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MACSS 30200

Problem Set #2

a) Research question.

They have a general topic that gives cohesion to the paper. However, the authors have three research questions.

The main topic is understanding the behavior of commission-motivates agents in the Indian insurance market. The first research question is: what is the effect of commissions on the recommendations that professional insurance advisors give to their clients? The second: what is the impact of the regulation that enforced the disclosure of fees for the unit linked insurance policy (ULIP) (an insurance instrument backed in the stock market)? Finally, the third question: do agents know if they are giving right or wrong advice? That is to say, if agents have a limited product knowledge and if that drives their recommendations or only the commissions.

b) What data did the paper use?

The author collected the data through three different experiments and thirty two interviews carried out in two cities in India. Each one is a simulated advice session, where an especially trained auditor and a random insurance agent meet. For the first experiment, they have 557 observations (information sessions); for the second one, 257; and finally, for the third one, 217. Sometimes, auditors visited the same agent more than once. Then, the total number of different financial advisors by each of the three experiments were 304, 198, and 209, respectively. The interviews were one to one sessions with insurance agents, where they were asked some hypothetical questions to realize if they understand the features of different financial products.

c) What theory did the paper reference to interpret the data?

The authors cite recent literature on models of the provision of advice to potential customers. There are two consequences of these models that the authors care. Firstly, regarding the quality of the advice given by commission-motivated agents, insurance agents recommend complex products with high commissions although those do not provide a benefit for the customer, according to the models by Inderst & Ottaviani (2012), and Gabaix & Laibson (2006). Secondly, that regulations and customer types affect the quality of advice, as depicted in the model of Inderst and Ottaviani (2012), sophisticated customers will receive a better advice.

The model by Inderst and Ottaviani (2012) considers two kinds of costumers, wary and naive. The first one forms rational beliefs and is aware of adviser's incentives. The latter believes that the advice's quality is not affected by advisors' commissions. The model is a game in five periods. In the times one to three, the company set the price, the advisor sets his fee, and the agent gets information about the products. In the step number four, the advisor recommends one

of two available products to the customer. One of them is appropriate for the client according to the characteristics, and one of them is not. However, sometimes the advisor have incentives to propose a non-optimal product, given the compensation scheme. Finally, in the step number five, the customer decide to take the offer or not, according to his characteristics, and their type (wary or naive). They analyzed the prevalence of compensation schemes, given two kinds of customers. Also, they studied the way in which providers and advisors can resolve their agency problem, and how this impact the efficiency of the advice.

d) Was your assigned paper a descriptive study, an identification exercise, a numerical solution to system of equations study, or some combination of the three?

The paper is mainly an identification study. The reference model was developed before the article. The authors test some of its implications. From the model, they got insights of the expected relationships among the variables. Then, through the experiment, they isolate confounding factors and get causal relationships between advisors' incentives and its recommendations.

The analysis of the interviews can be classified as an identification exercise. Its primary objective is to understand the characteristics of the agents, but the authors do not run regressions or create a new theoretical model.

e) What computational methods did this paper use to answer the research question? What was their result or answer to the question?

The computational methods are standard due to they use regular size data, less than a thousand observations from an experimental design. It does not require big data techniques. They used OLS, and they applied fixed effects for some of their regressions.

They found that recommendations of the financial advisors are of poor-quality. For instance, they recommend products with the highest profitability for them; they advise to buy unneeded products, even when they have information about the real requirements of the clients; and they sell whole and term insurance as complements instead of substitutes. There is some evidence that competition between agents can improve the quality of advising.

In the experiment related to regulations, they found that disclose the information about the commission of only one product generates a decrease in offering that product. That suggest that hiding information is a regular practice for insurance agents.

There is still some doubt about if agents give bad recommendations because they do not understand the features of their products, or if it is only related to commissions.

f) Give two suggestions to the author(s) of your assigned paper of things the authors might do to improve their results or strengthen their evidence for the answer to the question.

The first recommendation is to make clear the particular procedure they use to generate their tables. For instance, it is not obvious if they are using logistic regression or linear regression. It will discourage some readers to continue reading their paper.

The second recommendation will be to try to replicate their study to another country with homogeneous language. The result can be affected by the framing of the questions that the auditors memorized. However, because they use local languages, it is hard to understand if their results are biased or not because the academic community does not speak native Indian languages. In the same vein, I recommend preserving the exact framing in the main paper instead of the online appendix.

Finally, a third recommendation is to move their procedures from Stata to R. They limit the replicability of results by using proprietary software.

References

Gabaix, Xavier, and David Laibson, "Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets," *Quarterly Journal of Economics* 121 (2006), 505–540.

Inderst, Roman, and Marco Ottaviani, "How (Not) to Pay for Advice: A Framework for Consumer Financial Protection," *Journal of Financial Economics* 105 (2012), 393–411.