HONG KONG MONETARY AUTHORITY
香港金融管理局

# Mystery Shopping Programme Findings

May 2011

## Executive Summary

1. To complement its regulatory activities, the Hong Kong Monetary Authority (HKMA) engaged the Hong Kong Productivity Council[1] (the "Service Provider") to carry out a mystery shopping exercise (the "Exercise") which focused on the sales practices of retail banks for unlisted securities and futures investment products and structured deposits (collectively "Investment Products"). The Exercise covered four key areas, namely the know-your-client (KYC) process, explanation of product features and disclosure of risks, suitability assessment, and sales practices in respect of vulnerable customers.

2. The Exercise was conducted between July and November 2010, and covered 350 samples[2] from a mix of 20 small, medium and large banks (the "Banks"), which engaged in selling Investment Products to Hong Kong investors through their branches. A report (the "Report") summarising the findings on the sales practices of the Banks is enclosed (see <u>Appendix</u>).

3. The results of the Exercise revealed that the Banks generally had a high level of compliance with the KYC requirement. However, some of the samples revealed areas of potential concern in the sales process, in particular the lack of proper risk disclosure and not clearly providing reasonable justification for investment recommendation.

4. The HKMA has already followed up with the individual banks concerned in respect of the issues revealed in the Exercise. The relevant banks have been required to examine the root causes of the identified issues and to take appropriate corrective actions.

## Key Findings

### <u>Know-Your-Client</u>

5. In order to better understand their customer and to ensure investment suitability, authorized institutions (AIs) should collect from each customer relevant information that includes their financial situation, investment objectives, investment experience, investment knowledge, investment horizon, risk tolerance and education level, etc.

6. The findings of the Exercise revealed that out of the 285 samples where product recommendations were made, the Banks in 264 (92.6%) samples invited the

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[1] This was a joint engagement with the Securities and Futures Commission (SFC).

[2] "Sample" in this paper refers to each instance where a "shopper" acts as a potential customer to gather information on the sales process of a retail bank.

shoppers[3] to complete a risk profile questionnaire (RPQ) before introducing/ recommending the Investment Products. However, in the remaining 21 samples, the Sales Representatives ("Sales Reps") introduced/ recommended the Investment Products before carrying out a risk profile assessment, mostly on the basis of the shoppers' background information (e.g. age, investment objectives/ experience and expected investment return) obtained by Sales Reps during the sales process.

7. In general, the Banks' RPQs were designed to collect customers' information on age, investment objectives, financial situation, investment experience and knowledge, risk tolerance level, etc. For some banks where the RPQs did not collect information on customer's education level and/ or investment objectives, it was noted that the practices of their Sales Reps varied: while some Sales Reps asked the shoppers for the relevant information during the sales process, other Sales Reps did not. In light of this, the HKMA recommends that AIs should collect and document customer's education level and investment objectives in RPQ or some other KYC document in order to ensure proper record and standardized practices of their sales staff.

8. All the Sales Reps across the 20 banks did not influence or pressure the shoppers to answer any questions or change any answers to the RPQ, except for one sample where the Sales Rep suggested the shopper to choose all available answers for a question about investment horizon so as to facilitate account opening for other investment products in the future.

**<u>Explanation of product features and disclosure of risks</u>**

9. In order to help each customer make informed investment decisions, AIs should properly disclose and explain to customers the key features and risks of the investment products. In addition to explaining the benefits of the recommended products, AIs should always present balanced views, drawing their customers' attention to the disadvantages and downside risks as well. AIs should also ensure that the explanations made by their sales staff should be fair and not misleading. Failure to make full and fair disclosure of all material features and risks of the recommended products would affect customer's understanding of the nature of the investments and the risks involved.

10. The Exercise revealed that there was room for improvement in the disclosure of product features and risks by the Sales Reps. The Sales Reps in most samples provided the shoppers with a general description of the risks and features of the recommended Investment Products. However, unsatisfactory practices were

[3] "Shopper" in this paper refers to a person recruited by the Service Provider to act as a potential customer of the bank in question.

found in 5.6% of the samples involving product recommendations, where the Sales Reps failed to provide accurate or adequate information about the features and/ or risks associated with the recommended products (see paragraphs 39 – 44 of the Report).

