HONG KONG MONETARY AUTHORITY
香港金融管理局

Banking Conduct Department *銀行操守部*

Our Ref: B1/15C
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8 December 2014

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Mystery Shopping Programme (MSP) Findings

The Hong Kong Monetary Authority (HKMA) engaged a service provider during 2013 and 2014 to undertake a MSP to test check the sales practices of Authorized Institutions (AIs) in respect of investment and insurance products. A report summarising the findings of the MSP is attached at **Annex**. AIs should give due regard to the findings, and review their policies and controls to promptly implement any appropriate measures to enhance selling process, staff training, compliance monitoring and other relevant internal controls. AIs are also encouraged to adopt the good practices set out in the report, where applicable, to enhance their sales process and relevant controls, and to achieve the objective of treating customers fairly.

The results of the MSP revealed that the AIs under review were generally in compliance with the relevant regulatory requirements in respect of the sale of investment products, save for some samples which suggested room for further improvement. In respect of the sale of insurance products, the findings suggested some weaknesses in obtaining adequate information about the customer's circumstances and needs, ensuring suitability of recommendations, and disclosure of key features and risks as well as fees and charges of the insurance products.

Regarding the sale of investment products, the HKMA has shared with the banking industry in a circular issued on 30 July 2014 some findings and good practices as identified in this MSP and in the HKMA's on-going supervisory process, as well as reminding AIs to comply with the regulatory requirements and expected standards. As for insurance products, taking into account the findings of this MSP and in its on-going supervision, the HKMA has also

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issued a circular today to provide guidance to the banking industry on the expected selling practices for non-linked long term insurance (NLTI) products[1].

The HKMA has taken into account the findings of the MSP in formulating supervisory plans as well as measures for promoting good compliance culture of AIs and their staff. Areas of shortcomings are subject to greater scrutiny in the supervisory process. The individual AIs concerned have been required to take appropriate follow-up actions, including to improve relevant control measures. The HKMA will continue to deploy mystery shopping from time to time to test check AIs' sales practices.

Yours faithfully,

Carmen Chu

Executive Director (Banking Conduct)

Encl.

c.c. SFC (Attn: Mr James Shipton, Executive Director (Intermediaries))
Insurance Authority (Attn: Ms Carol Hui, Acting Assistant Commissioner of Insurance (Long-Term Business) and Ms Nancy Chien, Acting Assistant Commissioner of Insurance (Enforcement))

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1 Examples of NLTI products include endowment insurance plans, annuity insurance plans, whole life insurance plans and universal life insurance plan, etc.

Annex

HONG KONG MONETARY AUTHORITY
香港金融管理局

Mystery Shopping Programme Findings

December 2014

Executive Summary

1. To complement its supervisory activities, the Hong Kong Monetary Authority ("HKMA") engaged a service provider during 2013 and 2014 to carry out a mystery shopping programme ("MSP") in respect of the sale of investment products[1] and insurance products[2] by Authorized Institutions ("AIs") to test check their sales practices and assess the extent to which the applicable regulatory requirements issued by the HKMA, the Securities and Futures Commission ("SFC") and the Hong Kong Federation of Insurers ("HKFI") have been implemented. The key objectives of MSP were to identify areas for improvement and good practices for sharing with the industry and the investing public as appropriate, so as to promote good compliance culture among AIs and help general public to better understand their rights and responsibilities when subscribing to wealth management services and products. The MSP covered a number of areas, including the Know-Your-Customer ("KYC") procedures, risk disclosure, suitability assessment and implementation of HKMA's enhanced measures.

2. The MSP covered 350 samples[3] from a mix of 20 small-, medium- and large-sized retail banks (the "Banks") which engage in selling investment products and insurance products to Hong Kong investors through their branches.

3. Mystery shoppers ("shoppers") of various age groups and with different investment experience and financial position were assigned to visit designated branches of the Banks to make enquiries on investment products or insurance products. Each shopper was required to audio-record the meetings with bank staff, collect any materials provided by bank staff, and complete and submit a questionnaire after the visit. As the MSP was mainly for test checking the robustness of AIs' sales process and related controls, and the shopper would not make any investment or take out an insurance policy during the visits, no actual investment or insurance transaction was carried out. Due to this limitation, any further steps and procedures that were carried out just before the actual transaction might not be captured in the MSP.

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1 "Investment products" in this report include mutual funds/unit trusts, debt securities, equity-linked instruments and currency-linked instruments.

2 "Insurance products" in this report include Investment-linked Assurance Scheme ("ILAS") products and non-linked long term insurance ("NLTI") products. Examples of NLTI products include endowment insurance plans, annuity insurance plans, whole life insurance plans and universal life insurance plans, etc.

3 "Sample" in this report refers to each instance where a "shopper" acts as a potential customer to gather information about the sale process of the bank and may comprise more than one visit.

4. The 350 samples involved recommendations[4] on 370 investment products[5], 209 non-linked long term insurance ("NLTI") products and 15 Investment-linked Assurance Scheme ("ILAS") products[6]. Some samples involved recommendations on a combination of investment products, NLTI products and/or ILAS products, and some resulted in no recommendations. Implementation of additional safeguards for less sophisticated customers was tested in 173 samples which were conducted by vulnerable shoppers[7] and in 34 samples where Pre-Investment Cooling-off Period ("PICOP") arrangement[8] was applicable. Implementation of the cooling-off period requirement[9] of the HKFI was also tested in the samples that involved recommendations on insurance products.

