



HONG KONG MONETARY AUTHORITY
香港金融管理局

Banking Conduct Department

銀行操守部

Our Ref: B9/67C

16 August 2010

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Marketing through Third Parties of Instalment Payment Plans involving Pre-payment for Goods or Services

1. Recent cases have shown that, when AIs market instalment payment plans for the supply of goods or services (IPP) through third parties at locations other than banks' branches, such as the premises of merchants, customers may misunderstand the terms and conditions of the IPPs. It is therefore important for AIs to make such terms and conditions as transparent and comprehensible as possible for customers to avoid possible disputes when the goods or services contracted for are not delivered as expected.
2. IPPs usually involve prepayment by credit card and may involve goods or services to be delivered by the merchant at a later date. In the case of services, delivery may be over a considerable period. Examples include the provision of services by health and fitness clubs, educational services providers and travel agents. Disputes may arise when the services contracted for are not delivered for some reason, often because the merchant goes out of business. While disputes are less common with IPPs involving goods, difficulties may also arise when goods become faulty after the merchant has gone out of business but while payments are still outstanding.
3. 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 merchant, while the customer undertakes to repay the amount to

the bank in instalments through their credit card. The outstanding amount is counted against the credit limit on the customer's 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 merchant 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.

4. When this happens, the risks for the AIs are obvious. Not only may AIs suffer reputational damage from being seen as colluding with merchants, AIs may be inundated with complaints which may adversely affect their operations. Some AIs manage their credit risk through chargeback arrangements for IPPs but even this does not ensure the AI concerned will not lose money if there is a mismatch between the period of the chargeback and when a claim is made.

Risk Management Measures

5. To manage these risks, the HKMA requires AIs offering IPPs to adopt the measures set out below:

Documentation

6. The terms and conditions for IPPs should be made readily available to customers or prospective customers in accordance with paragraph 5.1 of the Code of Banking Practice (the Code). The terms and conditions should be drafted in accordance with the Code, in particular paragraphs 5.4, 5.7 and 26.1.
7. IPP agreements that are not subject to chargeback protection should be documented through separate and specific terms and conditions, either in A4 format or on a leaflet-type form. The terms and conditions should make clear the following points in plain language and an easily readable font:
 - (a) that the IPP is a loan agreement;
 - (b) that the customer is agreeing to pay for goods or services which may be delivered at a later date;
 - (c) that the instalment amount will be counted against the customer's credit limit;
 - (d) the repayment obligations of the customer, in particular whether

- he or she will be able to stop payment to the AI if the goods or services contracted for are not delivered by the merchant; and
- (e) that the customer will not enjoy chargeback protection.
8. The items listed in paragraph 7 should be in a prominent position on the front page of the agreement and in an easily legible font. The customer should be required to sign separately against each clause to confirm that he or she has read and understood these conditions. AIs should not process IPP applications unless all these signatures are present.
9. The terms and conditions document for IPPs not subject to chargeback protection should also contain a channel for the customer to call the AI from the point of sale so that the AI's staff can answer any questions from the customer and explain the terms and conditions and other payment options. The contact channel may be the telephone number of the AI's card centre or other enquiry call centre, which should be open 24 hours a day if possible. AIs should ensure that staff manning these enquiry lines have copies of the terms and conditions and are able to answer reasonable questions.

Managing relationships with merchants

10. AIs are reminded that they should have regard to the relevant risk management principles set out in the Supervisory Policy Manual module on Credit Card Business, in particular sections 4.8 and 5.2 when approving new merchants and monitoring their merchant accounts on an ongoing basis.
11. In addition, agreements between AIs and merchants regarding IPPs not subject to chargeback protection should require undertakings from the merchant to:
- (a) make available the terms and conditions of IPPs to the customer at the point of sale and encourage customers to read carefully and ensure they understand the terms and conditions, in particular the points mentioned in paragraph 7(a) to (e), before signing the agreement; and
 - (b) remind customers that they may contact the AI for an explanation of the terms and conditions of the IPP and other payment options and, if they are unable to do so immediately, explain that they may take the terms and conditions away with them and defer signing

until they have been able to speak with the AI.

Auditing compliance by merchants

12. AIs should have arrangements to audit the compliance of merchants with the undertakings mentioned above and any other requirements in the AIs' agreements with them. This may be done by sample checking by telephone with customers who have recently entered into IPPs or by "mystery shopping" arrangements. Where the auditing suggests that a merchant is not fulfilling the undertakings, AIs should follow up with the merchant and require it to take remedial measures. If such behaviour continues, AIs should consider terminating their relationship with the merchant.

Implementation

13. The arrangements set out in this letter, where not already adopted by AIs, should be implemented as soon as practicable by AIs offering IPPs and in any case no later than 1 October 2010. AIs who have questions regarding this circular may approach their usual contacts at the HKMA.

Yours faithfully,



Meena Datwani
Executive Director (Banking Conduct)