Reform of Insurance Distribution Channel for Consumer Protection

Asymmetric information may distort the choice of consumers in the insurance products market. A consistent increase in the number of consumer complaints in Korean insurance industry may be the evidence that the problem of asymmetric information at the distribution level put consumers in an unprotected position. The market maturity model suggests that avoiding stringent regulation by developing a more professional distribution channel, and creating products based on consumer needs is the key element in the fully integrated financial services market. Under the maturity phase, the structural changes of distribution channel are required to sustain the growth in Korean insurance industry.

This report assesses current situation of the distribution channel of Korea insurance industry regarding its legislative system, personal infrastructure, and commission structure. We identify some problems and propose the following reforms.

First, we find that the main role of distribution is focused upon the sales of new products, and as the result its function in financial planning and advice is very limited. Accordingly, financial advisor role of both, tied agent (i.e., solicitors) and general agents, needs to be strengthened to protect the consumers from various risks as well as to satisfy their needs associated with the asset management.

Secondly, there is the ambiguity in the authority and responsibility of distribution channels, which may lead to the disputes between
consumers and distribution channels. Thus, it may be necessary to enhance the authority of the solicitors in terms of the predictability of consumers. In addition, the independence and responsibility of general agents must be secured to protect consumers.

Thirdly, the agents working within the distribution channels lack the characteristics and skills that are required for financial planning and advisory services. We suggest the use of the diagnostic and education system, which can offer the successful career paths of an agent.

Fourthly, current remuneration system of distribution channel is entirely dependent upon the sales-based commission structure. The majority of the commission is from the initial commission that is paid to the distribution channel either in the first month or in the first year period. The existence of largely front-end loading commission means that the incentive of some distribution channels is structured to create new businesses rather than to provide the persistent service to the existing policies. The purpose of our analysis is to alleviate some negative consequences of current remuneration system of Korea insurance industry’s distribution channel.

We suggest the use of a number of different commission structures such as renewal and trail commissions that are written in terms of subsequent premiums or the size of the account value. Different commission structures will diversify the earning sources of distribution channels and make their role as financial planner and advisor more important. Moreover, we propose the introduction of an indirect regulation such as “minimum surrender value” that may protect consumers through increasing the size of the surrender value during the early period of policy.