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To: Chief Executives of all authorized insurers carrying on long term insurance business, Responsible Officers of all licensed insurance broker companies and licensed insurance agencies carrying on long term insurance business, Chief Executives of all authorized institutions, Responsible Officers of all MPF principal intermediaries

Dear Sirs,

Findings of Mystery Shopping Programme on Selling Practices in respect of Qualifying Deferred Annuity Policies and Tax-deductible Voluntary Contributions in Hong Kong

As previously announced in the joint circular of 29 December 2021, the Insurance Authority (**IA**), the Mandatory Provident Fund Schemes Authority (**MPFA**) and the Hong Kong Monetary Authority (**HKMA**) (together "the Regulators") had jointly conducted a mystery shopping programme (**MSP**) earlier in 2022 to help understand the selling practices of intermediaries[1] in respect of Qualifying Deferred Annuity Policies (**QDAP**) and Mandatory Provident Fund Tax-deductible Voluntary Contributions (**TVC**) in Hong Kong. A service provider was engaged to undertake the MSP[2]. The key objectives of the MSP were to facilitate the Regulators to gain insights into how QDAP and TVC are being marketed as well as to identify areas for improvement and good practices for sharing with the industry as appropriate. The Regulators also look forward to raising the industry's awareness and promoting a sound culture relating to the sale and marketing of QDAP and TVC among insurers and intermediaries.

The MSP covered a number of areas, including the know-your-customer procedures, financial needs analysis (as applicable to QDAP), suitability of recommendations, product and risk disclosure. This circular aims to share the key findings of the MSP and reiterate the importance of complying with all applicable regulatory requirements.

Save for certain aspects and some isolated samples which showed room for improvement, the intermediaries were generally in compliance with the relevant regulatory requirements according to the MSP findings. Intermediaries should ensure that the product introduced or recommended is appropriate or suitable for the customer's circumstances, and provide accurate

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1 "Intermediaries" refers to-
(a) licensed insurance intermediaries as defined in section 2(1) of the Insurance Ordinance;
(b) registered intermediaries as defined in section 2(1) of the Mandatory Provident Fund Schemes Ordinance; and
(c) authorized institutions as defined in section 2(1) of the Banking Ordinance.

2 The service provider engaged mystery shoppers ("shoppers") to pose as potential customers of the intermediaries under review. The shoppers did not proceed to the application stage in this MSP.

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and fair information of QDAP and TVC to the customer. Details of the findings in respect of the sale of QDAP and TVC are set out in **Annex I** and **Annex II** respectively. The industry should take into account the findings and review their policies and internal controls in respect of sales process, staff training, compliance checking and other relevant internal controls, so as to adhere to the principles of treating customers fairly and acting in customers' best interests.

The Regulators will take into account the findings of the MSP in formulating supervisory plans and related measures. The Regulators will also follow up the findings with the insurers and/or intermediaries concerned as appropriate and require them to take actions to address the issues noted as applicable. The Regulators will continue to monitor the industry's compliance with the relevant regulatory requirements in their on-going supervision.

Yours faithfully,

Carol Hui	Cynthia Hui	Alan Au
Executive Director	Acting Chief Operating Officer	Executive Director
Long Term Business Division	Mandatory Provident Fund	Banking Conduct Department
Insurance Authority	Schemes Authority	Hong Kong Monetary Authority

c.c. The Hong Kong Federation of Insurers
Professional Insurance Brokers Association
The Hong Kong Confederation of Insurance Brokers

Annex I

Key Findings of the Mystery Shopping Programme on Selling Practices in respect of Qualifying Deferred Annuity Policies (QDAP) in Hong Kong

A. General

1. Based on the MSP findings, there was room for improvement in the following areas in respect of the sale of QDAP:
   - know-your-customer procedures and product recommendation; and
   - disclosure and explanation of product features, risks and benefits.

2. In addition, inaccurate explanation of premium levies, improper sales tactics and potential non-compliance regarding use of gifts were also noted in some isolated samples.