5. In respect of the sale of investment products, the MSP revealed that the Banks generally were in compliance with the relevant regulatory requirements, save for some areas that exhibited room for improvement and some isolated instances with deviations from expected standards. In respect of the sale of insurance products, the findings suggested some weaknesses in obtaining adequate information about the customer's circumstances and needs, ensuring suitability of the solicitations or recommendations, and disclosure of key features and risks as well as fees and

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4 "Recommendations" in this report include cases where the sales staff introduced or recommended an investment product or insurance product to the shopper, who might or might not have indicated to the sales staff the specific types of product that he/she was interested in.

5 The sales staff introduced or recommended 279 (75.4%) mutual funds/unit trusts, 55 (14.9%) currency-linked instruments, 31 (8.4%) equity-linked instruments and 5 (1.3%) debt securities to the shoppers.

6 All samples involving recommendations on ILAS products were conducted before end-June 2013 (i.e. before the effective date for AIs to implement the enhanced measure of Important Facts Statement in accordance with the HKMA's circular of 22 April 2013).

7 "Vulnerable shoppers" in this report refer to (i) elderly shoppers aged 65 or above; or (ii) shoppers whose education level is primary or below.

8 PICOP is applicable to the sale of unlisted structured products to retail customers with less sophistication (e.g. elderly and first-time investor). Under the PICOP arrangement, AIs should allow the customers at least 2 calendar days (of which the last day should be a business day) to understand the product, consider the appropriateness of the investment and, if necessary, consult with family members and friends.

9 During the cooling-off period, purchasers of new life insurance policies have the right to cancel the policies and obtain a refund of any premiums paid (less any market value adjustment which may be applied by the insurers in the case of ILAS policies and single premium NLTI policies). The cooling-off period is 21 days after the delivery of the policy or issue of a notice (which informs the policyholder of the availability of the policy and the expiry date of the cooling-off period) to the policyholder or the policyholder's representative, whichever is the earlier. AIs should draw to the attention of the customer during the selling process his/her right to cancel the policy during the cooling-off period, how the customer may exercise the right and how the refund will be calculated.

charges of the insurance products. The major findings are summarised in the following paragraphs.

Key Findings

Investment products

6. The Banks in general had a high level of compliance with the KYC requirement and most bank staff required the shoppers to complete a risk profile questionnaire ("RPQ") before introducing or recommending investment products. Several isolated cases were noted that the sales staff tried to influence the shoppers to provide specific answers to the RPQ or some other KYC documents. Most sales staff introduced or recommended investment products based on the shoppers' risk tolerance assessment results. However, a few sales staff did not properly handle risk mismatch and, for example, suggested the shopper to amend the answers to the RPQ to result in a higher risk tolerance level.

7. Room for improvement in disclosure of product features and risks was noted. In some samples, while the sales staff provided a general description of the key features and risks of the recommended investment products, they did not adequately explain certain salient features and risks, such as the higher credit risk and the higher vulnerability to economic cycles of investment funds primarily investing in high-yield bonds ("high-yield bond funds"). In some samples the sales staff failed to provide proper explanation to the shoppers in handling shoppers' enquiries about product features and risks.

Insurance products

8. It was observed in a number of samples that the sales staff failed to make reasonable efforts in conducting Needs Analysis (for NLTI products), or RPQ and Financial Needs Analysis (for ILAS products) with the shoppers before introducing or recommending those insurance products. As the information about the shoppers' circumstances collected by the sales staff was inadequate, the suitability of the proposed NLTI products and/or ILAS products was unclear. In several samples, the sales staff introduced or recommended NLTI products or ILAS products to the shoppers who had indicated that they were not interested in insurance products, or were assessed as having no insurance needs. In some samples, the proposed NLTI products or ILAS products did not match the customer's circumstances in terms of needs and affordability.

9. There was also a need for improvement in respect of product disclosure. A small number of sales staff did not clearly disclose the insurance nature of NLTI products and ILAS products. In some samples, the disclosure of some of the key

features and risks such as credit risk of the insurance company, fees and charges, premium contribution period and consequences of premium holiday was inadequate.

Less sophisticated shoppers

10. In a number of samples, the sales staff did not properly mention the option of additional safeguards available to vulnerable shoppers, or the PICOP arrangement to the shoppers where applicable.

Other observations

11. Sales staff generally did not impose pressure on or induce the shoppers to make immediate decisions, save for a small number of samples where the sales staff tried to convince the shoppers to take out the recommended NLTI policies immediately on the grounds that the shoppers could further consider and cancel the policies during the cooling-off period, and/or emphasized that the recommended NLTI products would be sold out soon and urged the shoppers to make decisions immediately.

12. This MSP did not note any breach of the restrictions on use of gifts in promoting a specific investment or insurance product imposed by the SFC, the HKMA and the HKFI.

Good practices

13. Some good practices were observed from the MSP, for example, reminding the shoppers to avoid concentration or to maintain sufficient liquidity, declining to introduce or recommend any investment or insurance products to the vulnerable shoppers, and adopting a cautious approach and reminding the shoppers the relevant risks and consequences in cases where the shoppers initiated to change information about their circumstances.

14. When shoppers enquired about replacing their existing life insurance policies, most sales staff advised the shoppers to re-consider carefully and reminded the shoppers that they might suffer losses.

<u>HKMA’s follow-up work and way forward</u>

15. The HKMA has already required the individual AIs concerned to examine the root causes of the cases with deviations from expected standards, to take appropriate follow-up actions, and to enhance their relevant controls, staff training and compliance monitoring.