11. In respect of structured deposits, the Exercise revealed that some Sales Reps did not observe our requirement of disclosing the health-warning statement. In order to enhance the quality of disclosure to retail customers and apply the same principles of the SFC's new Product Key Facts Statement measure, the HKMA has introduced the Important Facts Statement (IFS) requirement for currency-linked and interest rate-linked instruments (including deposits) issued by AIs[4].

12. During the Exercise, it was noted in a few instances where Investment-Linked Assurance Scheme (ILAS) products were offered to the shoppers, Sales Reps failed to clearly explain the insurance nature and the fees and charges of the ILAS product to the shoppers. To enhance investor protection, the HKMA has further enhanced the regulatory requirements for the sales of ILAS products by AIs, including (among others) proper explanation of the nature and risks of ILAS products and ensuring customer suitability[5].

**Suitability assessment**

13. AIs should take all reasonable steps to ensure that any investment recommendation made by sales staff is suitable for the customer having regard to the customer's personal circumstances (such as investment objectives and horizon, investment experience, risk tolerance level and asset concentration, etc) together with the nature and risks of the recommended product. There should be proper controls and procedures in place to ensure that the products recommended by their sales staff are actually suitable for the customer, and are made in the best interests of the customer having regard to the customer's own personal circumstances. The underlying rationale for such product recommendation should be properly justified and documented.

14. The findings of the Exercise revealed that although the Sales Reps generally took into account the risk tolerance assessment results when introducing/ recommending Investment Products, most of them did not take into account all of the shoppers' personal attributes (e.g. investment horizon). It should be noted

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[4] For details of the IFS requirement, please refer to the HKMA circular "Important Facts Statement for Currency-Linked Instruments and Interest Rate-Linked Instruments Issued by Authorized Institutions (AIs)" issued on 18 April 2011.

[5] For details of the enhanced requirements for the sales of ILAS products, please refer to the HKMA circular "Enhanced Regulatory Requirements on Selling of Investment-Linked Assurance Scheme Products" issued on 14 March 2011.

that a mechanical matching of risk rating of customers and products per se might not necessarily satisfy the requirement of suitability obligation.

15. It was noted in a few samples that the Sales Reps introduced/ recommended Investment Products with risk ratings higher than the shoppers' risk tolerance assessment results. These Sales Reps generally selected Investment Products solely based on the shoppers' markets/ product preferences and/ or expected investment return without having sufficient regard to their individual circumstances and highlighting to them the risks involved in investing in the risk mis-matched products. They did not properly explain why these risk mis-matched products were considered suitable for the shoppers, but instead they only told the shoppers that investment in risk mis-matched products required management approval. A few of these Sales Reps even advised the shoppers the justification (that the shoppers might provide to the Banks) for investing in these risk mis-matched products (see paragraphs 46 – 48 of the Report).

**Vulnerable customers**

16. During the Exercise, 144 samples were conducted by vulnerable shoppers[6]. The Exercise revealed that a few banks adopted a cautious approach in handling vulnerable shoppers. In 62 (43.1%) out of these 144 samples, the Sales Reps declined to introduce/ recommend any Investment Products to the vulnerable shoppers either due to unavailability of suitable Investment Products or in view of their vulnerability (old age, low education level and/ or lack of investment experience and knowledge).

17. As mentioned in Paragraph 7 above, there were some samples where the shoppers' education level was not collected in both the risk profile assessment and the sales processes. As a consequence, some Sales Reps were not able to identify that the shoppers were vulnerable due to low education level.

**Good practices**

18. Good sales practices by Sales Reps were also noted during the Exercise (see paragraphs 53-55 of the Report). For example, some Sales Reps proactively reminded the shoppers to avoid being too "aggressive" and watch out for the high investment risks involved. In some samples where the shoppers expressed difficulty in understanding the recommended Investment Products, the Sales Reps further explained the risks and features of the products to the shoppers and advised the shoppers not to make hasty investment decision.

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[6] Vulnerable shoppers refer to (i) elderly shoppers aged 65 or above; or (ii) shoppers whose education level is primary or below and who have low investment experience and low net worth.

**Responses**

19. For the areas and samples that revealed potential non-compliance with the regulatory standards, the HKMA has required the banks concerned to examine the root causes of the identified issues and take appropriate corrective actions. The HKMA will continue to monitor and ensure that the relevant banks have put in place proper measures to address the identified issues. The HKMA will not hesitate to take regulatory actions for repeated material breaches.

