



Selling practices of authorized institutions in respect of investment and insurance products

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Background

On 30 September 2020, the Hong Kong Monetary Authority (“HKMA”) published a report on the findings of a mystery shopping programme (“MSP”) under which the selling practices in respect of investment and insurance products of 20 selected banks were covered. Based on the results of the MSP, apart from a few isolated samples, the banks were generally in compliance with the Know-Your-Customer (“KYC”) procedures, suitability assessment and implementation of additional safeguards for less sophisticated customers (including pre-investment cooling-off period) in respect of the sale of investment products. However, with regards to the sale of insurance products, whilst the banks generally complied with the relevant requirements, there was room for improvement in

a few areas including KYC procedures, suitability assessment, and disclosure of product features and risks. The HKMA also issued a circular on 20 October 2020 (the “Circular”) regarding its requirements of life insurance policy replacement.

The HKMA has indicated that it will take into account the findings of the MSP in formulating its supervisory plans. Therefore, not only were the 20 selected banks required to take follow-up actions with respect to the specific findings in the MSP, other institutions are also expected to improve the quality of their selling practices, in particular those pertaining to the selling of insurance products in accordance with the regulatory requirements and expectations as set out in the Report and the Circular.

In this regard, this document sets out the key findings from the MSP with respect to the selling of insurance products and the relevant regulatory requirements/expectations that banks are expected to comply with and follow.

Key findings in respect of sale of insurance products

A. Know-your-customer

Key findings in the MSP:

- some sales staff did not properly conduct Financial Needs Analysis (“FNA”) before recommending some non-investment-linked long term insurance (“NLTI”) plans to the customers.
- information collected from customers was inadequate for ensuring the suitability of the recommended NLTI plans, e.g. information such as life protection needs, wealth management needs, financial situation, and ability and willingness to pay premiums were not collected or adequately evaluated.

Regulatory requirements:

Authorized Institutions (“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.

B. Suitability assessment

Key findings in the MSP:

- some sales staff did not collect adequate information from customers for proper suitability assessment.

- some sales staff did not alert customers of a mismatch and/or did not explain why mismatched products were suitable when the recommended products did not match with the circumstances of the customers.

Regulatory requirements:

Als 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.

C. Disclosure of product features and risks

Key findings in the MSP:

- some 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.
- some sales staff did not disclose and explain to the customers 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.
- 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.
- in respect of annuity insurance, some sales staff did not provide adequate

disclosure regarding the salient features and risks of the annuity insurance plans.

Regulatory requirements:

Als 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.

D. Additional safeguards for vulnerable customers ("VCs")

Key finding in the MSP:

- some sales staff did not mention the options of additional safeguards available to the VCs.

Regulatory requirements:

Als should exercise extra care when selling NLTI plans to VCs. Among other things, Als 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).

E. Policy replacement

Key finding in the MSP:

- some sales staff failed to explain the definition of policy replacement, and/or the implications of and risks associated with policy replacement adequately when the customers enquired about replacing their existing life insurance policies.

Regulatory requirements:

Given the long-term nature of life insurance policies, a customer may suffer losses as a result of the financial implications (such as the cash value from surrender/lapse may be less than the total premium paid), insurability implications (such as a change in insurance coverage), claims eligibility implications (such as restarting the counting of waiting period for suicide clauses), etc., arising from policy replacement.

Als should put in place adequate policies and procedures and controls in handling insurance transactions involving policy replacement. Als should explain to customers the definition of policy replacement, and the implications of and risks associated with the policy replacement, so that customers can make an informed decision. As required under the Circular, Als are expected to take all reasonable steps to identify policy replacement at the point of sale, and conduct monitoring on policy replacement after the point of sale. Als are also required to assess and provide advice to the customer on whether the proposed purchase of a new life insurance policy is in the customer's best interests, taking account of the potential implications and adverse consequences to the customer arising from the policy replacement.

F. Cooling-off period**Key finding in the MSP:**

- some sales staff did not disclose and explain adequately the Specimen Warning Statement to customers.

Regulatory requirements:

Cooling-off period is an important measure to protect policyholders' interests, where the policyholders are given an opportunity to review their newly purchased life insurance policies. Als should bring to the customers' attention the Specimen Warning Statement (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.

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At Mazars, we have extensive experience working with the diversity of Financial Services players. We assist central banks, national regulators, major financial institutions and small and mid-size entities in dealing with the implementation of complex projects with multiple impacts, domestic and international.

Depending on the scope, coverage and specifics of your needs, our services with regard to investment / insurance product suitability would typically involve one or more of the following:

A. Regulatory reviews and advice

- I. Review and provide advice on your institution's:
 - policies and procedures,
 - product disclosure mechanism and controls,
 - frameworks, and/or
 - operational capabilities.
- II. Provide observations and recommendations to assist you in complying with regulators' expectations and common industry practice.
- III. Provide pre-inspection advice or reviews.

B. Design and implementation of policies and procedures

- I. Assist in designing and implementing enhancements to policies and procedures, governance frameworks, and suitability procedures.
- II. Assist in designing and implementing the processes and controls for sales of investment or insurance products.

C. Training and insights

- I. Providing targeted training specific to your institution's unique product offerings, sales activities, and frameworks.
- II. Provide ongoing insights into how peer firms are dealing with the regulatory requirements and any common challenges encountered along the way.

We are flexible in our approach and offerings. Please feel free to contact us with any enquiries.

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