16. The HKMA has taken into account the findings of the MSP in formulating supervisory plans as well as measures for promoting good compliance culture of AIs and their staff. Areas of shortcomings are subject to greater scrutiny in the supervisory process. The HKMA has already shared with the banking industry some findings and good practices in relation to the sale of investment products identified in the MSP and set out the HKMA's expected standards in July[10].

17. While AIs have not been active in selling ILAS products since the second half of 2013, in view of the HKMA's supervisory experience and the findings of the MSP, the HKMA will continue to monitor their sales practices and related controls in respect of ILAS products.

18. Also, in the light of the findings from this MSP exercise and its on-going supervision, the HKMA has also issued a circular today to provide guidance to the banking industry on expected selling practices for NLTI products. The guidance covers the areas of product due diligence, advertisements, suitability assessment, handling of vulnerable customers, product disclosure and management supervision.

19. Publication of the results of the MSP, including examples as revealed in this exercise, would also help the general public better understand their rights as well as responsibilities when subscribing to wealth management services and products.

[10] The HKMA's circular "Issues and good practices in relation to sale of investment products" issued on 30 July 2014.

Programme Introduction

20. To complement its supervisory work in relation to the sale of investment products and insurance products by AIs, the HKMA engaged a service provider during 2013 and 2014 to undertake a mystery shopping programme (“the MSP”) to test check the sales practices of AIs and assess the extent to which the applicable regulatory requirements issued by the HKMA, the SFC and the HKFI have been implemented. The MSP focused on a number of areas, including Know-Your-Customer procedures, risk disclosure, assessment of suitability of recommendation, and implementation of the HKMA’s enhanced measures.

21. The MSP was designed to meet the following objectives:

    (a) Operate as an additional supervisory tool allowing the HKMA to test check the sales process of AIs;

    (b) Allow the HKMA to gain insights into the way products are being sold and thus help address areas of potential risk in a proactive way;

    (c) Provide an additional basis for regulatory guidance and strategy; and

    (d) Identify areas for improvement and good practices for sharing with the industry and the investing public as appropriate, so as to promote good compliance culture among AIs, and help general public to better understand their rights and responsibilities when subscribing to wealth management services and products.

22. In order to provide a comprehensive and representative picture, 350 samples from a mix of 20 small-, medium- and large-sized retail banks that engaged in the sale of investment products and/or insurance products were covered in this MSP.

23. Methodology

    (a) Mystery shoppers acting as potential clients were deployed throughout the MSP. Each of the shoppers was assigned to visit a designated branch to make an enquiry on investment products or insurance products. However, they were not required to make any investment or take out any insurance policy during the visits.

    (b) A shopper questionnaire was designed to record the shoppers’ observation during their visits to the Banks. Each shopper was required to record the meetings, collect any materials provided by the sales staff, and complete and submit the questionnaire after the visit.

    (c) To ensure consistency and accuracy in the data collected, the service provider has performed quality control checking on all completed questionnaires against the relevant audio recordings.

24. Profiles of shoppers

For a representative reflection of the client profile, the MSP covered shoppers with different attributes as below:

- Age: young adult, middle-aged and the elderly (aged 65 or above);
- Risk tolerance: low, medium and high;
- Financial net worth: ranging from low net worth (less than HK$500,000) to high net worth (more than HK$2,000,000);
- Educational background: illiterate, primary education to tertiary education level; and
- Investment experience: from no investment experience to more than five years of investment experience.

Key Findings

<u>Investment Products</u>

<u>Know-Your-Customer ("KYC")</u>

25. In order to understand their customers and to ensure suitability of investment recommendations, AIs should collect from each customer relevant information about his/her personal circumstances such as age, financial situation, investment objectives, investment experience, investment knowledge, investment horizon, risk tolerance and education level.

26. The MSP revealed that among the samples that involved recommendations on investment products, most bank staff required the shopper to complete a risk profile questionnaire ("RPQ") or confirmed that the shopper had a valid RPQ with the bank before introducing or recommending the investment products.

27. In terms of procedures of conducting RPQ, in most samples the assessment process was conducted by non-sales staff and was audio-recorded as required by the HKMA, save for some exceptions. Also, the risk tolerance assessment results were confirmed with the shoppers except for one sample where the bank staff did not explain the RPQ result to the shopper.

28. Several sales staff tried to influence the shoppers to provide or change specific answers to the RPQ or some other KYC documents, so as to obtain the desired assessment results (e.g. higher customer risk tolerance) to match with a particular investment product or a wide range of investment products. In one instance, the sales staff advised that having experience in Mandatory Provident Fund products was equivalent to having experience in mutual funds or unit trusts.

> **<u>Example 1</u>:**
>
> In assisting the shopper who had indicated interest in equity-linked instruments ("ELIs") to open an investment account with the bank, the sales staff asked the shopper to sign a form to declare that the shopper had watched an educational video about derivatives while the shopper had not yet done so. Also, when the shopper indicated having only primary education level, the sales staff advised that the shopper could be regarded as having attained secondary education level even if she had studied up to secondary one only.
>
> The shopper was then asked to complete the RPQ. The original result of the RPQ indicated that the shopper's risk tolerance was level 2, but the sales staff said that, with such result, purchase of ELI was not allowed. The sales staff further suggested that the shopper could change the answers to RPQ, and

advised the shopper specifically on which questions to review, and even suggested that the shopper should choose a higher tolerance level for investment price movement.

