

Insurance Matters

Reimagining DDO as more than just compliance

At first glance, the design and distribution obligations could be seen as compliance boxes to tick. But a closer look reveals how they can create the momentum for better insurance products, better customer outcomes and, ultimately, better businesses.

Australia's insurers have much to do between now and April 2021, when new design and distribution obligations (DDO) become effective. The changes will transform the way insurers distribute products to retail consumers in Australia.

While the obligations of DDO are significant, forward thinking insurers will go above and beyond compliance to simplify products and make deep, lasting improvements to customer outcomes.



The new obligations

Australia's DDO requirements include:

- Undertaking a target market determination (TMD) for each retail product, including reviewing triggers that may suggest the TMD is no longer appropriate
- Taking steps that are reasonably likely to result in distribution consistent with the determination
- Notifying ASIC of significant dealings that are inconsistent with the TMD
- Maintaining information relating to the TMD and distribution of the product, and providing this to ASIC upon request.

Now is the time for issuers of financial products to prepare.



Major consequences for inaction

From April 2021, it will not be possible to distribute a retail product unless a target market determination (TMD) has been undertaken.

If the TMD or associated controls are deemed inadequate, distributors may no longer market the product.

The stark consequences of inaction have already been laid bare in other nations. For example, after some UK firms underestimated their own distribution obligations, their products were removed from sale.

Australian insurers cannot afford to make the same mistakes. But there's more to this than compliance and risk management. There's opportunity too.



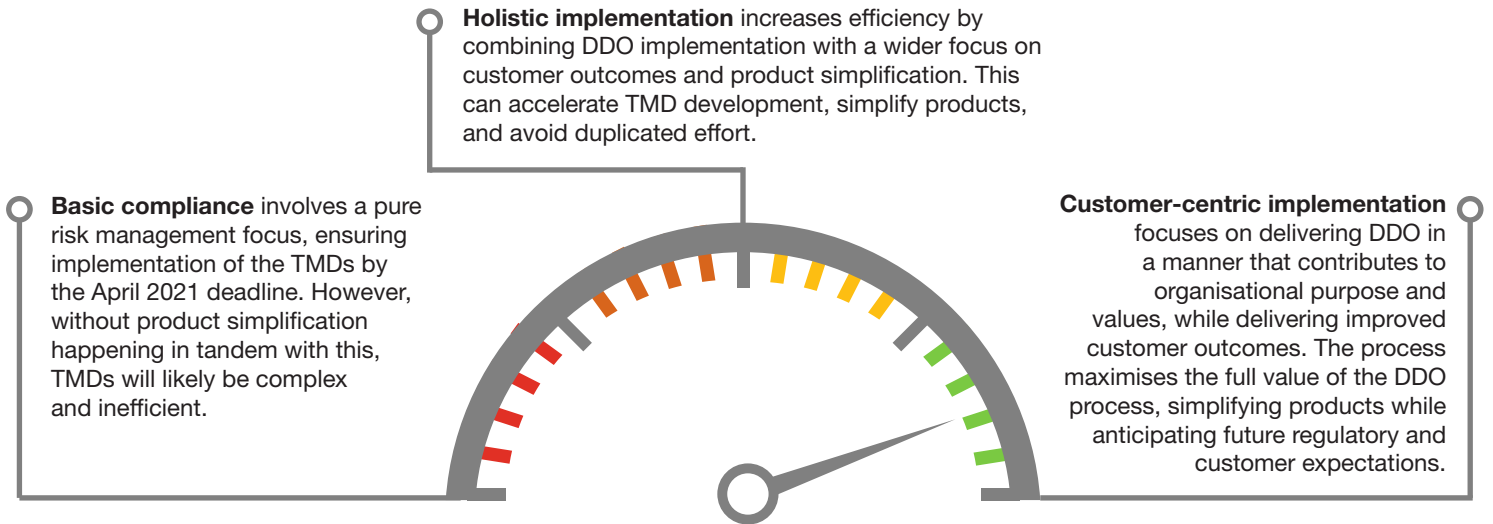
The higher you aim, the bigger the rewards

For many financial services institutions, DDO could be a game changer. By designing a DDO framework driven by purpose (rather than mere compliance) insurers will be more likely to:

- Build products that meet the needs of target customers
- Establish distribution controls to ensure those needs are consistently met
- Develop governance and culture to ensure products are sustainable
- Have people, processes and technology lined up and ready for the new DDO regime.

