

Status Quo Bias in Ocean Marine Insurance and Implications for Korean Trade

Hongjoo Jung[†]

Business School, Sungkyunkwan University, Republic of Korea

Soyoung Lim[†]

Department of Foreign Trade, Sungkyunkwan University, Republic of Korea

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Abstract

Purpose – This research uses ocean marine insurance (OMI) statistics, international emails, focus-group interviews, and surveys to fill the gap between the theory of behavioral insurance, particularly status quo bias (SQB), and the practice of OMI in Korea. The contractual forms of OMI, the oldest and most globalized form of commercial insurance, were developed in the UK as the Institute Cargo Clauses in 1906 and revised in 1963, 1982, and 2009. SQB has been academically explored, mostly in health insurance and the financial services sector, but never in OMI. Thanks to the availability of OMI statistics in Korea, we can conduct SQB research here for the first time in this field.

Design/methodology – We show the existence of SQB in the OMI of Korea through Korean statistics between 2009 and 2018, email correspondence with experts in the UK, Germany, and Japan, focus-group interviews with Korean OMI underwriters, an in-depth interview with one underwriter, and a survey of 15 OMI insureds (company representatives).

Findings – We find that Korean foreign traders rely on the old-type OMI contracts developed in 1963, whereas other industrialized countries use the newest type of OMI contract developed in 2009. With a simple loss ratio analysis during 2009–2018, we show that the behavior of insurers has little to do with rational profit maximization and is instead driven by irrational bias, as they forgo the more profitable contracts provided by the new clauses by keeping the old clauses. The consistent addiction to old types of contracts in the OMI market suggests strong SQB among Korean exporters, importers, bankers, or insurers, which we confirmed in our interviews and survey.

Originality/value – This research has significant originality and academic value because it reports new findings with crucial implications for the development of efficient trade practices and policy. First, this research is based on actual statistics that have not been used in previous Korean research on OMI. Second, this research shows that all-risk OMI policies provide more value to insureds, in terms of coverage given premium, than partial coverage policies, which differs from arguments previously made in Korea. Third, this research reveals strong SQB in Korea, where foreign trade plays a pivotal role in economic growth. That bias could be attributable to uninformed traders, informed but idle insurers, or conservative bankers. Fourth, to further develop foreign trade, policy initiatives are needed to review the current practices of OMI contracts and move forward with the new contract forms. All of these findings and arguments are both new and important.

Keywords: Behavioral economics, Institute Cargo Clauses, Ocean Marine Insurance, Status Quo Bias
JEL Classifications: F1 Trade, G2 Financial Institutions and Services, G4 Behavioral Finance

1. Introduction

The study of behavioral economics, finance, and insurance assumes that humans operate using bounded rationality or irrationality, unlike neoclassical economics, which presumes that both corporations and consumers operate rationally or use rational decision-making

[†] First author: jungprokorea@gmail.com, Corresponding author: sylim0131@gmail.com

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(Kunreuther et al., 2013; Richter et al., 2014). For example, neoclassical economics assumes that corporations and consumers try to maximize their expected profits and utility, respectively, in a mathematical way (Mankiw, 2020), whereas behavioralists say that other factors, such as psychological benefits, convenience, and altruism, affect people's behavior. That is, behavioral economics and finance theorists note several anomalies or biases in their economic perspectives, such as endowment bias, frame bias, anchoring bias, status quo bias (SQB), and overconfidence (Thaler, 2008).

Insurance is no exception in the trend toward behavioral economics. Although neoclassical economics and finance have contributed to the development of insurance theory, a lot has been unexplained by neoclassical theory (e.g., expected utility theory). That is, traditional neoclassical insurance theory argues that rational human beings purchase insurance at full coverage at an actuarially fair premium given no market failure, including information asymmetry (Mossin, 1968). However, behavioral insurance can explain a variety of irrational decisions in purchasing, supplying, and regulating insurance by incorporating human psychology.