B. Know-Your-Customer (KYC) and Product Recommendation

Financial Needs Analysis (FNA)

3. It is important for insurers and intermediaries to understand their customers and to collect relevant and sufficient information from each customer, through the use of FNA form where appropriate, so that they can properly assess the circumstances of the customer (including needs, financial situation, ability and willingness to pay premiums, etc.) before making any recommendation in respect of a suitable life insurance product for the customer. An FNA form is to facilitate the identification of suitable life insurance product(s) to meet the customer's needs and circumstances.

4. In the MSP, some intermediaries were found to have undermined the KYC and FNA processes. It was observed in a number of samples that the intermediaries did not make reasonable efforts to collect sufficient information through conducting FNA with the shoppers before recommending any life insurance product. Instead, the intermediaries recommended QDAP mostly on the basis of either the product preference of the shoppers or the shoppers' brief background information (e.g. age, budget for premium payments, and expected annuity income period and amount) obtained by the intermediaries before or during the sales process, which was inadequate for ensuring the suitability of the recommendations. In a few samples, the intermediaries even provided the benefit illustrations[3] (BIs) for QDAP prepared solely based on the limited information of the shoppers (e.g. age, gender, income, etc.) for the shoppers' reference in advance of the first meeting with the shoppers.

5. When assessing the ability and willingness of the shoppers to pay insurance premiums, it was noted that some intermediaries did not obtain the information regarding the source of funds and financial situation from the shoppers to assess whether the shoppers

[3] "Benefit illustration" refers to an illustration prepared and provided by the authorized insurer to the customer of a life insurance policy showing the projected surrender values and death benefits of the life insurance policy.

could afford the recommended products throughout the entire duration of the premium payment term.

6. In some instances, despite that the intermediaries invited the shoppers to conduct FNA, they did not clearly explain to the shoppers the purpose of the assessment. A few intermediaries even asked the shoppers to sign on the incomplete FNA forms.

7. While most of the intermediaries did not influence or pressure the shoppers in the FNA process, some intermediaries hinted or even guided the shoppers to answer the FNA forms in such a way that QDAP could be recommended to them. This might potentially result in unsuitable products being recommended to the shoppers.

Suitability of Recommendations

8. Intermediaries should have due regard to the relevant information provided by the customers in the FNA process and conduct an appropriate suitability assessment before making any recommendation. Where a mismatch exists (i.e. the life insurance product being recommended does not meet the circumstances of the customer based on the information collected during the FNA process) and the intermediary makes the recommendation despite the mismatch, the intermediary should clearly explain the mismatch to the customer and why (despite the mismatch) the life insurance product is recommended to the customer, and document the details of the explanation.

9. Where FNA was conducted with the shoppers in the MSP, some intermediaries provided recommendations based on the assessment results, which included assessment on each shopper's needs, financial situation, ability and willingness to pay premiums, etc., and gave brief explanations of why the recommended products were suitable for the shoppers. In the samples where two or more life insurance products were recommended, the intermediaries could largely explain the differences among the recommended products and respond to the shoppers' enquiries about which product would be more suitable based on the shoppers' circumstances. However, in some instances the intermediaries did not sufficiently elaborate on why the products were suitable for the shoppers having regard to their circumstances.

10. In the instances where the recommendations involved mismatch, some intermediaries did not draw the shoppers' attention to the mismatch or provide explanations on why such mismatched products were still recommended to them before continuing the sales process. This cast doubts on whether the intermediaries have given sufficient regard to the shoppers' circumstances in recommending the products.

Identification of Vulnerable Customers

11. Intermediaries should exercise extra care when dealing with vulnerable customers and be alerted that low education level (primary level or below) is one of the indicators for vulnerable customers. In the MSP, some intermediaries were not able to identify whether the shoppers were vulnerable customers because the intermediaries did not collect sufficient information of the shoppers for the purpose of identification of vulnerable customers during the sales process.

C. Disclosure and Explanation of Product Features, Risks and Benefits

12. Customers should be fully apprised of the product features, risks and benefits associated with the life insurance products recommended by intermediaries so that they could make informed decisions. In addition, intermediaries should always present balanced views about the products, including drawing the customers' attention to the disadvantages and downside risks. Intermediaries should ensure that information and explanations provided to the customers are fair and not misleading.