To achieve this, firms need to mobilise not only regulatory specialists, but also colleagues responsible for compliance, products, customers, legal, technology, and marketing. In order to be ready for DDO, we propose organisations can prepare in three ways.

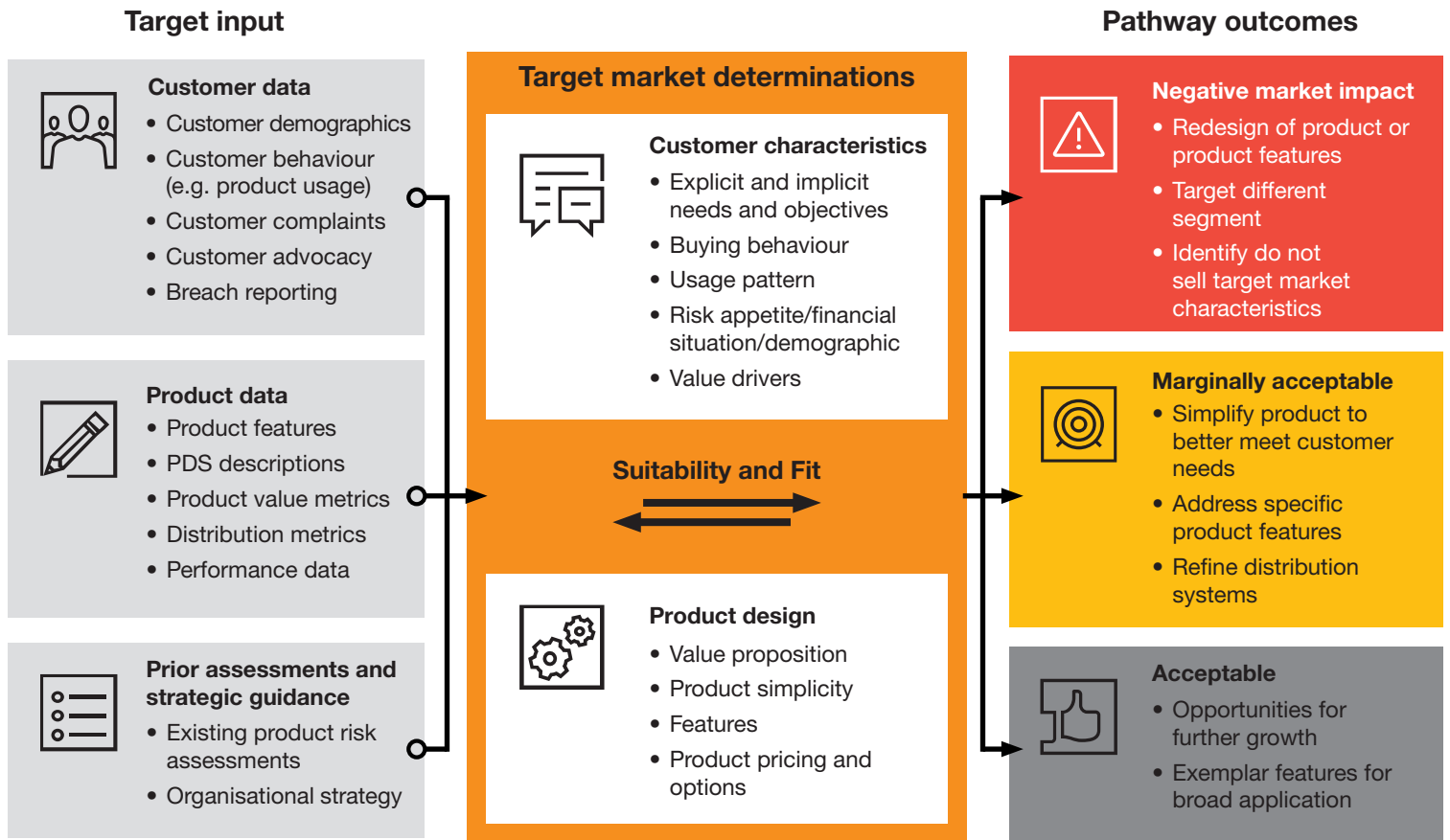
Figure 1: Three implementation options



Compliance alone is not enough

While it is not cause for alarm, we don't think a 'wait and see' approach anchored in complying with the requirements is wise. A lesson from the UK experience in preparing for DDO is that waiting until the last minute increases the cost, risk and disruption of the change. Such a strategy is also prime for disruption by competitors who have started preparing for and understanding the new environment sooner. An approach that puts customers at the centre of the change, helping create new experiences for them and value for the industry, and provides a foundation for efficient and effective compliance with the new obligations, will be the basis of winning organisations of tomorrow.