In this research, we check for the existence of SQB in the ocean marine insurance (OMI) market and explain the reasons for the SQB we find. SQB is an emotional bias, a preference for the current state of affairs or a phenomenon in which people stick with a pre-existing situation and are reluctant to move into another situation, even if the new situation offers more profit or utility. In the insurance market, either the insured or the insurer can adhere to an incumbent supplier, customer, contract, or condition. As we explain later, the health insurance and automobile insurance markets are well-known examples of SQB. Using both qualitative observation and quantitative data for the first time in this kind of insurance, we examine SQB in the OMI market, which is both global and liberalized.

OMI, particularly cargo insurance, is a commercial line of insurance used by international traders to hedge their maritime risks. The UK has been the leading country in OMI in terms of business, law, and transactions. As a hub country of OMI (and really insurance in general), the UK accounts for 30% of the world OMI market. Interestingly, UK enacted a written law of the MIA (Marine Insurance Act) law in 1906, even though it was at that time a common law country that relied on case law rather than statute. Thus, in the UK, OMI received a special treatment among various types of insurance.

However, the UK's original focus in the MIA took the perspective of the insurer rather than the shipper (traders) because in 1906, insurance was an infant industry deemed to need protection at the national level. Therefore, the MIA 1906 had several provisions favoring insurers, such as a disclosure or warranty that appeared to restrict the insureds' rights so severely that it was revised in the 21st century in the Consumer Insurance Act of 2012¹ and the Insurance Act of 2015.

Because the UK is where modern OMI originated and developed, many representative OMI contracts or clauses have been developed or amended there, as we discuss in detail below. Suffice it to say here that OMI contracts have been standardized and revised several times in the past 150 years, particularly in 1963, 1982, and 2009, and the most recent revision is supposed to be in global use.

Previous OMI research in Korea has mainly compared and analyzed the pros and cons of OMI clauses from 1963, 1982, and 2009. However, those studies did not focus on actual usage

¹ Many people pointed out that non-consumer insurance contracts such as OMI still had problems after the passage of the Consumer Insurance Act of 2012 because its legal application was limited to consumer insurance contracts. Therefore, the Insurance Act of 2015 was enacted in the UK. It applies to all insurance contracts, including non-consumer insurance contracts, and came into force in 2016. Two revisions of that law have further strengthened consumer rights.

but simply assumed that insurers or insureds would choose suitable OMI clauses based on rational calculations of their costs and benefits. In this research, motivated by behavioral economic theories, we explored the possibility of irrational choices in OMI clauses by collecting usage data for OMI contracts and examining the trends in the use of each clause. Using those data, we were able to capture the reality of OMI choices and examine the existence of SQB in the Korean OMI market. Furthermore, we surveyed underwriters and insureds to begin to understand that bias.

2. Literature Review

2.1. Behavioral Bias

Behavioral economics, which incorporates psychological insights into research on economic issues, changes the analysis of consumer behavior, industry, and overall markets and is widely used in fields such as policy development and management. Consumers respond to external demands with given resources in the decision-making process. Table 1 shows eight typical behavioral biases.

Table 1. Representative behavioral biases related to finance

	Bias	Definition
1	Endowment Effect/SQB	A tendency to stay in a state similar to the current state
2	Loss Aversion	A tendency to be more sensitive to losses than to gains of the same size
3	Overconfidence	A tendency to be overly optimistic or overestimate favorable or satisfactory outcomes
4	Mental Accounting	A tendency to implicitly allocate money to psychological accounts according to their purpose and to think about money differently for each psychological account
5	Framing	A tendency to vary conclusions drawn from the same information depending on how or by whom the information was provided
6	Anchoring	A tendency to make decisions around the information that matters most
7	Heuristics	A tendency to use experience-based methods such as guesswork or common sense in the problem-solving process
8	Herding	A tendency to imitate decisions made by other people or members of a similar group to reduce exploration costs and complexity

Source: Thaler (2008).

Though behavioral economics focuses on irrational choices made by individuals, many researchers have also applied those theories to firms' decisions. Inconsistent with the interpretations of existing studies, companies sometimes make decisions that do not suit profit maximization, such as sticking to existing methods. Langevoort (1997) showed that there are irrational corporate decisions that cannot be explained by agency theory, transaction cost theory, or stakeholder theory. Campana (2016) and Heaton (2019) used behavioral economics to interpret a firm's poor choices and found causes such as self-deception, overconfidence, endowment effect, and excessive optimism. Thus, previous studies have already shown that it is both possible and fruitful to apply behavioral economics theory to company decisions.