13. It was noted in the MSP that the product disclosure practices and the level of disclosure varied amongst the intermediaries. Nonetheless, the intermediaries in general could mention the basic product features, risks and benefits of QDAP including the eligibility for tax deduction under salaries tax and personal assessment, policy currency, premiums, policy term, annuity payment period, death benefit, amounts of the guaranteed and non-guaranteed benefits, and consequences of full surrender.

14. However, the disclosure and explanation of certain product features, risks and benefits of QDAP were found inadequate in some instances. Examples included internal rates of return, investment-related details of underlying investments, policy on determining future bonus and dividend declaration, assumptions adopted in the preparation of projected non-guaranteed benefits in the BIs, the risk of not being eligible for claiming tax deduction (despite purchase of QDAP), credit risk of the insurer, inflation risk, liquidity risk, and consequences of withdrawal/ partial surrender.

15. The default option for annuity payments of QDAP is cash pay-out whereas some QDAP may allow the policy holders to decide whether to retain the entire or part of the annuity payments in the policy to generate additional interest income (if any) in the future (i.e. accumulation option). It was observed that a number of intermediaries introduced to the shoppers the accumulation option only, or did not inform them the default option for annuity payments was cash pay-out nor the fact that the shoppers could change the annuity payment option anytime without any charges. Also, some intermediaries did not explain the BIs on accumulation option or mention the interest rate for annuity payments under accumulation option was not guaranteed.

16. Isolated samples were noted where a few intermediaries provided incorrect information about QDAP such as QDAP was a savings plan but not a life insurance product, and the guaranteed benefits of QDAP could still be received by the shopper upon winding up of the insurer. Several intermediaries also incorrectly stated that there were no fees and charges for QDAP, notwithstanding that in fact the insurance and related costs are embedded in the premiums paid.

17. It was noted that some intermediaries did not present balanced views and focused only on the good points of QDAP and did not provide adequate or appropriate explanation of risks involved. For instance, some intermediaries did not properly explain the additional high and low return scenarios provided in the BIs showing the variability of the ultimate results of the projected performance of QDAP. Some intermediaries claimed that the actual non-guaranteed benefits of QDAP would not be zero, or would usually be higher than those illustrated in the BIs, or that the insurers had proven track

records of bonus/ dividend declaration and therefore the future bonuses/ dividends or non-guaranteed portion of the annuity payments of QDAP were highly certain, which might not be true. The non-guaranteed benefits of QDAP could be affected by factors such as investment returns, claims and profits of the insurer and thus the total amount of annuity payments would be impacted when the non-guaranteed benefits were not achieved.

18. The MSP also revealed that the intermediaries generally provided the product brochures and the BIs to the shoppers during the sales process, save for some isolated samples where the intermediaries did not provide the product brochures or provided an outdated version of product brochures to the shoppers.

D. Other Observations

19. While most of the intermediaries could advise the shoppers the correct premium amounts required for QDAP and the applicable premium levies, a few samples revealed that the intermediaries claimed that the premium amounts consisted of premium levies and that premium levies were charged by the Government. In fact, premium levies are payable along with premium payments by policy holders of all insurance policies to the IA through the insurers. Besides, premium levies are not premium payments and thus not eligible for tax deduction purpose.

20. Intermediaries generally did not impose pressure on or induce the shoppers to make hasty decisions, save for a few samples where the intermediaries emphasised that the promotion for the recommended QDAP would end soon and urged the shoppers to make decisions immediately.

21. There were some isolated samples where the intermediaries tried to offer cash coupons or festive hampers to the shoppers to induce the shoppers to take out the recommended QDAP, which might not be in compliance with the relevant regulatory requirements.

E. Good Practices

22. Some good practices by intermediaries were noted in the MSP, including ascertaining the documents were legible to the shopper who was a vulnerable customer; confirming the understanding of the shoppers from time to time during the course of disclosure and explanation of product features, risks and benefits of QDAP to facilitate the shoppers in making informed decisions; and advising the shopper to re-consider carefully as the shopper might suffer losses if the shopper cancelled the existing policy to purchase QDAP.

Annex II

Key Findings of the Mystery Shopping Programme on Selling Practices in respect of Mandatory Provident Fund Tax-deductible Voluntary Contributions (TVC) in Hong Kong

A. General

1. Based on the MSP findings, there was room for improvement in the following areas relating to conduct requirements under the MPFA Guidelines on Conduct Requirements for Registered Intermediaries (**Conduct Guidelines**):

   - know-your-customer procedures;
   - explanation of product features and disclosure of risks; and
   - disclosure of information about monetary and non-monetary benefits receivable by Mandatory Provident Fund (MPF) intermediary.