After the shopper had changed the answers to the questions, the process of conducting RPQ was audio-recorded. Notwithstanding that the RPQ result was revised, there was still a risk mismatch between the RPQ result and the product risk rating of the ELI. In response to the shopper's enquiry about the handling of risk mismatch, the sales staff said that it depended on whether the shopper would further amend her answers to the RPQ at the time of actual transaction, instead of highlighting to the shopper that the ELI might not be suitable for her.

<u>Disclosure of product features and risks</u>

29. AIs should properly disclose and explain to customers the key features and risks of the investment products, so as to help customers make informed investment decisions. In addition to explaining the benefits of the recommended products, AIs should always present balanced views, drawing customers' attention to the disadvantages and downside risks as well. AIs should also ensure that information and explanation made by their staff is fair and not misleading. Regular and appropriate training should be provided to sales staff.

30. The MSP revealed that there was room for improvement in the disclosure of product features and risks by the sales staff. In some samples, while the sales staff provided a general description of key features and risks of the recommended investment products, they did not adequately explain to the shoppers certain salient features and risks, for example, the higher credit risk and the higher vulnerability to economic cycles of high-yield bond funds.

31. Some sales staff did not provide accurate and adequate information about the recommended investment products or did not provide adequate and proper explanation in response to shoppers' enquiries of product features and risks. The following paragraphs showed some examples.

32. In a sample, the sales staff did not present balanced views to the shopper on the recommended products.

<u>Example 2</u>:

The sales staff introduced/recommended a few bonds and investment funds to the shopper. It appeared that the sales staff mainly focused on positive features of the recommended products and did not provide adequate and proper explanation of risks involved. For example, for one of the bonds recommended,

> the sales staff made such comments as "you (shopper) would not lose because there would be interest income", and "the price of the bond would certainly rise in the next 3 to 5 years".
>
> For the three investment funds recommended (of which two were high-yield bond funds), the sales staff did not explain any risks, but represented that since the investment funds were investing in hundreds of companies, any loss would be very minimal (at most 1%) if one of the companies collapsed. When the shopper enquired whether high interest income was guaranteed for investing in high-yield bond funds, the sales staff replied that the interest income would not be low and the shopper could receive interest payment every month. Such reply was inaccurate.

33. In the samples where the shoppers expressed difficulty in understanding or when questions were asked about the features and risks of the recommended investment products, some sales staff failed to address the queries properly. For example:

    (a) In answering the shoppers' enquiries about high-yield bond funds, several sales staff did not explain that high return was not guaranteed for investing in high-yield bond funds.

    (b) In response to a shopper's query regarding whether the recommended ELI was secure, the sales staff only replied that it depended on whether the shopper would feel at ease even receiving stocks and keeping the stocks for dividend income, and whether the shopper would be in need of using the investment money, but without reminding the shopper that investment involved risks and that in the worst case scenario the entire investment principal could be totally lost.

    (c) A sales staff told the shopper that the recommended investment fund was investing in equities, but in fact the investment fund was investing in debt securities only. Also, upon the shopper's enquiries, the sales staff admitted that he did not know what the minimum investment amount and the product tenor of the recommended investment fund were.

    (d) In a sample, when handling a shopper who had expressed that he did not understand the risks of investment funds, the sales staff merely said that investment must involve risks, which could be high or low, and did not disclose any relevant risks involved.

34. It was noted that a number of sales staff did not provide the Product Key Facts Statements and/or the Important Facts Statements (as the case may be), which summarized key features and risks of the products, to the shoppers during the

selling process, though some of them provided the shoppers with other product documents such as product leaflets, marketing materials and fund fact sheets.

Suitability assessment

35. AIs should take reasonable steps to ensure that any investment solicitation or recommendation made by sales staff is suitable for the customer having regard to the customer's personal circumstances.

36. Sales staff generally provided recommendations based on the shoppers' risk tolerance assessment results. In the samples where the shoppers requested for some specific investment products with higher risk rating than the shoppers' risk tolerance assessment results, or that the shoppers did not have relevant experience, the sales staff generally pointed out the risk mismatch and the potential unsuitability, and did not recommend such products to the shoppers.

37. In the samples that involved risk mismatch, the sales staff generally drew the shoppers' attention to the potential unsuitability before continuing the sales process. However, a few of these sales staff did not properly handle the risk mismatch resulted therefrom and, for example, suggesting the shopper to consider amending the answers to RPQ so as to result in higher risk tolerance level, and/or guiding the shopper to declare willingness to accept higher risk.

38. Mismatch between investment product tenor and shopper's target investment horizon was noted in several samples, where investment products with longer investment tenor or of medium to long-term nature were introduced or recommended to shoppers with short investment horizon. For example, investment funds, which should be regarded as medium to long-term nature, were introduced/recommended to customers with investment horizon as short as one year or below. The sales staff concerned did not highlight to the shopper about the tenor mismatch, and did not provide proper justification why the recommended products were suitable for the shoppers despite the tenor mismatch.

Example 3:

A sales staff told the shopper that she could proceed with the transaction even though there was risk mismatch, as long as the shopper declared that she could accept higher risks despite the lower risk tolerance level. The sales staff failed to explain to the shopper that if there was a risk mismatch, the product might not be suitable for the shopper. On the contrary, the sales staff attempted to hint to the shopper to change the RPQ result or to declare accepting the mismatch, without understanding and considering all the circumstances of the shopper.

<u>Example 4</u>:

The sales staff introduced and recommended two bonds with a maturity period of more than 5 years while the shopper's indicated investment horizon was less than 3 years. The sales staff said that the yield of bonds with longer tenor was higher and the shopper could sell the bonds anytime in the secondary market, but did not adequately explain the risks (e.g. the price of bonds might drop when interest rate rose). Also, the sales staff stressed that the price of one of the recommended bonds would certainly rise within 3 to 5 years.

