

**Report on the Findings of the
Mystery Shopping Programme
on Selling Practices of Authorized Institutions
in respect of Investment and Insurance Products**

Hong Kong Monetary Authority

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I. Executive Summary

1. The Hong Kong Monetary Authority (“HKMA”) engaged a service provider from the second half of 2018 to 2020 to carry out a mystery shopping programme (“MSP”) in respect of the selling practices of investment and insurance products by Authorized Institutions (“AIs”). The key objectives of the 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 investing in wealth management products or taking out insurance policies. The MSP covered a number of areas, including Know-Your-Customer (“KYC”) procedures, disclosure of product features and risks, suitability assessment and implementation of additional safeguards for less sophisticated customers.
2. The MSP covered a total of 352 samples¹ from 20 selected retail banks (“the Banks”). Among the 352 samples conducted for the Banks, 206 samples involved recommendations² on 391 investment products³; 118 samples involved recommendations on 182 non-investment-linked long term insurance (“NLTI”) plans; and 28 samples resulted in no recommendation as the sales staff considered that no products matched the results of the risk profiling questionnaire (“RPQ”) or Financial Needs Analysis (“FNA”) of the mystery shoppers (“shoppers”)⁴ or their personal profiles. Among the samples that involved recommendations, implementation of additional safeguards for less sophisticated customers was tested in 154 samples (of which 68 samples involved applicable Pre-Investment Cooling-off Period (“PICOP”) arrangement⁵).
3. The results of the MSP suggested that the Banks were largely in compliance with

¹ “Sample” in this report refers to an instance where a “shopper” acts as a potential customer to gather information on the sale process of the selected retail bank concerned, and may comprise more than one visit to that bank.

² “Recommendations” in this report include cases where the sales staff introduced or recommended an investment 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.

³ The sales staff introduced or recommended 265 (67.8%) mutual funds/unit trusts, 73 (18.7%) currency-linked instruments, 49 (12.5%) equity-linked instruments and 4 (1.0%) debt securities to the shoppers.

⁴ “Shopper” in this report refers to a person recruited by the service provider to act as a potential customer of the Banks.

⁵ PICOP is applicable to the sale of unlisted structured products and debentures with special features to retail customers with less sophistication (e.g. elderly and first-time investor). Under the PICOP arrangement, AIs should allow the customers at least two 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. For information, such requirement was refined after the fieldwork of the MSP by the HKMA’s circular dated 25 September 2019 on “Investor Protection Measures in respect of Investment, Insurance and Mandatory Provident Fund Products”.

the regulatory requirements, save for certain aspects and some isolated samples. In respect of investment products, the Banks were generally in compliance with the KYC procedures, suitability assessment and implementation of additional safeguards for less sophisticated customers (including PICOP), save for some isolated samples. As for insurance products, the results of the MSP suggested room for improvement in a few areas such as KYC procedures, suitability assessment, and disclosure of product features and risks. The major findings are summarised in the remaining parts of this report.

II. Programme Introduction

Objective

4. To complement the HKMA's supervisory work in relation to the sale of investment and insurance products by AIs, the HKMA engaged a service provider to undertake an MSP as an additional supervisory tool to assess AIs' implementation of the applicable regulatory requirements issued by the HKMA, the Securities and Futures Commissions ("SFC"), the Insurance Authority ("IA") and the Hong Kong Federation of Insurers ("HKFI").

Selection of target branches

5. A total of 351 branches⁶ of 20 retail banks of different sizes that engaged in the sale of investment and/or insurance products were selected for assessment in this MSP.

Methodology

6. Shoppers of various background were assigned to visit the designated branches of the Banks to make enquiries on investment or insurance products.
7. The MSP was mainly for test checking the robustness of the sale process and related controls of AIs, and the shopper may not make any actual investment or take out an insurance policy during the visits. Due to this limitation, any further steps and procedures that would be carried out just before the actual transaction might not be captured in the MSP.

⁶ The 351 branches were covered by a total of 352 samples, of which 347 branches were covered by 1 sample each (i.e. 347 samples); 2 branches were covered by 2 samples each (i.e. 4 samples); and 2 branches were jointly covered by 1 sample.