Financial consumers, can be broadly classified as “general financial consumers” and “specialized financial consumers,”² as given in the 2021 Financial Consumer Protection Act of Korea. Just as the protection of financial consumers is currently an increasing demand and trend at home and abroad, so Korea enacted the Financial Consumer Protection Act, which is scheduled to be implemented in 2021. In general, financial consumer protection focuses on the consumers of household financial insurance, but some corporate financial insurance also has a lot of information asymmetry between consumers and insurers, as we show later in this research. Nevertheless, corporate consumers are loosely considered to be specialized financial consumers who are not as protected by the law or regulators as general financial consumers, who are understood to be on an unequal footing with their business counterparties. As small- or medium-sized enterprises, foreign traders might also need public protection, although not so much as individual consumers, because they are not as well informed as large enterprises.

2.2. Status Quo Bias

SQB is a phenomenon in which the characteristics of an initial situation, rather than those of the available alternatives, influence an individual’s choice. That is, it is a tendency of people to stick where they have been, even when they have better options. Samuelson and Zeckhauser (1988) wrote the key paper from which discussion of SQB has emerged. They examined numerous economic decision-making processes, such as health insurance and pension planning, and found that investors disproportionately and (economically) inappropriately remained as they were, sticking with the status quo because of cognitive misperceptions, switching costs, and psychological commitment (Krieger and Felder, 2013). Similar to the endowment effect in some sense, SQB can be explained by prospect theory’s concept of loss aversion (Tversky and Kahneman, 1991), the inertia theory, the decision avoidance theory, and the incomplete preferences theory (Murwirapachena and Dikgang, 2018).

Much of the financial research that has emerged from discussion of SQB has focused on two issues: pension and personal financial planning and health insurance. First, in the stock market or mutual fund market, SQB shows up in a large number of funds as a positive influence of previous growth on current growth, but it also appears in smaller segments of the industry. As a matter of fact, the greater the number of alternatives, the more pronounced SQB becomes (Kempf and Ruenzi, 2006). Brown and Kagel reported that in their experiment, subjects exhibited robust SQB inconsistent with standard economic theory (Brown and Kagel, 2009). The magnitude of SQB depends on the nature of the investment opportunity and certain investor characteristics (Freiburg and Grichnik, 2013). Second, in health insurance and health affairs, SQB appears because premium elasticities are significantly higher for new hires than for incumbent employees (Strombom et al., 2002). In terms of health, SQB played a more important role in the elderly group than in younger age groups (Becker and Zweifel, 2008). With more choices serving to inhibit switching among health plans, people with longer periods of attachment to a particular health plan were less likely than others to express an intention to switch plans (endowment effect) (Frank and Lamiraud, 2009). SQB also plays a role in consumer choices about health insurance policies, particularly among inexperienced consumers (Krieger and Felder, 2013). Patterns of transition into Medicare Advantage from traditional Medicare (and vice versa) suggest significant SQB in taking up Medicare Advantage and find that such “stickiness” both increases with a beneficiary’s tenure in Medicare (Sinaiko et al., 2013) and decreases with the number of membership years

² According to that law, “specialized financial consumers” can take risks in accordance with a financial product contract in light of their expertise in financial products or the size of the owner’s assets.

(Afendulis et al., 2015), with differences across countries, such as between the Netherlands and Germany (Leukert-Becker and Zweifel, 2014). Other factors that positively explain SQB are age and morbidity, with education and income having the opposite effects (Karl et al., 2019). Other research has found SQB in areas such as the water sector (Murwirapachena and Dikgang, 2018).

2.3. Ocean Marine Insurance(OMI)

According to the 2019 International Union of Marine Insurance (IUMI) report, more than two-thirds of the world's cargo is shipped by ocean marine transportation.³ Korea's economic success is based on foreign trade, with a volume ranked 9th in the world in 2019. In other words, Korean trade and economic growth have skyrocketed since the 1960s thanks to OMI, with concomitant growth in academic research about OMI.