<u>Insurance Products</u>

<u>Know-Your-Customer ("KYC")</u>

39. AIs should make every reasonable effort to ensure that the long term insurance policy (including non-linked long term insurance ("NLTI") products and Investment-linked Assurance Scheme ("ILAS") products) proposed is suitable to the needs and resources of the potential policyholder as disclosed to the AIs. As such, AIs should seek to obtain adequate information about the customer's circumstances and conduct (i) a Needs Analysis with the customer before introducing or recommending NLTI products; and (ii) a Financial Needs Analysis ("FNA") as well as a RPQ with the customer before introducing or recommending ILAS products.

NLTI products

40. Before determining and proposing a suitable NLTI product to a customer, AIs are expected to collect from the customer relevant information about his/her needs and resources during the KYC process, including:

    (a) customer's need(s)/objective(s) within his/her target timeframe(s);

    (b) liquidity needs;

    (c) retirement plan;

    (d) life protection needs based on evaluation in Needs Analysis as required by HKFI;

    (e) customer's financial information (such as income, liquid assets, expenses, financial liabilities/commitments);

(f) source of funds for premium payment and its sustainability as considered by the customer;

(g) the impact of the customer’s retirement plan on his/her affordability; and

(h) the amounts of funds and the period that the he/she is willing and able to make premium payment.

41. The MSP revealed that in a number of samples involving recommendations on NLTI products, the sales staff did not make reasonable efforts to conduct Needs Analysis with the shoppers before introducing or recommending the NLTI products. In a sample, the sales staff indicated that Needs Analysis was only a new additional service and advised the shopper that he could opt out from the Needs Analysis.

42. Some sales staff orally enquired background information about the shoppers. However, in general the information collected from Needs Analysis and oral enquiry was inadequate for ensuring suitability of the proposed NLTI products, as the sales staff did not request the shoppers to complete the whole set of Needs Analysis, and/or did not ask for adequate information from the shoppers.

43. In a few samples the sales staff suggested the shopper might declare a larger amount of personal assets so as to justify a larger proposed premium for the recommended NLTI plan, or documented incorrect information about the shopper’s circumstances (e.g. target timeframe) on the Needs Analysis document.

ILAS Products

44. To ensure that an ILAS product is suitable for a customer, AIs should collect from each customer relevant information including financial circumstances, investment objectives, investment experience, preferred investment horizon, risk tolerance, purpose of taking up the product, target horizon for insurance policy/ILAS product, and capacity to pay premiums for insurance, etc.

45. The MSP revealed that in a number of samples where ILAS products were introduced or recommended, the sales staff did not conduct RPQ and/or FNA with the shoppers before introducing or recommending the ILAS products.

46. Some sales staff orally enquired about the background information of the shoppers. However, in general the information collected from FNA and oral enquiry was inadequate for suitability assessment, as the sales staff did not request the shoppers to complete the whole set of FNA, and/or did not ask for adequate information from the shoppers.

47. It was noted that in a few samples the sales staff tried to influence the RPQ assessment by telling the shoppers that if the RPQ results were too conservative, there would only be limited investment choices.

Disclosure of product features and risks

48. AIs should properly disclose to customers the nature, key features and risks of insurance products, as well as fees and charges. The disclosure should present balanced views, and be fair and not misleading, so as to help customers to make informed decisions. In particular, AIs should make it clear to the customers at the outset that NLTI products are insurance products while ILAS products are investment-linked insurance products. Any description that disguises the insurance element is misleading and unacceptable.

49. The MSP revealed room for improvement in the disclosure of product features and risks by the sales staff. In some samples the sales staff failed to provide accurate or adequate information about the recommended NLTI products or ILAS products, or did not provide adequate or proper explanation in response to shoppers' enquiries about product features and risks. Examples are highlighted below.

NLTI products

50. It was noted that in several samples the sales staff did not provide an accurate or clear explanation on the nature of the NLTI plans, such as representing that the insurance element of the recommended NLTI plans was complimentary or was so small that it could be disregarded, or representing that the recommended NLTI plans were similar to a deposit.

Example 5:

When the shopper asked whether the recommended NLTI plan was a deposit or an insurance product, the sales staff replied that it could not use the term "time deposit" but conceptually it was the same, and said that there was no insurance element in the NLTI plan.

51. A number of sales staff failed to provide proper explanation in relation to the fees and charges of the recommended NLTI plans, and several sales staff incorrectly stated that there were no fees and charges for the recommended NLTI plans, notwithstanding that in fact part of the premiums was for the insurance and related costs, and there might be other fees and charges (e.g. administration costs) for some NLTI products.

52. A number of sales staff failed to explain adequately the credit risks (including the name of insurance company, the fact that the paid premium would become part of the insurance company's asset and that shoppers would be subject to the credit risk of the insurance company). In several samples, the sales staff made incorrect statements about the credit risk arising from the recommended NLTI plans, for instance, representing that the recommended NLTI plan was risk-free; representing that making premium payment to the insurance company was equivalent to putting the money at the bank; and representing that the bank would pay the death benefit (which in fact should be the insurance company, not the bank as merely an intermediary).

53. In explaining the product features such as guaranteed benefits, projected benefits, cash values, assumptions, and future bonuses and dividend declarations, some sales staff did not provide proper or adequate information. For example, several sales staff mentioned that the future bonuses or dividends were highly certain, or that the current declared rate or the interest rate on accumulated bonuses was already at the lowest level and would probably go up.