III. Key Findings in respect of Sale of Investment Products

Know-Your-Customer (“KYC”)

8. 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. AIs should also, as part of the KYC procedures, assess a customer’s knowledge of derivatives and characterise the customer based on his/her knowledge of derivatives. The assessment of a customer’s risk profile should be carried out by non-sales staff.⁷
9. The MSP revealed that prior to product recommendations, most of the bank staff invited the shoppers to complete an RPQ and had the process audio recorded, save for a few samples in which the sales staff briefly introduced investment products without confirming that there was a valid RPQ result for the shoppers.
10. In a few samples, the sales staff tried to influence the shoppers to give specific answers or amend the answers of the RPQs so as to achieve a higher customer risk tolerance assessment result, such that more product choices would be available for the shoppers’ consideration. In one sample, the sales staff suggested the shopper selecting “capital growth” instead of “income orientation” in respect of investment objective, and choosing “less than 3 transactions” when going through the relevant RPQ questions even though the shopper did not have any experience in fund investments. In another sample, the sales staff guided the shopper to provide aggressive answers in the RPQ, in particular about the investment experience. These kinds of behavior undermined the effectiveness of the client profiling for suitability assessment. Most bank staff did not collect information about the customers’ knowledge of derivatives.

Disclosure of Product Features and Risks

11. AIs should properly disclose and explain to customers the key features and risks of 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

⁷ Subject to situations specified in section (A)(III.1) of Annex 1 of the HKMA’s circular dated 25 September 2019 on “Investor Protection Measures in respect of Investment, Insurance and Mandatory Provident Fund Products”.

and downside risks as well. AIs should also ensure that information and explanation made by their staff is fair and not misleading. Sales staff should also avoid over-reliance on product disclosure by sales recap, which may be conducted after the customer has indicated his/her intention or already made a decision to purchase the product (though before execution of transactions).

12. The MSP revealed that some product features, risks and sales related information (e.g. capacity (i.e. the principal/agent) in which the bank was acting, affiliation of the bank with the product issuer and the monetary benefits received by the bank from selling the respective products) of the recommended investment products were not disclosed. For example:

- For investment funds that invest/ may invest in high-yield bonds, sales staff did not explain certain product specific risks (e.g. relatively higher credit risk and higher vulnerability to economic cycles). In addition, when the shoppers asked whether investors could receive high interest income from investing in such funds, most sales staff failed to properly explain that high return was not guaranteed.
- For equity-linked instruments (“ELIs”)/ currency-linked instruments, the disclosures about key product risks (e.g. issuer risk) and sales related information were sometimes omitted.

13. In response to the shoppers’ question as to whether the recommended investment products were safe, a few sales staff presented unbalanced views to the shoppers. For example:

- In a sample, the sales staff represented that investing in fund products was absolutely more secure than in stocks due to relatively lower price volatility.
- In a sample, the sales staff merely stated that the recommended investment fund was secure because of the low product risk rating assigned.
- In a sample, the sales staff comforted the shopper by emphasising the financial strength of the fund houses of two investment funds and stressed that those were all multi-national corporations, and drew the shopper’s attention to the sound track performance record of the funds recommended, without reminding the shopper the potential risks associated with the products.

14. In general, sales staff provided Product Key Facts Statements (“KFS”) and/or

Important Facts Statements (“IFS”), which summarised key features and risks of the products, to the shoppers. Yet, in some samples, the sales staff failed to do so, though most of them provided other product documents such as product leaflets, marketing materials and fund fact sheets to the shoppers.

