CENTRE FOR MICRO FINANCE

CMF POLICY MEMO

Role of Financial Intermediaries in the Indian Life Insurance Sector

Principal Investigators: Santosh Anagol (Wharton School), Shawn Cole (Harvard Business School), Shayak Sarkar (Harvard University)

Introduction

Agents continue to be the lifeblood of India's life insurance sector, even with rapid urbanisation and advent of customer-friendly technologies. As there are several complexities associated with the sector, most consumers prefer taking the agent route to purchase a policy rather than through direct purchase. There are two schools of thought which discuss the role of agents in providing product recommendations to customers that lack adequate information.

Snapshot of India's life insurance sector

- Total premium amount collected in 2007-08: $44 billion
- Number of insurance sales agents: 2.7 million
- Commission collected by agents in 2007-08: $3.73 billion
- Proportion of insurance customers purchasing through agents: 90 per cent

The first of these argues that due to a general lack of awareness, agents are able to sell products that maximize their own well being to consumers. This implies that agents sell products for which they receive the highest commissions, irrespective of the benefit derived by the customer. The second school of thought, on the other hand, believes that consumers are rational and can discern and discount for the selfish behaviour by the agent at the time of making decisions about an insurance product. Keeping these two schools of thought in mind, a study was conducted by the Centre for Microfinance (CMF) in the state of Gujarat, the results of which demonstrate strong implications for the commissions based wage structure that is characteristic of the markets for financial products in the low income sector. .

Research Findings

The study focused on three related experiments, the focus and findings of which are discussed below. All three studies used an audit study methodology, wherein individuals were trained to visit agents, express interest in life insurance policies, and seek recommendations. The study was designed as a randomized controlled trial (RCT), and the primary results from each experiment are highlighted below.

Exp. No.	Goal of experiment	Result
1	To test whether, and under what circumstances, agents recommend products suitable for consumers.	First set of 299 audits demonstrated that life insurance agents do not provide good advice. ULIPs, for which commissions were substantially higher, were recommended.
2	To test whether agents will recommend products contrary to initial preferences of the customer	Agents cater equally to both the initial preference of the customer and the actual needs of the customer. This is true even when the agent has an incentive to de-bias the customer because the commission on the more suitable product is higher
3	To test how disclosure regulations affect the quality of advice provided by life insurance agents	On July 1, 2010, the Indian insurance regulator mandated that insurance agents disclose the commissions they earned on equity linked life insurance products. It was found that the disclosure policy led to substantially less ULIP recommendations

Research Implications

Several implications can be drawn after observing the results presented in the earlier table. Firstly, as consumer awareness continues to be lacking, the industry needs to find ways to ensure that suitable products are offered to a customer, rather than those that solely proliferate the sector's growth. There has clearly not been enough education provided to investors in this agent driven system.

Whole life insurance is proven to be economically inferior to a combination of investing in savings accounts and purchasing term insurance. Despite this fact, life insurance agents overwhelmingly encourage the use of whole insurance, the reason being higher commissions associated with these products. Auditors that were trained to demonstrate an extensive understanding of insurance products were fourteen percentage points less likely to receive a recommendation of a whole life insurance product.

Despite recent norms on disclosure requirements on ULIPs, agents are now recommending more opaque products, suggesting that the disclosure requirements for financial products needs to be more consistent across substitute products. It is also evident that agents cater to customer pre-existing conceptions of the right product mix for them, and do not try to de-bias customers away from their initial beliefs completely, which can be seen as effective strategy to not drive away clients, even if their conceptions may be incorrect.

Policy Recommendations

- Clearly define the expectations and scope of operation for life insurance agents
- Comparative study of parallel incentive systems which promote the need of the investor, rather than only the commission of the agent
- IRDA should either directly get involved or find partners in the private sector to educate investors in best practices for selecting a life insurance product
- Monitoring of agents and life insurance providers in both the public and private sectors to ensure better compliance with IRDA regulations

For starters, regulators and practitioners must first mutually agree on the role of agents in the insurance sector. Only once this is done can a proper assessment on their effectiveness be conducted, especially in terms of their role on educating customers.

Author: **Abhay Agarwal, Research Consultant, CMF, IFMR, Chennai**