54. A few sales staff did not present balanced views and focused only on the good points of the recommended NLTI plans and did not provide adequate explanation of risks involved, and some of the explanations were also inappropriate.

Example 6:

The sales staff emphasized that the return of the recommended NLTI plan was four hundred times better than placing a deposit, but did not adequately explain the key features and risks of the recommended NLTI plan. The sales staff claimed that the current interest rate on the accumulated bonus was at the historical lowest level and would probably rise rather than fall in the future, and told the shopper that if the interest rate doubled, the bonus would be doubled, which was incorrect as the bonus to be declared was decided by the insurance company discretionarily instead of linked to the prevailing interest rate level.

55. In several samples the sales staff did not properly disclose and explain the premium contribution period of the recommended NLTI plans as well as the risks and consequences of exercising premium holiday (e.g. fees and charges would still be deducted during the premium holiday and the policy might lapse if the account value was insufficient to pay the fees and charges).

56. Several sales staff did not properly address the shoppers' queries. For example, a sales staff could not answer the shopper's questions of what if the shopper could not pay the premium during the premium contribution period and whether all paid premium would be lost if the policy lapsed as a result of not paying premium. In

some samples, the sales staff did not accurately explain the cooling-off period for NLTI products.

ILAS Products

57. It was noted that in a few samples the sales staff failed to make it clear to the shoppers the nature of the ILAS products and made ambiguous disclosure about the insurance element.

> **<u>Example 7</u>:**
>
> After knowing that the shopper was looking for return higher than deposit and had moderate risk appetite, the sales staff said that fund investment would be suitable to the shopper, but then started introducing an ILAS product, without touching on any underlying funds throughout the discussion. When the shopper asked whether there was any insurance element in the recommended product, the sales staff gave unclear and inappropriate replies (e.g. the product did not have insurance as the sum assured was so small and therefore was irrelevant; could regard the product as an investment scheme as there were a number of underlying investment funds for choosing; and in response to the shopper's further query, the sales staff still represented that the product was a fund investment).

58. Some sales staff did not adequately explain to the shoppers the credit risk of the ILAS products (including the name of the insurance company, the fact that the premium paid would become part of the insurance company's assets and that the shopper would not have any rights to or ownership of the underlying investment assets, and thus was subject to the credit risk of the insurance company).

59. Also, some sales staff did not adequately explain the fees and charges (including the fees and charges at both the scheme level and the underlying investment asset level; that the return on the ILAS policy as a whole might be lower than the return of the underlying investment assets due to the fees and charges; that part of the fees and charges paid would be used to cover the charges for the life insurance coverage; and that the insurance charges would reduce the amount that could be applied towards investment in the underlying assets). A few sales staff incorrectly stated that insurance charges would only be a small or limited sum, contrary to the fact that the insurance charges might increase significantly during the term of ILAS policy due to factors such as age and investment losses.

60. In a small number of samples the sales staff did not properly disclose and explain the premium contribution period and the risks and consequences of exercising premium holiday (e.g. the value of the ILAS policy might be reduced due to

continuing fees and charges, the entitlement to bonuses might be affected, and the ILAS policy might be terminated and the policyholder might be subject to a surrender penalty if he or she failed to resume making the premium payment).

Example 8:

The sales staff incorrectly regarded the lock-in period as the premium contribution period of the recommended ILAS plan, and did not explain to the shopper that if the shopper did not continue to pay premium after the lock-in period, the shopper would have to apply for premium holiday so as to maintain the policy in effect. Further, when the shopper asked what if she had financial difficulty and was unable to pay premium, the sales staff only said that assuming the shopper had paid 3 years' premium, the shopper was required to keep one-year's premium as account value and could withdraw the balance. The sales staff did not explain that it would be a case of exercising premium holiday, and the consequences.

61. In a few samples the sales staff did not present fair and balanced views in explaining the features and risks of the recommended ILAS products, for example, stressing the free fund switching feature of ILAS products, or failing to explain the longer-term nature of ILAS products.

Example 9:

When the shopper indicated that she would need some time to consider the recommended ILAS plan, the sales staff stressed that the recommended ILAS plan was a plan that the shopper could do investing when she was in good health condition, and was "principal protected" in case of death. The sales staff however did not remind the shopper of the investment risks involved if she wanted to get back the money in her lifetime.

Besides, the sales staff stressed the free fund switching features of ILAS plan, and claimed that it would otherwise cost over 10% per year if the shopper directly switched investment funds a few times in a year. The sales staff however did not remind the shopper of the various other fees and charges of the recommended ILAS plan.

Example 10:

Instead of reminding the shopper about the longer-term nature of ILAS products, the sales staff emphasized that the recommended ILAS plan was flexible and that the shopper could surrender the policy even before the end of premium contribution period with profits earned. This was not appropriate as early surrender might result in losses.

62. The MSP revealed that a number of sales staff did not provide the product documents (i.e. the Product Brochure, Product Key Facts Statement, Investment Choice Brochure and/or illustration document) and/or the HKFI Education Pamphlet "Questions you need to ask before taking out an ILAS product" to the shoppers during the selling process.

Life insurance policy replacement

63. When shoppers enquired about replacing their existing life insurance policies, most sales staff advised the shoppers to re-consider carefully and reminded the shoppers that they might suffer losses if they cancelled their existing policies. Nevertheless, several sales staff failed to do so, or suggested the shoppers to replace their existing insurance policies with the recommended NLTI plans. Further, most of the sales staff did not provide the relevant leaflet "Life Insurance Policy Replacement – What you need to know" of the OCI to the shoppers.