20. The HKMA will take into account the findings of the Exercise when formulating supervisory plan and measures. Areas where shortcomings were identified in the Exercise will be subject to greater scrutiny in the supervisory process. The HKMA will also use mystery shopping exercise as one of the regulatory tools from time to time to assess the industry's compliance with the relevant requirements.

21. In order to promote a good compliance culture among AIs, the HKMA will issue a circular to AIs reminding them to give due regard to the issues identified in this Exercise when AIs perform their regular compliance monitoring of the sale processes and provide training to their frontline staff.

**Appendix**

# REPORT ON MYSTERY SHOPPING PROGRAMME FOR THE SALE OF UNLISTED SECURITIES AND FUTURES INVESTMENT PRODUCTS IN HONG KONG

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BANKING SECTOR

May 2011

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# 1. EXECUTIVE SUMMARY

1. A service provider[1] was engaged to carry out a mystery shopping exercise. This report summarizes the findings of the exercise which focused on sales practices for unlisted securities and futures investment products ("Investment Products"). In respect of the banking sector, the scope of Investment Products was expanded to include structured deposits.

2. The exercise was carried out between July and November 2010. During this period, a total of 350 samples[2] were conducted on 20 retail banks ("the banks").

3. The mystery shopping exercise revealed that the banks, to some extent, were in compliance with the regulatory requirements, except for some isolated samples. The banks in general had a high level of compliance with the Know-Your-Client ("KYC") requirement, but there were areas such as risks disclosure and suitability assessments that required further enhancement by the banks. The major findings of this report are summarized in the following paragraphs:

<u>Know-Your-Client</u>

4. In 92.6% of the samples involving product recommendations, the sales representatives ("Sales Reps") invited the shoppers[3] to complete a risk profile questionnaire ("RPQ") before introducing / recommending the Investment Products. However, in the remaining small number of samples, some of the shoppers' attributes (particularly the investment objectives and / or education level) were not collected by the Sales Reps.

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[1] All references to service provider in this report refer to us – Hong Kong Productivity Council

[2] "Sample" in this report refers to each instance where a "shopper" acts as a potential customer to gather information on the sales process of a retail bank

[3] "Shopper" in this report refers to a person recruited by the service provider to act as a potential customer of the bank in question

5. With the exception of one sample, the Sales Reps properly collected information from the shopper. In the exceptional sample, the Sales Rep suggested the shopper to choose all available answers for a question about investment horizon in order to facilitate opening of investment accounts for various products in the future.

<u>Explanation of product features and disclosure of risks by the Sales Reps</u>

6. Sales Reps generally recommended the shoppers to invest in mutual funds (mainly those with the underlying investment being equities or bonds). In some samples, structured deposits (mostly currency-linked) or debt securities (mostly renminbi bonds) were recommended to the shoppers.

7. Most Sales Reps provided the shoppers with a general description of the risks and features of the recommended Investment Products. However, in 5.6% of the samples, the Sales Reps did not provide sufficient or accurate information about the features and / or risks of the products to the shoppers.

8. For structured deposits, the Sales Reps generally disclosed the nature, basic features and major risks and explained that the structured deposits were not principal-protected. Some Sales Reps did not highlight to the shoppers that the structured deposits were not equivalent to time deposits. In particular, most Sales Reps did not draw the shoppers' attention to the "health-warning" statement[4].

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[4] The "health-warning" statement: "This is a structured product involving derivatives. The investment decision is yours but you should not invest in the [product name / type] unless the intermediary who sells it to you has explained to you that the product is suitable for you having regard to your financial situation, investment experience and investment objectives".

Suitability assessment

9. In 285 (81.4%) out of the 350 samples, the Sales Reps introduced / recommended Investment Products to the shoppers. For the remaining 65 (18.6%) samples, the Sales Reps refrained from introducing / recommending any Investment Products to the shoppers if they were vulnerable shoppers[5] or if suitable Investment Products were unavailable.

10. Most Sales Reps introduced / recommended the Investment Products mainly based on the shoppers' risk tolerance assessment results and did not take into account all the relevant personal circumstances of the shoppers (e.g. investment horizon).