Suitability Assessment

15. AIs should take reasonable steps to ensure that any investment solicitation or recommendation is suitable for the customer having regard to his/her personal circumstances. In respect of sale of investment funds, soliciting/ recommending customers into frequent switching of investment funds can hardly be justified, especially those making little or no economic sense to the customers. In the suitability assessment, AIs should ensure that due consideration is given to the circumstances of the customers (including investment objective, investment horizon, etc.) as well as the risks of and consequences arising from certain trading pattern (such as transaction costs involved in frequent switching of funds).
16. In general, the sales staff provided recommendations based on the shoppers’ risk tolerance assessment results. In cases where the shoppers asked for risk-mismatched investment products, the sales staff generally drew the shoppers’ attention to the potential unsuitability. However, in one sample, the sales staff proactively recommended a risk-mismatched investment product to the shopper without alerting the shopper of the risk mismatch or providing justifications why the risk-mismatched product was suitable for the shopper.
17. Some samples tested the scenarios where the shoppers showed interest in investment funds (e.g. multi-asset/equity/bond funds) but wished to invest for a very short period of time. More than a half of the sales staff drew the shoppers’ attention to potential unsuitability of short-term investment in funds, as the fees and charges to be incurred from such short-term trading might undermine the shoppers’ investment return, or reminded the shoppers that fund investment was generally suitable for medium-to-long-term investments.
18. However, sales staff in a few samples not only failed to remind the shoppers of the above, but also expressed that such funds were of high liquidity or could be switched frequently to realise the profit. For example, the sales staff in two samples agreed with the shoppers that the funds could be switched frequently, like stock trading, to realise the profit or loss.

Additional Safeguards for Less Sophisticated Customers

Vulnerable Customers (“VCs”)

19. AIs should exercise extra care when dealing with VCs. Among other things, AIs should allow retail banking customers who are VCs to choose during the initial transaction whether they would like to (i) bring along a companion to witness the sale process; and/or (ii) have one more frontline staff member to handle the sale. The VCs can choose to have either, neither or both safeguard(s).
20. In several samples, the sales staff did not properly offer the options of additional safeguards to the shoppers in the course of investment product recommendations.

PICOP

21. In order to provide enhanced protection to retail customers with less sophistication (e.g. elderly and first-time investors with high asset concentration), for unlisted structured products and debentures with special features, AIs are required to allow such 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 clearly⁸.
22. Most of the sales staff properly explained the mechanism of PICOP to the shoppers, and took the initiative to allow the shoppers to have two calendar days to consider the appropriateness of the investment products before placing the orders.
23. A few samples reflected that some sales staff were not familiar with the applicability of the PICOP arrangement (e.g. the sales staff in a sample was not aware that PICOP arrangement was applicable to the shopper who was not an elderly but a first-time buyer with high concentration, until a warning message was prompted by the bank’s internal system). Besides, a few sales staff asked the shoppers to either increase their declared net worth or lower the investment amount in order to avoid the PICOP arrangement. A few sales staff claimed that the banks would not verify the shopper’s self-declared net worth.

Other Observations

24. In terms of the selling techniques, none of the sales staff used high-pressure or

⁸ For information, such requirement was refined after the fieldwork of the MSP by the HKMA’s circular dated 25 September 2019 on “Investor Protection Measures in respect of Investment, Insurance and Mandatory Provident Fund Products”.

unfair techniques to force or entice the shoppers to make the investment decisions.

25. In a sample, after conducting risk profiling and introducing ELIs, when the sales staff noticed that the shopper's intended investment amount would exceed a specific level of his/her net worth, the sales staff said that such transaction could not be processed at the branch, and suggested the shopper conducting the transaction through the online platform, as there was no such constraint on investment amount under the online platform. Such suggestion, with the possible intent of getting around regulatory requirements on suitability assessment and PICOP, might not be in the best interest of the customer.

Good Sales Practices

26. In general, sales staff refused to introduce or recommend risk-mismatched products to the shoppers. For the samples where the shoppers enquired about high-yield bonds, the sales staff advised that such products could only be sold to professional investors according to their banks' policies and thus not suitable for the shoppers. A small number of them suggested the shoppers seeking advice from professionals and/or family members before placing an order.
27. Sales staff generally confirmed with the shoppers whether they understood the features and risks of the recommended investment products before making investment decisions or asked if they have any questions regarding the products. For example, the sales staff in one sample suggested an elderly who did not have any experience of investment funds visit the official websites of the SFC or other relevant organisations to gain more knowledge in investment funds.
28. When shoppers asked if the recommended investment products were safe, most sales staff presented a balanced view to the shoppers, such as stating that the products were not principal-protected and that there were risks associated with the products and price fluctuation.
29. To address some shoppers' concerns about suitability of investment in fund products for a short investment horizon, the sales staff in general provided explanations in a prudent manner. The sales staff explained to the shoppers that taking into account the fees and charges to be incurred in trading of funds, fund products should preferably be treated as medium-to-long term investments.

