17th of December 2021

Target Market Determinations ("TMD") What are they?

From October 5th, 2021, the Australian Securities and Investment Commission (ASIC) has introduced new laws that affect issuers and distributors of financial products. For the insurance industry, this means that there are broad implications for both underwriters and brokers to ensure that their fiduciary duty to the client is upheld. The changes have come as a result of the findings from the Hayne Royal Commission into Financial Services. With widespread regulatory reform across the whole industry, the insurance industry has stood out as a particularly unregulated sector.

As a result, amendments to the Corporations Act as well as the creation of Regulatory Guide 274 (RG 274) have brought more stringent regulation sector wide. The previous Duty of Disclosure has been replaced by a Duty to Answer Honestly as well as the financial service provider's obligation to conduct a proper *Target Market Determination for retail Insurance products*. This article is designed to provide you, as either an underwriter or broker, another insight into what TMD's are and what your obligations are in respect of TMD's.

What is a TMD?

A TMD is product specific documentation that outline the characteristics of consumers that are likely to be in the target market for the product. This means that for each specific product, the hypothetical client's objectives, financial situation, and needs must be understood and the broker must take reasonable steps to assess whether the client fits the description outlined for the particular insurance policy. The TMD only affects retail clients, so the products for which TMDs need to be written include home and contents insurance, landlords insurance, motor vehicle insurance, travel insurance, credit insurance, life insurance and personal property insurance.

Who writes TMDs?

As outlined in RG 274, it is the responsibility of the issuer (in the case of insurance, the underwriter) to create the TMD document. Whilst the distributor (in the case of insurance, the broker) is not required to create their own TMD, they must take reasonable steps to properly distribute the insurance policy to the correct class of consumers. These TMD documents, as along with the necessary Design and Distribution Obligation Policy, are necessary to avoid compliance scrutiny and regulations. Naturally, Guildfords can assist to prepare the DDO policy for you.

Requirements of TMDs

RG 274 states that the TMD must be in writing, describe the class of consumers that comprise the target market for the product, specify any distribution conditions, review triggers, review periods and outline when brokers should provider underwriters with the number of complaints and any other relevant information to ensure that TMD remains up to date with the relevant class of consumers.

In addition, the underwriter needs to take reasonable steps in relation to the distribution, including making the TMD publicly available. One way underwriters do this is by providing a link to each specific product's TMD on their website, and providing brokers with these links as well as informing them of any updates so brokers can outline this to customers.

Class of Consumers

For insurance clients, it is important to determine their objectives, financial situation and needs. In addition to this, key attributes for insurance need to be included, namely the eligibility criteria to assess the fit of the policy for each consumer as well as what specifically the insurance covers. Most importantly in the TMD is an explanation showcasing how the key attributes of the insurance policy meet the objectives, financial situation and needs of the client.

When assessing whether a consumer fits into the target market, the underwriter is required to develop an objective criterion in which to assess these elements. Despite the more intense regulation, RG 274 provides some flexibility, outlining that a client must only "likely" be in the target market.

Keeping the TMD up to date (Review)

RG 274 also outlines a list of requirements to keep the TMD up to date. The TMD should outline specific events and circumstances that indicate the insurance policy is no longer consistent with the likely objectives, financial situation and needs of consumers of the target market. Additionally, the periods of review for TMDs should be reasonable. Given that TMDs are only just being introduced into the financial services industry now, it is our recommendation that these TMDs are reviewed within three months of coming into effect, with subsequent reviews to be conducted annually.

The TMDs must also specify clear instructions to brokers regarding what they need to report to underwriters as well as the frequency of reporting. It is at the underwriter's discretion how much detail is provided in reports, but it is an ASIC requirement that the number of complaints are reported.

When a review of a TMD occurs, there are three possible outcomes. Either (i) there is no change to the insurance product and its distribution, (ii) the underwriter changes the product design, target market and distribution or (iii) the underwriter ceases to distribute the product.

Letting ASIC know about any Significant Dealings

As the regulatory body, ASIC is required to be notified of any significant dealings that may include potential harm to consumers or whether a consumer has been incorrectly distributed a product given they are outside the target market. This will likely lead to a reassessment of the objective criterion put in place by the underwriter to assess whether a consumer fits into the target market.

Broker Obligations

The biggest change for brokers is that they must not distribute a financial product unless a TMD has been made for it. However, RG 274 allows distributors a degree of discretion to distribute products where they believe a TMD is not necessary.

For insurance brokers, this means that if they are dealing with a wholesale client, a policy that is not considered to be part of general insurance for retail clients will not require a TMD. Similar to the underwriters, brokers also need to take into account relevant factors in assessing the client, with a greater emphasis placed on their role in this as they have the direct contact with the consumer.

In addition to this, RG 274 outlines the assessment criteria for whether a consumer is reasonably likely to be in the target market. For insurance cover, this involves brokers asking both direct as well as "knock out" questions, which will act to prevent consumers from purchasing inappropriate cover. Moreover, if the broker holds any data on the consumer or on a class of similar consumers, brokers can use this to reasonably determine whether the consumer fits the target market or not.

Finally, distributors need to keep records to be provided to the underwriter based on the review period outlined in the TMD. The records be kept for seven years and will consist of the number of complaints the broker receives in relation to the financial product, the steps taken to mitigate the incorrect distribution of the TMD as well as any information that the underwriter has requested from the broker relating to TMDs.

Asking additional and specific Questions

In the case that the broker is not reasonably satisfied or able to discern the consumer's likelihood of being in the target market, they have the scope to ask additional questions. In this case, the broker must only ask questions for the sole purpose of determining whether the consumer is in the target market.

As our insurance industry moves into a period of greater regulation and compliance, it is important that all the relevant documentation and assessment of customer fit in the target market is designed to ensure that our insurance policies meet the fiduciary duty.