2. In addition, it was observed that some intermediaries introduced or recommended QDAP to the shoppers and discouraged the shoppers from opening TVC accounts without understanding the shoppers' circumstances.

B. Know-Your-Customer (KYC)

Verification of Customer Identity

3. An intermediary should take all reasonable steps to establish the identity of a customer by checking the customer's identity document to verify the customer's identity and to acquire a basic understanding of the customer. However, in the MSP it was observed that only a few intermediaries checked the shoppers' identity documents during the selling process.

Identification of Vulnerable Customers

4. In the course of conducting a regulated activity, intermediaries should provide extra care of, and support for, customers with special needs (i.e. vulnerable customers[4]) during the sales and marketing process relating to the making of a key decision, such as by offering the vulnerable customers the opportunity to be accompanied by a companion or an additional staff member to witness the sales process. Hence, it is important for the intermediaries to take reasonable steps to check in the first place whether a customer is a vulnerable customer. However, the MSP revealed that most intermediaries did not take reasonable steps to check whether the shoppers were vulnerable customers (e.g. asking about their education level).

[4] Vulnerable customers are the persons who are not, or may not be, able to fully understand the type of information to be provided and discussed or who are not, or may not be, able to make a key decision. Such customers may include, for example, those who are illiterate, with low level (primary level or below) of education, visually or otherwise impaired in a manner that affects their ability to make the relevant key decision independently.

C. Explanation of Product Features and Disclosure of Risks

Explanation of TVC Features

5. An intermediary should have a good understanding of the MPF scheme which the intermediary promotes and/or on which the intermediary gives regulated advice. In selling TVC, the intermediary should be familiar with the features of TVC, and the procedures for opening and making contributions to TVC account. The intermediary should disclose and explain the key features of TVC to a customer that would assist the customer in understanding TVC.

6. During the MSP, it was observed that most intermediaries did not explain adequately the key features of TVC or disclose relevant risks to the shoppers. For instance, most intermediaries did not tell the shoppers that their MPF benefits in a TVC account can be transferred to another TVC account at any time.

Explanation of the Default Investment Strategy

7. When inviting a customer to join or transfer to an MPF scheme, the customer should be informed that if no constituent fund is selected, the contribution will be invested under the default investment strategy (DIS) of the MPF scheme.

8. However, it was noted in the MSP that most intermediaries did not adequately inform the shoppers about the DIS arrangement and they also did not explain adequately to the shoppers the key features of the DIS, such as the DIS consists of two constituent funds and the key features and risks of each of them, the automatic annual de-risking mechanism, and fees and charges, such as the fee control.

Information about Transfer out of Guaranteed Funds

9. When inviting a customer to transfer to an MPF scheme, an intermediary should find out from the customer if the transfer would result in a transfer out of a guaranteed fund. If the transfer would result in a transfer out of a guaranteed fund, the intermediary should warn the customer that a transfer of the MPF benefits out of a guaranteed fund may cause certain or all of the guarantee conditions not being satisfied, thus resulting in the loss of the guarantee. The intermediary should also advise the customer to check the offering document of the original scheme or consult the MPF trustee for details before transferring out of the guaranteed fund.

10. In the MSP, for the samples where the shoppers requested transfer of TVC to another TVC account, the intermediaries did not check with the shoppers whether the transfer would result in a transfer out of a guaranteed fund of the original scheme. The intermediaries also did not advise the shoppers to check the offering documents of the original schemes or consult the MPF trustees for details.

Disclosure of Risks Relating to Investment Performance

11. An intermediary should not advise a customer to make a constituent fund selection based primarily on past investment performance. It was observed in the MSP some intermediaries did not make proper risk disclosure (e.g. types and levels of risk) to the shoppers when they discussed fund performance. The intermediaries recommended the constituent funds to the shoppers primarily based on the past investment performance without reminding the shoppers that past performance is not indicative of future performance.