First, research was conducted on the factors that determine the choice of OMI contracts. For example, La, Gong-woo (2005) conducted an empirical study of the factors by which Korean trading companies select insurance conditions when signing an OMI contract, such as the insurance premium rate, nature/type of cargo, and transport section, and examined how those factors influenced the perils covered, the warranty, and the covered loss. Lee Bong-Sang (2008)'s empirical study of the causes and effects of OMI choices revealed differences in the selection of insurance conditions that depended on the size of the import-export enterprise, the transaction period, the degree of use of information, the degree of delegation of authority, the work experience of the person in charge, the level of work knowledge of the person in charge, and the degree of emphasis on transaction cost reduction in the import-export enterprise.

A few researchers have conducted comparative research on the types of OMI contracts. Oh, Ji-Yang (2010) found that the old 1963 clauses were abolished in the UK after 1983 and that the new clauses were thus compulsory in that OMI-leading country. Emphasizing the advantages of ICC(A) contracts, compared with ICC(B) or ICC(C), he insisted on a unified use of ICC(A) and the exclusion of other contracts to free insureds from the burden of proof. However, he did not recognize the wide use of the old 1963 contracts in Korea. On the contrary, La, Gong-woo (2013) proposed quite the opposite idea, recommending the partial coverage contracts such as ICC(B) or (C) over the 'expensive' ICC(A), based on results of simulation research. He argued that most Korean foreign traders mistakenly prefer the old 1963 clauses, which carry excessive insurance premiums and complexity in their terms and conditions. But his comparison of insurance premiums relied on simple absolute premium (rate) levels, not the relative value that measures both price and coverage together. Jeong, Bun-Do and Yoon, Bong-Joo (2013) and La, Gong-Woo (2014) compared the ICC(A), ICC (B), and ICC(C) contracts to find reasonable premium conditions and operating expenses in a theoretical context without considering loss ratios in the whole market. More recently, Koo, Jong-soon (2017) comprehensively analyzed the terms and conditions used exclusively for container cargo in international transportation.

To wrap up the OMI literature review, we find that no research has explicitly compared the use of the old and new clauses in Korea or elsewhere. That is, it is still necessary to compare the cost-effectiveness of the old and new contracts, including specific contracts for particular groups, to see which contract offers the most value to insureds and insurers.

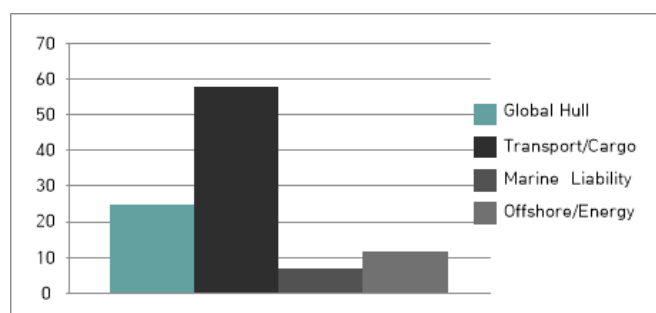
³ According to Clarksons Research, cargo carried is spilt 71% by sea, 16% by air, and 13% by land based on weight. IUMI (2019), An analysis of the global marine insurance market 2019, IUMI, p.9.

3. Development of OMI Contracts and Their Use in Foreign Countries

3.1. Overview of the Global OMI Market

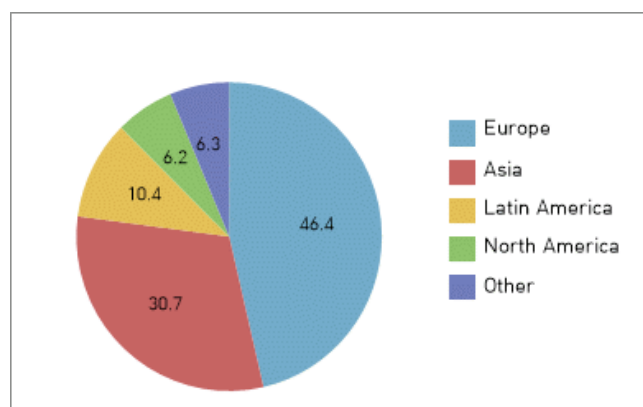
Figs. 1 and 2 display the size of the OMI market in 2018. Cargo insurance and Europe are the largest line of business and region, respectively, followed by hull insurance and Asia. Fig. 3 shows the total loss ratios for cargo insurance from 2005 to 2018, focusing on insurance premiums, total premiums, payments, and outstanding claims. During that time, they fluctuated between 55% and 88%, averaging 70%. According to IUMI, cargo insurance is generally not very profitable, but it is better in Asia than in Europe.

