MACS 30200 Perspectives of Research
Critical Review

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Research question

Are life insurance agents providing low quality advice to customers for higher commissions in India?

Data

The paper obtained data by conducting three experiments on 1) general quality of advice, 2) the effect of disclosure regulation on quality of advice, and 3) whether sophisticated customers are more likely to get right advice.

Theory

This paper is theoretically supported by Inderst and Ottaviani (2012c) and Gabaix and Laibson (2006) when making two sets of predictions: the quality of advice provided by commissions-motivated agents, and the extend regulation and customer types affect the quality of advice. The paper took the empirical result found in the above literatures that, first, commissions-motivated agents appear to provide low quality financial advice for higher commissions; second, sophisticated customers will receive better advice. Further, based on results from Inderst and Ottaviani (2012c), this paper also tested how a disclosure requirement on commissions affects financial advice.

Descriptive, identification or numerical solution

This paper is the combination of these three types.

It describes the proportion of term recommendation made for groups with different customer behaviour affects the type of advice given by the agent, the proportion of agents recommending ULIP products. It uses regression analysis to find relationships between dependent variables and independent variables in each regression (see Method section for detail). Moreover, the paper models market competition by calculating best response for firms in monopoly game or Bertrand duopoly game and simulates consumers' preferences towards whole life insurance products or liquid saving products by maximising their lifetime utility functions.

Method and results

The paper uses linear and logistic regressions to fit data from three experiments and solves equations to maximise firm's profit under monopoly and Bertrand duopoly game to model competition.

They ran three regressions for data from the first experiment, with the presence of term insurance in the agent's recommendation, logarithm of risk coverage recommended and logarithm of premium amount recommended as dependent variables respectively. The main independent variables are bias for term from auditor, genuine need for term of auditor, and an interaction between these two. From results from these regressions, the authors found agents are providing low quality advice by 1) recommending a dominated product, 2) cater to customer preferences rather than providing suitable products, and 3) recommending a combination of term insurance and whole insurance.

For experiment two, the regression has dependent variables of the presence of term insurance in the agent's recommendation. The main independent variable is Shopped Around, which suggests the sophistication level of the auditor. The paper thus shows

customers who complained before are likely to receive better advice. In other words, sophisticated customers are likely to receive right advices

Five regressions were run to evaluate data from disclosure experiment. The dependent variable for each regression are: a binary equal to 1 if any ULIP (unit linked insurance policy) product is recommended, the recommendation of a term policy, the recommendation of a whole policy, the logarithm of the risk coverage and the logarithm of premium of the recommended policy. This provided evidence that products requiring disclosure of commissions are recommended less than other products.

Suggestions

1. Dataset is too small. There are 557 observations for the quality of advice experiment, 257 for disclosure experiment and 217 for sophistication experiment. The results may be more accurate with a larger dataset.
2. There may be incomplete or incorrect since people may not willing to to disclose privacy. Reducing bias will also improve results.