an increasingly popular form of consumption. Both consumers and businesses stand to benefit from this mode of consumption - consumers normally enjoy discounts and the cash flow of businesses can be improved. Problems may however arise, when traders with no intention or ability to supply the contracted products trick consumers into making pre-payment.

At present, consumers can institute civil action when they encounter such situations. However, most consumers may not be willing to go to the court for dispute resolution. Depending on the facts of individual cases and the sufficiency of evidence, the abovementioned unfair practice may at present be caught by criminal offences under the Theft Ordinance and the common law offence of "conspiracy to defraud". However, the evidential threshold required is high.

To address the inadequacy in existing law, the Commerce and Economic Development Bureau plans to put in place new criminal provisions specific to consumer transactions, as distinct from offences in the area of general criminal law, to prohibit the practice of accepting payment with the intention at the time of acceptance not to supply the contracted products. The Bureau will soon issue a consultation document to solicit public views.

My reply to the three parts of the question is as follows:

(a) We appreciate the intended purpose of the suggestion, as set out in part (a) of the question, of requiring pre-payments to be deposited in a special bank account. Nevertheless, there are a host of specific implementation issues to be resolved.

First of all, a wide spectrum of industries currently accept pre-payments for goods or services. Even in respect of a specific industry, it would be a daunting task to formulate a reasonable and objective yardstick for determining when individual traders may withdraw deposits from the special accounts set up to hold the pre-payments, not to mention the formulation of general criteria to be applicable to all industries receiving pre-payments. Besides, considerable administrative costs would be involved in the operation and regulation of the proposed accounts. Depending on the actual situation, the resultant increase in costs may be passed onto consumers. Small businesses may be more vulnerable to changes in costs, and as a result, the "market habitat" may be altered.

In addition, the suggestion of asking service providers to deposit prepaid amounts in designated bank accounts is similar in effect to banks withholding such funds for a period to help manage their credit risk, which already occurs in some cases. However, this would affect the cashflow of the merchants. Therefore, in considering the proposal, we need to strike a balance between protecting consumers and the business operating environment for the merchants. The important point is to ensure that consumers understand the terms and conditions of the agreements they enter into and the obligations these agreements entail.

As a matter of fact, the offer of discounts to consumers is normally contingent upon businesses being able to receive pre-payments. Such discounts would not be made available if the payments are deposited into a special account. Having considered the above factors, we believe that a more pragmatic approach is to prohibit the practice of accepting pre-payments without the intention or ability to supply the contracted goods or services by creating a new criminal offence.

(b) The Hong Kong Monetary Authority (HKMA) is discussing with the banking sector ways to avoid possible misunderstanding by customers of the terms of credit agreements. The focus is on ensuring that customers who enter into instalment payment plans in pre-payment for services are provided with clear and specific terms and conditions of the agreements at the point of sale. The terms and conditions should make clear that the agreement constitutes a loan; and the customers' repayment obligations in case the services are not provided for any reason, including whether the customer will be able to stop payment of any of the relevant loan amount. The HKMA intends to issue guidance to authorised institutions in this regard in the next month or so.

(c) At present, we do not consider it necessary for the Financial Secretary to appoint an inspector under section 143 of the Companies Ordinance to investigate the relevant company. We understand that many Planet Yoga members have reported their case to the Police. The Police is now making enquiries and following up the case. If there is evidence suggesting that the case involves criminal act such as fraud, the Police will take appropriate action.

Ends