Fig. 1. Marine premiums in 2018 by line of business

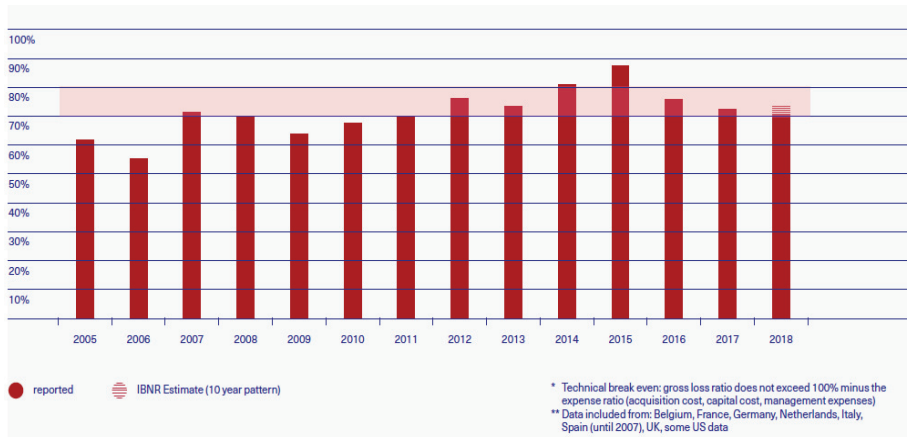


Source: IUMI (2019).

Fig. 2. Marine premiums in 2018 by region



Source: IUMI (2019).

Fig. 3. Total loss ratio of European (and some US) cargoes

Source: IUMI (2019).

3.2. Development of OMI contracts

The UK is well known to be the global center of OMI. The oldest commercial insurance developed in London, MIA 1906, and several OMI clauses began there and were adopted by global traders. More specifically, in 1779, Lloyd's S.G. policy form was adopted as a standard insurance policy form at a general meeting of Lloyd's. The Lloyd's S.G. policy form was a contract established by accumulated experiences and cases in the OMI and was used as a single, unified standard insurance policy form. Various precedents have accumulated since then, and the use of that single form has reduced contractual uncertainty or unclarity in the market.

However, the industrial revolution and rapid development in the international transportation environment made Lloyd's S.G. policy form untenable for OMI in the 20th century. Accordingly, the need for a major revision was discussed, but due to various concerns, Lloyd's S.G. policy form was not revised; instead, additional individual agreements between parties were attached to the standard insurance policy. However, that also caused disputes about those separate terms and conditions and the scope of compensation. At last, the need for a unification of terms and conditions became inescapable.

The Institute of London Underwriters (ILU) is an organization accredited by the British government to serve for interests of London OMI companies established under the British Corporation Act of 1884. The ILU aimed to defend the interests of marine insurers and promote the development of OMI business through mutual cooperation and joint action. In 1963, the ILU enacted the first Institute Cargo Clauses (ICC) to be attached to and supplement the existing Lloyd's S.G. policy form. The policy forms linked to the original Lloyd's policy at that time are called ICC (A/R), ICC (WA), and ICC (FPA). In this research, we call them the *old contract*.

In 1978, as an initiative to free the ICC policies from the S.G. policy, the UNCTAD Secretariat highlighted the need to establish a new international standard for OMI policies, terms, and conditions. In response, the Joint Hull Committee and Joint Cargo Committee began work in 1979 to prepare a new standard insurance policy to replace the Lloyd's S.G. policy form. As a result, the Institute Time Clauses-Hulls and ICC were promulgated in 1982.

Thus, the Lloyd's S.G. policy form, which had been used for about 200 years, was discontinued in 1983. The new ICC forms, called the MAR form in UK practice, are distinct from the Lloyd's S.G. policy. The ICC, thus established in 1982, is divided into terms A, B, and C, as shown in Table 2, according to the scope of the damages to be covered, and in practice it is called the *new terms*. It is similar to the coverage provided by the ICC (A/R), ICC (WA), and ICC (FPA) created by the ILU in 1963.

