

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

**A. General**

1. Based on the MSP findings, there was room for improvement in the following areas in respect of the sale of QDAP:
  - know-your-customer procedures and product recommendation; and
  - disclosure and explanation of product features, risks and benefits.
2. In addition, inaccurate explanation of premium levies, improper sales tactics and potential non-compliance regarding use of gifts were also noted in some isolated samples.

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

Financial Needs Analysis (FNA)

3. It is important for insurers and intermediaries to understand their customers and to collect relevant and sufficient information from each customer, through the use of FNA form where appropriate, so that they can properly assess the circumstances of the customer (including needs, financial situation, ability and willingness to pay premiums, etc.) before making any recommendation in respect of a suitable life insurance product for the customer. An FNA form is to facilitate the identification of suitable life insurance product(s) to meet the customer's needs and circumstances.
4. In the MSP, some intermediaries were found to have undermined the KYC and FNA processes. It was observed in a number of samples that the intermediaries did not make reasonable efforts to collect sufficient information through conducting FNA with the shoppers before recommending any life insurance product. Instead, the intermediaries recommended QDAP mostly on the basis of either the product preference of the shoppers or the shoppers' brief background information (e.g. age, budget for premium payments, and expected annuity income period and amount) obtained by the intermediaries before or during the sales process, which was inadequate for ensuring the suitability of the recommendations. In a few samples, the intermediaries even provided the benefit illustrations<sup>3</sup> (BIs) for QDAP prepared solely based on the limited information of the shoppers (e.g. age, gender, income, etc.) for the shoppers' reference in advance of the first meeting with the shoppers.
5. When assessing the ability and willingness of the shoppers to pay insurance premiums, it was noted that some intermediaries did not obtain the information regarding the source of funds and financial situation from the shoppers to assess whether the shoppers

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

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

6. In some instances, despite that the intermediaries invited the shoppers to conduct FNA, they did not clearly explain to the shoppers the purpose of the assessment. A few intermediaries even asked the shoppers to sign on the incomplete FNA forms.
7. While most of the intermediaries did not influence or pressure the shoppers in the FNA process, some intermediaries hinted or even guided the shoppers to answer the FNA forms in such a way that QDAP could be recommended to them. This might potentially result in unsuitable products being recommended to the shoppers.

#### Suitability of Recommendations

8. Intermediaries should have due regard to the relevant information provided by the customers in the FNA process and conduct an appropriate suitability assessment before making any recommendation. Where a mismatch exists (i.e. the life insurance product being recommended does not meet the circumstances of the customer based on the information collected during the FNA process) and the intermediary makes the recommendation despite the mismatch, the intermediary should clearly explain the mismatch to the customer and why (despite the mismatch) the life insurance product is recommended to the customer, and document the details of the explanation.
9. Where FNA was conducted with the shoppers in the MSP, some intermediaries provided recommendations based on the assessment results, which included assessment on each shopper's needs, financial situation, ability and willingness to pay premiums, etc., and gave brief explanations of why the recommended products were suitable for the shoppers. In the samples where two or more life insurance products were recommended, the intermediaries could largely explain the differences among the recommended products and respond to the shoppers' enquiries about which product would be more suitable based on the shoppers' circumstances. However, in some instances the intermediaries did not sufficiently elaborate on why the products were suitable for the shoppers having regard to their circumstances.
10. In the instances where the recommendations involved mismatch, some intermediaries did not draw the shoppers' attention to the mismatch or provide explanations on why such mismatched products were still recommended to them before continuing the sales process. This cast doubts on whether the intermediaries have given sufficient regard to the shoppers' circumstances in recommending the products.

#### Identification of Vulnerable Customers

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

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

12. Customers should be fully apprised of the product features, risks and benefits associated with the life insurance products recommended by intermediaries so that they could make informed decisions. In addition, intermediaries should always present balanced views about the products, including drawing the customers' attention to the disadvantages and downside risks. Intermediaries should ensure that information and explanations provided to the customers are fair and not misleading.
13. It was noted in the MSP that the product disclosure practices and the level of disclosure varied amongst the intermediaries. Nonetheless, the intermediaries in general could mention the basic product features, risks and benefits of QDAP including the eligibility for tax deduction under salaries tax and personal assessment, policy currency, premiums, policy term, annuity payment period, death benefit, amounts of the guaranteed and non-guaranteed benefits, and consequences of full surrender.
14. However, the disclosure and explanation of certain product features, risks and benefits of QDAP were found inadequate in some instances. Examples included internal rates of return, investment-related details of underlying investments, policy on determining future bonus and dividend declaration, assumptions adopted in the preparation of projected non-guaranteed benefits in the BIs, the risk of not being eligible for claiming tax deduction (despite purchase of QDAP), credit risk of the insurer, inflation risk, liquidity risk, and consequences of withdrawal/ partial surrender.
15. The default option for annuity payments of QDAP is cash pay-out whereas some QDAP may allow the policy holders to decide whether to retain the entire or part of the annuity payments in the policy to generate additional interest income (if any) in the future (i.e. accumulation option). It was observed that a number of intermediaries introduced to the shoppers the accumulation option only, or did not inform them the default option for annuity payments was cash pay-out nor the fact that the shoppers could change the annuity payment option anytime without any charges. Also, some intermediaries did not explain the BIs on accumulation option or mention the interest rate for annuity payments under accumulation option was not guaranteed.
16. Isolated samples were noted where a few intermediaries provided incorrect information about QDAP such as QDAP was a savings plan but not a life insurance product, and the guaranteed benefits of QDAP could still be received by the shopper upon winding up of the insurer. Several intermediaries also incorrectly stated that there were no fees and charges for QDAP, notwithstanding that in fact the insurance and related costs are embedded in the premiums paid.
17. It was noted that some intermediaries did not present balanced views and focused only on the good points of QDAP and did not provide adequate or appropriate explanation of risks involved. For instance, some intermediaries did not properly explain the additional high and low return scenarios provided in the BIs showing the variability of the ultimate results of the projected performance of QDAP. Some intermediaries claimed that the actual non-guaranteed benefits of QDAP would not be zero, or would usually be higher than those illustrated in the BIs, or that the insurers had proven track

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

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

#### **D. Other Observations**

19. While most of the intermediaries could advise the shoppers the correct premium amounts required for QDAP and the applicable premium levies, a few samples revealed that the intermediaries claimed that the premium amounts consisted of premium levies and that premium levies were charged by the Government. In fact, premium levies are payable along with premium payments by policy holders of all insurance policies to the IA through the insurers. Besides, premium levies are not premium payments and thus not eligible for tax deduction purpose.
20. Intermediaries generally did not impose pressure on or induce the shoppers to make hasty decisions, save for a few samples where the intermediaries emphasised that the promotion for the recommended QDAP would end soon and urged the shoppers to make decisions immediately.
21. There were some isolated samples where the intermediaries tried to offer cash coupons or festive hampers to the shoppers to induce the shoppers to take out the recommended QDAP, which might not be in compliance with the relevant regulatory requirements.

#### **E. Good Practices**

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