11. Some Sales Reps did not perform proper suitability assessment and introduced / recommended the Investment Products solely based on the shoppers' markets preferences and expected return without having sufficient regard to the shoppers' personal circumstances. These Sales Reps usually did not provide proper justifications for the suitability of the recommended products.

Vulnerable customers

12. In a number of samples involving product recommendations for vulnerable shoppers, the Sales Reps did not introduce another Sales Rep to the shoppers and / or invite the shoppers to bring along witnesses to help ensure that they understood the product features and risks.

Good practices

13. Good sales practices by the Sales Reps were also noted during this exercise. A few Sales Reps proactively reminded the shoppers to avoid being too "aggressive" and watch out for the high investment risks involved, as well as advised the shoppers not to make hasty investment decisions.

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[5] Vulnerable shoppers refer to (i) elderly shoppers aged 65 or above; or (ii) shoppers whose education level is primary or below and who have low investment experience and low net worth.

# 2. PROGRAMME INTRODUCTION

## 2.1 BACKGROUND AND OBJECTIVE

14. In their respective reports to the Financial Secretary in December 2008 on issues arising from the Lehman Minibonds incident, both the HKMA and the Securities and Futures Commission (SFC) (described together as "the Regulators") recommended the introduction of a Mystery Shopping Programme ("MSP"). These recommendations were made with the intent of enhancing the existing regulatory framework by providing an additional supervisory tool to oversee the practices of regulated entities selling investment products in Hong Kong.

15. The Regulators have jointly engaged a service provider to assist them in implementing the MSP covering the sale of unlisted securities and futures investment products ("Investment Products") in Hong Kong.

16. In respect of the banking sector, taking into account the popularity of structured deposits (e.g. currency-linked deposits and interest rate-linked deposits) among retail customers, the scope of Investment Products under the MSP was expanded to include structured deposits as well.

17. The MSP complements the Regulators' regulatory activities by helping to assess whether the Sales Reps are complying with the applicable rules and regulations when selling Investment Products to investors in Hong Kong.

## 2.2 SELECTION OF TARGET BANKS

18. In order to better gauge the prevailing market practices, the HKMA selected a mix of small, medium and large banks which engaged in selling Investment Products to Hong Kong investors through their branches. A total of 341 retail branches of 20 banks were selected as target samples.

## 2.3 FIELDWORK ARRANGEMENT

19. The fieldwork was carried out between July and November 2010.

## 2.4 METHODOLOGY

20. The MSP focused on three key areas, namely the KYC process, explanation of product features and disclosure of risks, and suitability assessment. For the banking sector, the MSP also covered sales practices in respect of vulnerable customers.

21. Shoppers acting as potential customers were deployed throughout the MSP exercise to visit and assess the banks. The shoppers used their real personal particulars (including name, age and address). The service provider provided training to the shoppers on product information, securities regulation, sales practices of retail banks, and how to complete the shopper questionnaire.

22. A shopper questionnaire was designed by the Regulators to document the shoppers' experiences during their visits to the banks. Each shopper was required to complete and submit the questionnaire to the service provider after the visit.

23. Specific instructions were provided to the shoppers on how to approach the banks and act during the customer interview. In this regard, the shoppers were asked to express interest in Investment Products and have face-to-face meetings with the Sales Reps. However, the shoppers were not required to make any actual investments. The shoppers would record what happened during the meetings, complete the questionnaires and collect any materials provided by the Sales Reps.

24. During the mystery shopping exercise, the service provider carried out quality control tests and checked all completed questionnaires against the relevant records to ensure the completeness and accuracy of the questionnaires.

## 2.5 PROFILES OF SHOPPERS

25. The MSP covered shoppers with different attributes, for example:

    (a) Age: young adult, middle aged or the elderly (aged 65 or above);

    (b) Risk appetite: high, medium or low;

    (c) Financial net worth: ranging from low net worth (less than HKD 500,000) to high net worth (more than HKD 2,000,000);

    (d) Educational background: illiterate, primary education to tertiary education level; and

    (e) Investment experience: from no investment experience to more than 5 years of investment experience.