D. Disclosure of Monetary and Non-Monetary Benefits Receivable by MPF Intermediaries

12. A conflict between the interests of an intermediary and the interests of a customer may arise where the intermediary receives benefits (monetary or non-monetary) from other parties (e.g. sponsor or trustee) upon completing a sale or upon giving regulated advice. The intermediary must disclose the conflict to the customer. To better address the conflict of interest arising from receipt of benefits by the intermediary from other parties, the intermediary must provide the customer with a statement (at the time of the invitation, inducement or advice) to disclose the information about the monetary and non-monetary benefits.

13. Nevertheless, it was observed from the MSP that most intermediaries did not disclose the information of monetary and non-monetary benefits receivable to the shoppers during the selling process. Without disclosure of such information to the shoppers, the shoppers did not have sufficient information to facilitate them to make informed decisions.

E. Opening of TVC Accounts

14. When carrying on a regulated activity, an intermediary should take reasonable steps to understand the circumstances of a customer (such as the customer's education level) as is necessary for ensuring that the recommended product is appropriate for the customer and provide accurate information to the customer.

15. In the MSP, for all samples where the shoppers were interested in tax-deductible products but did not indicate any preference for TVC or QDAP, the intermediaries did not take reasonable steps to understand the circumstances of the shoppers or have regard to the circumstances of the shoppers to introduce or recommend an appropriate product to the shoppers, and did not provide adequate or accurate information about TVC for the shoppers to make informed decisions. Without a proper understanding of or due regard to the shoppers' circumstances, the intermediaries could not ensure that the recommended products were appropriate to the shoppers.

16. Furthermore, some intermediaries discouraged the shoppers from opening TVC accounts by providing inaccurate information or misleading statements to the shoppers. For instance, an intermediary told the shopper that the TVC account opening time was long and the withdrawal conditions for TVC were not flexible and the intermediary did not enquire about the shopper's age or retirement plan. In another instance, the

intermediary told the shopper that the risk of making TVC was high. In fact, the level of risk could vary from high to low depending on the constituent fund choice of the shopper.

17. Apart from the samples mentioned in paragraphs 15 and 16 above, in some other samples where the shoppers indicated their interest to make TVC, the intermediaries made endeavours to explain the features of QDAP and repeatedly mentioned QDAP to the shoppers even though the shoppers had explicitly and repeatedly expressed to the intermediaries that they were not interested in QDAP. However, for samples where the shoppers indicated their interest to buy QDAP, the intermediaries did not introduce TVC to the shoppers. Some intermediaries also made misleading statements to discourage the shoppers from opening TVC accounts. For instance, an intermediary asked the shopper not to open TVC account as the return of TVC was poor. In another instance, the intermediary emphasised the negative aspects of TVC when making comparison with QDAP (e.g. longer lock-in period and higher return volatility for TVC) instead of presenting a balanced view about the products.

18. Currently, the tax-deductible limit of $60,000 for each year of assessment is shared between TVC and QDAP premiums. These two products are different in product features and an intermediary should recommend what is appropriate for a customer. It was observed in the MSP that some intermediaries introduced a product to the shoppers without considering particular circumstances of the shoppers (e.g. despite the shoppers' strong indication of preference for a particular type of tax-deductible product). Such selling behaviour might be driven by the intermediaries' endeavours to introduce more product choices to the shoppers or by better remuneration to the intermediaries. To facilitate the shoppers in making informed decisions, intermediaries are expected to advise on the relative benefits and drawbacks of both products and recommend which one is more appropriate for the shoppers based on the shoppers' circumstances.

19. A customer may rely on an intermediary's advice when the customer compares TVC and QDAP before making decision to choose TVC or QDAP. The intermediary should take reasonable steps to understand the circumstances of the customer and provide accurate information upfront for the customer to make an informed decision.

F. Good Practices

20. In the MSP, some intermediaries made good use of various tools available on the MPFA website (e.g. Trustee Service Comparative Platform) to provide an overview of the services offered by different MPF schemes to the shoppers. In some samples, the intermediaries made good use of electronic tools (e.g. tax calculator provided by the Government and/or the digital tools provided by MPF principal intermediaries[5]) to assist shoppers in making informed decisions.

[5] An MPF principal intermediary is a business entity registered by the MPFA to engage in conducting MPF sales and marketing activities and giving regulated advice.