Example 11

The sales staff suggested the shopper to use the recommended NLTI plan to replace his existing life insurance policy. The sales staff commented that the shopper would not get the money back if he was alive as the shopper's existing policy had no saving elements, and the insurance premium of the existing policy would increase with age, while in contrast the recommended NLTI plan had a fixed premium over the policy term. The sales staff added that if the shopper cancelled his existing policy, the lost insurance protection could be replaced by the recommended NLTI plan. The sales staff failed to remind the shopper of the important consequences that could result from policy replacement, and did not provide the shopper with the relevant leaflet "Life Insurance Policy Replacement – What you need to know".

Suitability assessment

64. AIs should have proper policies and procedures and internal controls in place to ensure their sales staff obtain adequate information about the customer's circumstances and assess suitability for the customer based on the nature, features and risks of the insurance products. In general, AIs should not recommend an

insurance product which does not match the customer’s circumstances, or where the customer indicates that he/she does not need or want insurance products.

65. In a number of samples, the sales staff have not collected adequate information of the shoppers for suitability assessment. The sales staff did not demonstrate to have paid due regard to the shoppers’ circumstances in recommending NLTI products and ILAS products.

NLTI products

66. In several samples, the sales staff did not give due regard to the shopper’s needs or objectives. Notwithstanding that those shoppers had indicated that they were interested in investment products but not insurance products, or were assessed as having no life protection needs, the sales staff still introduced or recommended NLTI products.

Example 12:

The shopper only indicated interest in investment product, but the sales staff replied that there was no investment zone in the branch and recommended the shopper to consider NLTI products. The sales staff represented that no risk was involved, which was incorrect given the credit risks of insurance companies. Although the shopper had reiterated that he was not interested in any insurance product after the sales staff’s introduction of the first NLTI product, the sales staff continued to introduce two more NLTI products to the shopper, claiming that those plans had only small portion of insurance elements.

67. Mismatches between the recommended NLTI plan and the shopper’s circumstances (including needs and affordability) were noted in a number of samples. Examples of mismatches include: the premium contribution period of the recommended NLTI plan went beyond the shopper’s indicated period that he/she was willing and able to make premium payment; the NLTI plan’s policy term or time until annuity was distributable has exceeded the customer’s target timeframes; and the premium contribution amount exceeded the amount of funds that the shopper was willing and able to pay. In these samples, it was unclear whether and how the sales staff had taken into account the shopper’s circumstances in the suitability assessment, and the sales staff did not highlight to the shopper the mismatch and that the NLTI plan might not be suitable for him/her.

ILAS Products

68. In a sample, an ILAS plan was recommended despite that the shopper did not indicate any relevant insurance objective (e.g. estate planning). Further, the

disclosure about the insurance element of the recommended ILAS plan made by the sales staff was unclear and ambiguous.

69. Mismatch was noted in several samples where the recommended ILAS plan had a whole-life policy term which was longer than the shopper's target horizon for ILAS products or target investment horizon. The sales staff did not provide justification for the mismatch, and did not highlight to the shopper the mismatch and that the ILAS plan might not be suitable for him/her.

70. Also, affordability issue was noted in a few samples where the total premium payable within the lock-in period or the period before premium holiday could be exercised already accounted for all the disclosed available assets of the shoppers. The sales staff failed to obtain further information from the shopper to ascertain whether the shopper could afford paying the premium in the remaining premium contribution period. AIs should note that in product due diligence, while they should determine the tenor of an ILAS product taking into account the lock-in period among other things, the lock-in period however is not necessarily and should not be automatically taken as equivalent to the tenor and/or the premium contribution period of an ILAS product.

Example 13:

The shopper disclosed to the sales staff his available assets for premium payment. The sales staff recommended an ILAS plan for which the aggregate minimum premium payment within the lock-in period accounted for all of the shopper's disclosed available assets, and the plan had a whole-life premium contribution period. Given that the shopper had retired and there was no sign that he had other regular income sources, the sales staff failed to ascertain that the shopper could afford the premium payment after the lock-in period.

Additional Safeguards for Less Sophisticated Customers

Vulnerable customers

71. AIs should exercise extra care and have enhanced policies and procedures for dealing with vulnerable customers. Among other things, AIs should allow vulnerable customers to choose during the initial transaction whether they would like to (i) bring along a companion to witness the sales process; and/or (ii) have one more frontline staff to handle the sale. The vulnerable customers can choose to have either, neither or both safeguards.

72. During the MSP, 173 samples were conducted by vulnerable shoppers. Some sales staff did not mention any of the additional safeguards for vulnerable customers to the shoppers, whereas some only suggested the shoppers to bring along a companion.

73. There were some samples where information about the shoppers' education level was not collected in both the risk profile assessment and the sales process. As a consequence, the sales staff did not offer the choices of additional safeguards for vulnerable customers to shoppers of low education level.

Pre-investment cooling-off period ("PICOP")

74. In order to provide enhanced protection to retail customers with less sophistication (e.g. elderly and first-time investor), for unlisted structured products, AIs are required to allow the customers at least two calendar days to consider the appropriateness of the proposed investment before placing an order. Where PICOP is applicable, AIs should explain the PICOP arrangement clearly.

75. However, in some samples where PICOP arrangement was applicable, the sales staff did not properly mention the PICOP arrangement to the shoppers.