# 3. FINDINGS

## 3.1 GENERAL

26. In 348 (99.4%) out of the 350 samples, it was observed that the product sales process was conducted in the designated “investment corner”, which was physically segregated from the ordinary banking business area. For the other two samples, the shoppers observed that the product sales process was conducted either in the bank’s customer service corner or in the branch manager’s room outside the “investment corner”.

27. In 17 (4.9%) out of the 350 samples, the Sales Reps of a few banks requested the shoppers to sign off a consent form to allow the banks’ sales staff to access and utilize the shoppers’ deposit information for investment and wealth management purpose even though the shoppers did not have any deposit account with the banks.

28. Out of the 350 samples, the Sales Reps recommended Investment Products to the shoppers in 285 samples (81.4%). For the remaining 65 (18.6%) samples, most Sales Reps either (i) refused to provide investment services to the vulnerable shoppers in view of their old age, low education level and / or lack of investment experience; or (ii) refused to introduce / recommend any Investment Products to the vulnerable shoppers due to unavailability of suitable products after taking into account the shoppers’ low risk tolerance assessment results.

29. The sales practice of a few banks was found to be different across their Sales Reps. Some Sales Reps required the shoppers to open a bank account before conducting risk profile assessment and introducing / recommending Investment Products. In respect of the risk profile assessment process, the Sales Rep might either (i) invite the shopper to conduct the risk profile assessment by a non-sales staff or via a calling centre with audio-recording; (ii) conduct the risk profile assessment for the shopper without audio-recording; (iii) invite the shopper to conduct the risk profile assessment by himself without audio-recording; or (iv)

not invite the shopper to conduct the risk profile assessment at all before product recommendations. The lack of uniformity of sales practices may cause operational difficulty for sales compliance monitoring.

# 3.2 KNOW-YOUR-CLIENT

**General Observations**

30. In 264 (92.6%) out of the 285 samples involving product recommendations, the Sales Reps invited the shoppers to complete an RPQ before introducing / recommending the Investment Products. It was found that in 11 banks, all the shoppers were invited to complete an RPQ before the Sales Reps introduced / recommended Investment Products. Figure 1 shows the number of samples where risk profile assessment was not conducted before product recommendation.

**Figure 1: Number of samples where risk profile assessment was NOT conducted before product recommendation**

| **No. of samples where risk profile assessment was NOT conducted before product recommendation** | **No. of banks** |
|---|---|
| Nil | 11 |
| 1 | 3 |
| 2 | 3 |
| 3 | 1 |
| 4 | 1 |
| 5 | 1 |
| **Total no. of samples where risk profile assessment was NOT conducted before product recommendation** | **Total no. of banks involved** |
| 21 | 9 |

Base: 285 samples involving product recommendations

31. In general, the banks' RPQs contained questions which were aimed at collecting customers' information on their age, investment objectives, investment horizon, financial situation, investment experience and knowledge, as well as risk tolerance level. For some banks where the RPQs did not collect information on customer's education level and / or investment objectives, it was noted that the practices of their Sales Reps varied: while some Sales Reps asked the shoppers for the relevant information during the sales process, other Sales Reps did not.

32. In 262 (96.0%) out of the 273 samples where RPQs were completed and product recommendations were involved, the risk profile assessment processes were audio-recorded, except that some Sales Reps of seven banks conducted the risk profile assessments for the shoppers without audio-recording. These Sales Reps usually indicated to the shoppers that a risk profile assessment by a non-sales staff with audio-recording would only be conducted upon product purchase. Nevertheless, the Sales Reps confirmed the risk tolerance assessment results with the shoppers in all these 273 samples.

33. The Sales Reps across the 20 banks generally provided a copy of the RPQ to the shoppers, except for a few isolated samples of nine banks and for some branches of a bank with a usual practice of destroying the RPQ record before the shoppers left the branch premises so long as the shoppers were not the bank's customers. Therefore, a copy of the RPQ was not provided to the shoppers for the latter case.

**Other Observations**

34. With the exception of one sample (see Example 1 below), it was observed that all the Sales Reps across the 20 banks did not influence or pressure the shoppers to answer any questions or change any answers to the RPQ.

> **Example 1:**
>
> After knowing that the shopper was interested in investing in funds with higher returns, the bank staff appeared to have exerted undue influence on the shopper in answering the question of investment horizon in the RPQ. In order to facilitate account opening for other investment products (e.g. stocks and currency-linked products) in future, the bank staff suggested the shopper to choose all available answers for a question about investment horizon.

