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.

<u>Disclosure of Risks Relating to Investment Performance</u>

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.