Figure 2: Target market determination development





Making TMD go further

A structured approach is required to deliver consistent and efficient target market determinations, starting with collaboration between colleagues across the business to create the principles and framework that will guide your TMDs. See **Figure 2**.

Effective TMDs require inputs such as customer data, product data, prior assessments and previous strategic guidance. Product design should be viewed through the lens of the customer segments they aim to serve. This helps to identify customer hot spots and simplification opportunities, and to quantify the value delivered to customer segments.

Final TMD results will then present a clear-eyed view of your products. Some may be 'acceptable' (providing best practice and raising the prospect for future growth) or 'marginally acceptable' (requiring further simplification to fully meet customer needs). Others may have a 'negative market impact', necessitating major change (e.g. redesigning a product, or switching a product from one customer segment to another that would be better served by it).

Investing in a robust TMD approach in the short term will reap rewards in the long term. It will enable technology and digital tools to be applied at scale, accelerating the TMD process and embedding ongoing DDO monitoring, review triggers and compliance. It will also make a more lasting strategic contribution, paving the way for future technology, process and people change.

Our recommended framework, **Figure 3**, applies a customer lens across the full product life-cycle to understand:

- How insurance products meet customer needs in the target market
- How marketing, sales and distribution can place the right products into the hands of the right customers
- How measurement and feedback can be used to continuously improve product design and distribution to the target market.

Figure 3: A customer-led and holistic approach to DDO



The path for market-leading insurers

Of course, this journey cannot begin until insurers know where they are starting from. To assess this, insurance leaders should ask themselves and their colleagues the following questions:

- Do we understand our customers' needs, objectives and circumstances?
- Are our products designed for human users?
- Do our sales and distribution processes enable the right customers to self-select the right products?

In order to activate the questions above, **Figure 4** takes a closer look at how organisations can shift to become the market-leading firms of tomorrow.

Forward thinking insurers who answer the above questions and transition to the new state will then set their organisations up to rise to the DDO challenge. In doing so, they will transform how they design and distribute products for customers and establish new ways to continuously improve their products, services and institutions.

Figure 4: The way forward: Customers, products and distribution transformed

		From	→	To
Product Products are designed to meet customer needs	Customer characteristics	Customer understanding built on folk psychology and demographic personas	→	Deep understanding of customer needs, circumstances and behaviours based on behavioural economics and enhanced segmentation
	Product design	Complex products designed for sale to demographics segments	→	Simple modularised products designed for needs of target markets Compliant by design/ designed for humans
	Customer value proposition	Revealed preference through purchase taken to mean value offered	→	Customer value assessed against meeting of needs, experience and market prices
Distribution and performance Distribution is in line with design	Marketing	Mass-marketing to build awareness and attract sales	→	Marketing designed to induce target-market customers to self-select into the product, and non-target to self-select out
	Sales and distribution	Transactional sales with disclosure involving offer of full portfolio of products	→	Choice architecture for offer and selection of right product within target market
	Performance information	Legal, reactive and complaint driven monitoring of product performance	→	Productive continuous monitoring Products compliant by design, narrowing monitoring requirements
	Renewals, switching and exit	Hard to switch to more suitable product	→	Ease of switching allows better self-selection into products by target market
Continuously improved Outcomes are analysed for continuous improvement	Claims	Operational focus	→	Strategic value as input to target market determinations and identification of poor customer outcomes
	Complaints and feedback	Complaints treated as problem to be solved	→	Customers have a range of channels through which they can complain and obtain fast and satisfactory resolution Feedback used to solve the root cause of problems across the full target market
	Continuous improvement	Project based prioritisation	→	Persistent and real time

Getting ready - we can support your organisation with all three implementation options

Having guided overseas clients through similar design and distribution changes, PwC has a dedicated team of insurance industry specialists ready to support Australia’s insurers during this period of evolution. Our team can discuss and evaluate each of the three implementation options available, determining which option is best suited to your organisation.

Contact us to find out more

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