## 3.3 Explanation of Product Features and Disclosure of Risks

**General Observations**

35. In the 285 samples involving 659 product recommendations, the Sales Reps introduced / recommended 561 (85.1%) mutual funds (mainly those with the underlying investment in equities or bonds) to the shoppers. 84 structured deposits (12.7%) and 11 debt securities (1.7%) were recommended in the other samples.

36. In respect of mutual funds, the Sales Reps in general disclosed the funds' basic information (e.g. the region of investment and the nature of the underlying assets), their historical performance as well as the relevant fees and charges. However, in 5.6% of the samples, the Sales Reps did not provide sufficient or accurate information about the features and / or risks of the products to the shoppers.

37. In respect of structured deposits (mostly currency-linked), the Sales Reps in general disclosed the nature, basic features and major risks of the structured deposits. However, in some samples, the Sales Reps did not highlight and explain to the shoppers the lock-in feature as well as the termination conditions relating to the structured deposits. The Sales Reps generally drew to the shoppers' attention and explained that the structured deposits were not principal-protected, but some Sales Reps did not highlight to the shoppers that the structured deposits were not equivalent to time deposits. In particular, most Sales Reps did not draw the shoppers' attention to the "health-warning" statement.

38. In respect of debt securities (mostly renminbi bonds), the Sales Reps in general disclosed the nature, features and major risks involved, but some of them did not explain the features of lock-in period and termination conditions.

**Other Observations**

39. In 5.6% of the samples, the Sales Reps did not provide proper and adequate information about the features and / or risks of the recommended Investment Products to the shoppers to help shoppers make informed investment decisions. The following examples highlight the deficiencies noted.

Provision of inaccurate information about recommended products

40. In one sample, the Sales Rep indicated to the shopper that the recommended equity-linked deposit required the shopper to receive the underlying equity (i.e. physical delivery) if the final price fell below 95% of the strike price, but in fact it was 100% capital-protected and would be settled in cash only.

41. In one sample, the Sales Rep indicated to the shopper that the quoted return was on a monthly basis, but in fact it was an annual return. In a few other samples, the Sales Reps told the shoppers that the mutual funds were issued by the bank, but in fact they were issued by the bank's related company.

42. During the mystery shopping exercise, we noted a few instances where Investment-Linked Assurance Scheme ("ILAS") products were offered to the shoppers. Some of these Sales Reps did not clearly explain to the shoppers whether the recommended Investment Products were mutual funds or underlying funds of an ILAS product, which was a life insurance policy.

**Example 2:**

Due to unclear explanation by the Sales Rep, it was difficult for the shopper to understand whether the recommended Investment Product was a mutual fund or an underlying fund of an ILAS. On one hand, the Sales Rep provided an ILAS product brochure to the shopper, which included the recommended product as one of the underlying funds available for investors to choose for such ILAS product, but did not disclose the “insurance” nature (if any) of the recommended product throughout the sales process. On the other hand, the Sales Rep indicated to the shopper that the recommended product could be redeemed and turned into cash anytime. If the recommended product was an ILAS product, such description was not appropriate given the high penalty fees during its lock-in period. In fact, the Sales Rep did not mention the fees and charges in the sales process.

Inadequate disclosure of the recommended products

43. Some Sales Reps did not present balanced views and focused only on good points (e.g. good historical performance and popularity among investors) without drawing the shoppers’ attention to the disadvantages and downside risks of the recommended Investment Products (see below for an example).

**Example 3:**

The Sales Rep failed to draw the shopper’s attention to the disadvantages and downside risks of the recommended mutual fund. Throughout the sales process, the Sales Rep merely focused on the advantages of investing into the fund and repeatedly represented that the fund outperformed the Hang Seng Index over the past years. The investment risks involved were not mentioned.

44. A Sales Rep (see Example 4 below) failed to provide adequate disclosure and explanation about the product features and risks of a mutual fund to a shopper.

**Example 4:**

The Sales Rep disclosed to the shopper the 3-year lock-in period, the guaranteed coupon for the first year and the coupons for each of the remaining two years would be based on the performance of 2823.HK (i.e. A50 China Index ETF). However, the Sales Rep did not mention to the shopper the underlying constituents of the fund (including a swap arrangement and the corresponding counterparty default risk), and the risks of investing in China A-share market (including the synthetic nature of the A50 China Index ETF).