IV. Key Findings in respect of Sale of Insurance Products

Know-Your-Customer (“KYC”)

30. AIs should ensure that the NLTI plan recommended is suitable for a customer taking into account the customer’s circumstances. To achieve this, AIs should seek to obtain adequate information about the customer’s circumstances, including needs, financial situation, ability and willingness to pay premiums, etc., through a proper FNA process before recommending any NLTI plan.
31. The MSP revealed that some sales staff did not properly conduct FNA with the shoppers before recommending the NLTI plans. Although the sales staff enquired certain background information about the shoppers, the information collected was inadequate for ensuring the suitability of the recommended NLTI plans. In a number of samples, information such as life protection needs, wealth management needs, financial situation, and ability and willingness to pay premiums were not collected or adequately evaluated.
32. In a few samples, the sales staff tried to assert different degrees of influence on the shoppers in an attempt to justify the NLTI plans being recommended.

Suitability Assessment

33. AIs should take reasonable steps to ensure that their sales staff obtain adequate information about the customer’s circumstances and conduct suitability assessment for the customer based on the nature, features and risks of the NLTI plan.
34. The MSP revealed that some sales staff did not collect adequate information from the shoppers for proper suitability assessment, did not alert the shoppers of the mismatch and/or did not explain why the mismatched products were suitable for the shoppers when the recommended products did not match with the circumstances of the shoppers, such as the premium payable exceeding the amount the shoppers indicated as what he/she was willing and able to pay for the premiums. For example, in one sample, while the shopper expressed that he/she would only pay certain amount for annual premium, the sales staff still recommended to the shopper a plan with annual premium which was several times of the shopper’s indicated amount.

Disclosure of Product Features and Risks

35. AIs should have in place adequate policies and procedures to ensure that their sales staff properly disclose and explain the nature as well as key features and risks of the NLTI plans to customers during the selling process, so as to help the customers make informed decisions. The information and explanation provided by sales staff should be fair and not misleading.
36. The MSP revealed that while sales staff provided the shoppers with general information of the recommended NLTI plans, there was room for improvement in disclosure of product features and risks.
37. In some samples, the sales staff did not explain adequately the key risks of NLTI plans such as credit risk; liquidity risk associated with the plans; inflation risk; and consequences of early surrender or early premium discontinuance. In some samples, the sales staff did not disclose and explain to the shoppers that part of the premiums will pay for the insurance and related costs besides contributing to the saving and wealth accumulation aspect of the NLTI plans.
38. In respect of participating plans (i.e. insurance plans that pay non-guaranteed dividends or bonuses to the policyholders), some sales staff did not adequately explain the benefit illustrations of the recommended plans, such as the assumptions of or the possible fluctuations in the non-guaranteed benefits. The customers might not be aware of the specific part of benefits which were non-guaranteed, or might have mistaken expectation on the return of the participating plans. In one sample, the sales staff mentioned to the shopper that while the future bonuses could be higher or lower, the policy must entitle to some bonuses every year and there would not be significant difference from the figures illustrated in the benefit illustration.
39. In respect of annuity insurance which had become increasingly popular in recent years, the MSP revealed that some sales staff did not provide adequate disclosure regarding the salient features and risks of the annuity insurance plans. For example, under an annuity insurance policy, accumulated savings would turn into a stream of income over a period of time. It was important for the customers to understand that the cash value of an annuity policy would be decreasing as annuity payments were being paid out. However, the disclosure and explanation by the sales staff on such feature and the impact on the cash value and/or death benefits of the policy (e.g. at the maturity or termination of the annuity policy the cash value

and/or death benefits might be significantly lower than the total premium paid or even reach zero) was unclear and needed improvements in some samples.