76. Besides, a few sales staff were not clear about the applicability of PICOP. For example, in a sample, even the products recommended were investment funds, the sales staff, in response to the shopper's enquiry, replied that PICOP was applicable for investors with no investment experience, elderly, risk-mismatched transaction or transaction with asset concentration of over 20%. The explanation was not accurate, as risk-mismatch was not a prerequisite for applying PICOP and PICOP was not applicable to investment funds.

Other Observations

77. The sales staff in general did not impose pressure on or induce the shoppers to make immediate purchase decisions. However, in a small number of samples, the sales staff tried to convince the shoppers to take out the recommended NLTI policies immediately on the grounds that the shoppers could further consider and cancel the policies during the cooling-off period, and/or emphasized that the recommended NLTI products would be sold out soon and urged the shoppers to make decisions immediately.

Example 14:

After the discussion, the shopper requested to leave and to take some time to consider the proposal, but the sales staff claimed that the product documents could not be taken away unless the shopper signed to take out the recommended NLTI plan, and added that the shopper could cancel the policy during cooling-off period and the full amount would be refunded. The shopper felt being pressurised to take out the recommended NLTI plan.

78. This MSP did not note any breach of the restrictions on use of gifts in promoting a specific investment or insurance product imposed by the SFC, the HKMA and the HKFI.

Good selling Practices

79. Some good selling practices were observed during the MSP. For example, several sales staff advised the shoppers not to invest more than a certain percentage of their assets or liquid assets in the particular investment or insurance products, so as to avoid concentration risk and to save for rainy days.

80. In some samples, the sales staff emphasized the long-term nature of insurance products, and reminded the shoppers to ensure that they had sufficient money for the premium payments, having regard to their cash flows, liquidity needs and/or emergency cash needs, before making the decisions.

81. In the samples where the shoppers initiated to change information about their circumstances, the sales staff concerned generally adopted a cautious approach:

    (a) In a sample where the shopper disagreed with the low risk tolerance assessment result, the sales staff explained to the shopper why her investment objective and personal circumstances warrant a lower risk tolerance level.

    (b) In another sample where the shopper initiated to change to a longer target timeframe after the sales staff refused to introduce NLTI products to her, the sales staff asked the shopper to re-consider carefully if a longer target timeframe really suited her circumstances, and reminded the shopper to ensure having sufficient money for the whole contribution period.

    (c) In a sample, the sales staff explained to the shopper that given ILAS product had a longer tenor, and the shopper did not choose insurance as her purpose of taking up the product, ILAS product might not be suitable for her. The sales staff asked the shopper to reconsider carefully. As the shopper insisted and initiated to change for a longer target horizon, the sales staff explained the HKFI Education Pamphlet “Questions you need to ask before taking out an

ILAS product" to the shopper before proceeding to introduce an ILAS product. Moreover, in the second visit, the sales staff re-confirmed with the shopper her interest in ILAS product and reminded the shopper that further analysis on shopper's affordability would be needed if the shopper proceeded to actual application for the ILAS plan.

82. In the samples conducted by vulnerable shoppers, several sales staff refused to introduce or recommend any product in view of the shopper's old age, lack of investment experience and/or low risk tolerance assessment result. A few of them recommended the vulnerable shoppers to choose products with lower risk (e.g. fixed deposit). A small number of sales staff reminded the elderly shoppers not to make hasty decisions.

83. As mentioned above, in answering shopper's enquiries about replacing their existing life insurance policies, most sales staff advised the shoppers to re-consider carefully and reminded the shoppers that they might suffer losses if they cancelled their existing policies.

HKMA's follow-up work and way forward

84. For the cases with deviations from expected standards, the HKMA has already required the individual AIs concerned to examine the root causes (e.g. assessing the reasonableness of sales target and the appropriateness of remuneration system) and take appropriate follow-up actions (such as enhancing training and guidance to staff, branch supervision and other appropriate control measures to ensure staff adherence to regulatory requirements). The HKMA will continue to monitor and ensure that the relevant AIs have put in place proper enhanced measures.

85. The HKMA has taken into account the findings of the MSP in formulating supervisory plans as well as measures for promoting good compliance culture of AIs and their staff. Areas where shortcomings were identified in the MSP are subject to greater scrutiny in the supervisory process. The HKMA will also continue to use MSP as one of the supervisory tools from time to time to test check AIs' sales practices.

86. Regarding the sale of investment products, the HKMA has shared with the banking industry in a circular issued on 30 July 2014 some findings and good practices as identified in this MSP and in the HKMA's on-going supervisory process.

87. As for insurance products, in light of the findings revealed in this MSP and in its on-going supervisory process, the HKMA has also issued a circular today to

provide guidance to the banking industry on expected selling practices for NLTI products. The guidance covers the areas of product due diligence, advertisements, suitability assessment, handling of vulnerable customers, product disclosure and management supervision.

88. While AIs have not been active in selling ILAS products since the second half of 2013, in view of the HKMA's supervisory experience and the findings of the MSP, the HKMA will continue to monitor their sales practices and related controls in respect of ILAS products.

89. In respect of the findings identified in this report, AIs are expected to give due regard to them, and promptly implement appropriate measures to enhance selling process, staff training, compliance monitoring and other relevant internal controls. AIs are also encouraged to adopt the good practices, where applicable, to enhance their sale process and relevant controls, and to achieve the objective of treating customers fairly.

90. Publication of the results of the MSP, including examples as revealed in this exercise, would also help the general public better understand their rights as well as responsibilities when subscribing to wealth management services and products.