The Sales Rep also did not explain to the shopper how the potential coupons for the second and the third years of the investment period would be linked to the performance of 2823.HK (i.e. the coupon calculation mechanism).

## 3.4 SUITABILITY ASSESSMENT

**General Observations**

45. For the samples where the RPQs were completed with an overall client risk rating and product recommendations were involved, most Sales Reps introduced / recommended the Investment Products mainly based on the shoppers' risk tolerance assessment results and did not take into account all of the shoppers' personal attributes (e.g. investment horizon). Nevertheless, all these samples did not involve risk mis-matched products.

46. There were a few samples where the Sales Reps introduced / recommended Investment Products with risk ratings higher than the shoppers' risk tolerance assessment results. These Sales Reps generally selected Investment Products solely based on the shoppers' markets / products preferences and / or expected investment return without having sufficient regard to their risk tolerance assessment results as well as highlighting to them the risks involved in investing in the risk mis-matched products and the potential unsuitability.

47. As mentioned in Section 3.2, there were 21 samples (7.4%) of 9 banks where the Sales Reps introduced / recommended the Investment Products before carrying out a risk profile assessment. Instead of inviting these shoppers to complete an RPQ, these Sales Reps usually introduced / recommended the Investment Products either based on (i) shoppers' background information (e.g. investment objectives, investment experience and / or expected investment return); or (ii) the popularity and performance of the products and / or the lower level of risk involved in the bond funds or RMB bonds.

48. Among these 21 samples, a few Sales Reps subsequently invited the shoppers to conduct an RPQ and found that the products recommended earlier involved a risk mis-match. However, these Sales Reps did not recommend other Investment Products to the shoppers with due regard to the RPQ assessment results. Instead, the Sales Reps only told the shoppers that investment in risk mis-matched products required management approval and advised the shoppers

the justification (that the shoppers might provide to the banks) for investing in these risk mis-matched products. The Sales Reps did not draw the shoppers' attention to the risks involved in investing in the risk mis-matched products and explain why these risk mis-matched products were considered suitable for the shoppers (see below for examples).

**Example 5:**

Based on the shopper's previous investment experiences, the Sales Rep recommended two Investment Products before carrying out a risk profile assessment. The risk profile assessment was subsequently conducted. Upon the shopper's enquiry for the risk ratings of the recommended products, the Sales Rep replied that she had joined the bank for 3 months and was not familiar with the bank's system, so she could not retrieve from the system the risk ratings of the recommended products. The Sales Rep then indicated to the shopper that "it does not matter even if your risk tolerance assessment result does not match with the product risk rating, as you would just need to sign-off a risk mis-match acknowledgement afterwards. The most important thing is the performance of the product. Let me show you the performance record.". The rationale for recommending the two Investment Products was not explained.

**Example 6:**

After knowing the shopper's expected investment horizon of 3 to 5 years, the Sales Rep recommended two mutual funds (with underlying investments in China market) with product risk ratings of "5" to the shopper before carrying out a client risk profile assessment. Risk profile assessment was subsequently conducted and the resultant client risk tolerance level was "4", which was lower than the risk rating of the two recommended funds (i.e. risk mis-matched products). The Sales Rep only indicated to the shopper that the recommended funds were of higher risks than her risk tolerance assessment result but did not explain the rationale underlying the investment recommendation. Instead, the Sales Rep advised the shopper that the justification (that the shopper may provide to the bank) for investing in the higher risk products could be: "You understand that the China market is volatile but it is your preference".

Given that the shopper did not indicate her preferred investment / market (e.g. China market) to the Sales Rep, the basis for the Sales Rep's recommendation of the two funds was questionable.

**Example 7:**

The shopper indicated that she was not interested in insurance products. However, the Sales Rep introduced / recommended two mutual funds with the highest product risk rating underlying an ILAS product to the shopper, taking into account the shopper's expected investment horizon of 3 years and expected annual investment return of 10%. The Sales Rep neither invited the shopper to carry out a client risk profile assessment nor mentioned the "insurance" nature of the recommended ILAS during the sales process. The basis for the Sales Rep's recommendation was questionable. Further, the Sales Reps did not present balanced views and mainly focused on the advantages and good performance of the recommended funds underlying the ILAS product.