Additional safeguards for VCs

40. AIs should exercise extra care when selling NLTI plans to VCs. Among other things, AIs should allow retail banking customers who are VCs to choose whether they would like to (i) bring along a companion to witness the sale process; and/or (ii) have one more frontline staff member to handle the sale. The VCs can choose to have either, neither or both safeguard(s).
41. In the MSP, some sales staff did not mention the options of additional safeguards available to the VC shoppers.

Policy Replacement

42. Given the long-term nature of life insurance policies, a customer may suffer losses as a result of the financial implications (such as cash value from surrender/lapse may be less than the total premium paid), insurability implications (such as change in insurance coverage), claims eligibility implications (such as restarting the counting of waiting period for suicidal clauses), etc., arising from policy replacement. AIs should put in place adequate policies and procedures and controls in handling insurance transactions with policy replacement. AIs should explain to the customers the definition of policy replacement, and the implications of and risks associated with the policy replacement, so that the customers can make an informed decision.
43. The MSP showed room for improvement when sales staff handled transactions involving policy replacement. For example, when the shoppers enquired about replacing their existing life insurance policies, some sales staff failed to explain the definition of policy replacement, and/or the implications of and risks associated with policy replacement adequately. In one sample, while the shopper expressed difficulty in understanding some items on the Customer Protection Declaration (CPD) form, the sales staff did not provide any further explanation to address the shopper's enquiry, nor did he/she provide the leaflet "Life Insurance Policy Replacement – What you need to know" to the shopper. It was also noted that in some samples the sales staff did not provide such a leaflet to the shoppers as required.

Cooling-off Period

44. Cooling-off period is an important measure to protect policyholders' interest, where the policyholders are given an opportunity to review their newly purchased life insurance policies. AIs should bring to the customer's attention the Specimen Warning Statement⁹ (which among others, aims to draw customers' attention to their right to cancel the policy within the cooling-off period and obtain a refund of any premium paid) in the selling process.
45. In some samples, the sales staff did not disclose and explain adequately the Specimen Warning Statement to the shoppers.

Other Observations

46. In terms of the selling techniques, in a few samples the sales staff tried to convince the shoppers to take out the recommended NLTI plans immediately on the grounds that the shoppers could further consider and cancel the policies during the cooling-off period; or the recommended plans were time-limited offers and the best plan for the shoppers. The shoppers might felt being pressurised to make the insurance purchase.
47. For example, in one sample, the sales staff urged the shopper to purchase on the spot by suggesting the shopper not to bring along his/her family member(s) to join the sale process as intended. The sales staff tried to convince the shopper by stating that the shopper could still cancel the policy during the cooling-off period if his/her family member(s) opposed the purchase later. The sales staff also offered to pretend the signing of documents with the shopper when his/her family member(s) came to the branch next time.

Good Sales Practices

48. Some sales staff advised the shoppers to consider carefully in purchasing a new insurance plan which involved policy replacement and not to make hasty decisions.
49. In one sample, in response to the shopper's enquiry on the availability of premium financing to the recommended plan, the sales staff advised that premium financing should not be a determining factor for product selection but the shopper should

⁹ Refer to footnote 7 of Annex to the HKMA's circular dated 8 December 2014 on "Selling of Non-Linked Long Term Insurance ("NLTI") Products".

consider whether the recommended plan could meet his/her needs.

50. In another sample, when conducting FNA, the sales staff explained to the shopper the wordings in the FNA in detail to ensure that the shopper understood the definitions of those wordings in the FNA (e.g. the meanings of dependents, family income protection needs, inflation rate, return rate).

V. Way Forward

51. The HKMA has started following up with the AIs concerned on the observations of the MSP, and requiring the AIs concerned to take appropriate actions to address the issues identified in the MSP.
52. The HKMA has taken into account the findings of the MSP in formulating the supervisory plans as well as measures for promoting good compliance culture of AIs and their staff. Areas of shortcomings will be subject to greater scrutiny in the supervisory process. The HKMA will continue to monitor the selling practices of AIs in its ongoing supervision.
53. 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.
54. Publication of the results of the MSP would also enable the general public to better understand their rights as well as responsibilities when investing in wealth management products or taking out insurance policies.