## Other Observations

49. For a few banks adopting the “portfolio” wealth management approach and introduced / recommended the risk mis-matched Investment Products to the shoppers, the Sales Reps in some samples did not draw the shoppers’ attention to the risk mis-match and did not advise the shoppers to avoid concentration in the recommended higher risk product(s).

## 3.5 VULNERABLE CUSTOMERS

50. Among the 350 samples, 144 (41.1%) samples of the 20 banks were conducted by the vulnerable shoppers. Out of these 144 samples, 62 (43.1%) samples of 18 banks did not involve product recommendations as the Sales Reps declined to introduce / recommend any Investment Products to the vulnerable shoppers either due to unavailability of suitable Investment Products or in view of their old age, education level and / or lack of investment experience and knowledge.

51. Out of the remaining 82 (56.9%) samples involving product recommendations to the vulnerable shoppers, there were a number of samples where the Sales Reps did not introduce another Sales Rep to the shoppers and / or invite the shoppers to bring along witnesses to confirm the shoppers' understanding of the product risks and features.

52. Some Sales Reps were not able to identify that the relevant shoppers were vulnerable (with low education level) because the shoppers' education level was neither collected in the RPQ nor otherwise enquired by the Sales Reps throughout the sales process.

# 4. GOOD PRACTICES

53. Good sales practices by Sales Reps were also noted during this exercise. Sales Reps in general did not introduce / recommend Investment Products of risk ratings higher than the shoppers' risk tolerance assessment results and / or of risk return profile that did not match with the shoppers' investment objectives, investment horizon and investment experiences, etc. In samples where the shoppers requested for some Investment Products that were either of risk ratings higher than the shopper's risk tolerance or assessed to be not suitable for the shoppers by the Sales Reps, the respective Sales Rep highlighted to the particular shopper the following:

    (a) The requested products were of higher risk rating than his / her risk tolerance assessment result and drew to the shopper's attention that the products might not be suitable for him / her in view of the risk mis-match;

    (b) if the shopper decided on his / her own volition to invest in the product, the shopper should ensure that he / she has sufficient net worth to assume the risks and bear the potential losses of trading in these higher risk products;

    (c) the shopper was required to provide adequate justification for his / her choice of the products and to sign his / her acknowledgement of the risk mis-match; and

    (d) the relevant risk mis-matched sales transaction would have to be subject to management approval.

54. In some samples where the shoppers expressed difficulty in understanding the recommended Investment Products, the Sales Reps further explained the risks and features of the products with the relevant product leaflets to the shoppers and advised the shoppers not to make hasty investment decision.

55. In samples conducted by the elderly shoppers, some Sales Reps proactively reminded the shoppers to watch out for the high investment risks involved and not to be too "aggressive" even though the shoppers were assessed with the highest risk tolerance after conducting the client risk profiling.

# 5. WAY FORWARD

56. The SFC has already set out the requirements governing sales practices in the Code of Conduct[6], Internal Control Guidelines[7] and the Suitability FAQs[8]. The HKMA has also issued circulars to banks on supplementary requirements. The HKMA may wish to consider reminding the banks to put in place proper controls and procedures to ensure compliance with the relevant regulatory requirements regarding the selling of Investment Products to investors in Hong Kong.

57. In particular, banks should be reminded to provide their customers with enough relevant information to make informed investment decisions. Such information would include providing customers with an accurate explanation of product features and risks. Banks should also carry out proper suitability assessments and provide regular training to their sales staff so as to equip them with regularly updated and complete information about the Investment Products they sell and the relevant regulatory guidelines and requirements. Furthermore, banks should perform effective monitoring of the sales process.

58. Regarding the examples and areas of potential non-compliance that have been highlighted in this report, the HKMA may wish to follow up these with the banks concerned and require the banks in question to take appropriate action to address the issues noted.

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[6] Code of Conduct for Persons Licensed by or Registered with the SFC

[7] Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC

[8] Questions and Answers on Suitability Obligations

59. The HKMA is advised to take into account the experiences and observations gained in this exercise when designing similar mystery shopping programmes in the future.