Table 2. Institute Cargo Clauses 1982

Classification	Contents
ICC (A)	<ul style="list-style-type: none"> - Similar to the 1963 ICC (A/R) - The widest range of insurance coverage: all risks are covered by insurance
ICC (B)	<ul style="list-style-type: none"> - Similar to the 1963 ICC (WA) - The scope of insurance coverage is narrower than the ICC (A) terms and wider than the ICC (C) terms through the use of the With Average condition
ICC (C)	<ul style="list-style-type: none"> - Similar to the 1963 ICC (FPA) - The narrowest insurance coverage under the condition of Free from Particular Average

Twenty years after the change in ICC policies, strong demand for another change arose with the unfortunate breakout of terrorism in the United States in 2001, the continuing trend of containerization, and other environmental changes in international modes of transportation. To cope with those changes, the Joint Cargo Committee of the British Insurance Market initiated a revision of the 1982 ICC on January 1, 2009, to modernize the words used in the terms and conditions and clarify the interpretation of the contents of compensation to protect the interests of the insured by reducing the disclaimer and extending the insurance period. Details of that revision are given in Table 3.

Table 3. Comparison of ICC 1982 and ICC 2009

Article	1982	2009	Reason for modification
ICC (A)	goods, cargo underwriters except as provided	subject matter insured insurers except as excluded	Modernize the words Modernize the words Clearly indicate that the articles mentioned are exclusions
4. 3	Liftvan Servants	Delete the word Employees	Delete ambiguous terms Modernize the words
4. 5	proximately	Delete the word	Reduce confusion and conflict
4. 6	Brief description of losses, damages and costs for bankruptcy ⁴	Details of loss, damage, and costs for bankruptcy ⁵	Reduction of the insured's immunity when the carrier goes bankrupt (good faith insured protection)

⁴ 4.6 loss, damage, or expense arising from insolvency or financial default of the owners, managers, charterers, or operators of the vessel.

⁵ 4.6 loss, damage, or expense caused by insolvency or financial default of the owners, managers, charterers, or operators of the vessel where, at the time of loading of the subject-matter insured on board the vessel, the Assured are aware, or in the ordinary course of business should be aware, that such insolvency or financial default could prevent the normal prosecution of the voyage. This exclusion shall not apply where the contract of insurance has been assigned to the party claiming hereunder who has bought or agreed to buy the subject-matter insured in good faith under a binding contract.

Table 3. (Continued)

Article	1982	2009	Reason for modification
4.7	arising from weapon of war	directly or indirectly caused by or arising from any weapon or device	Expansion of exclusions to cover terrorist attack or atomic attack
8.1	on delivery	on completion of	
10	held covered ⁶	must be notified ⁷	Delete ambiguous terms and clarify
15	This insurance shall not inure	This insurance	Modified to simple expression

Source: Richards Hogg Lindley (2009), Institute Cargo Clauses 2009 – A Comparison of the 1982 and 2009 Clauses, with additional commentary.

In practice, the ICC 1963, ICC 1982, and ICC 2009 can be used freely, but few data have been collected about their actual usage ratios. IUMI has no data for OMI transactions with respect to those contract forms. We were only able to get the following expert opinion from IUMI.

Dear Professor Jung, I just received the following response from our British member, the Lloyd's Market Association: Speaking from the UK perspective, there are no statistics for this, only a common knowledge of use in practice. Underwriters are free to use whatever wording they like as long as it's not illegal or clearly wrong by reason of obsolescence. The ICC 2009 clauses are in general use in the UK. It is thought there was no use of the 1963 wording after 1982 in the UK, and very little if any use of 1982 after the 2009 release. However, usage is never mandated. I hope this is helpful and will revert when I hear from our German member association. Best wishes, Hendrike Khl, Policy Director, IUMI International Union of Marine Insurance⁸

That is, UK OMI focuses on the 2009 form (the newest one) with a few exceptions that use the 1982 form and very few that use the 1963 forms. Even in the absence of any legal requirement to use the newest one, it has apparently come to dominate use through the market principle. As the originator of OMI law, principles, and business, the UK might have no reason to stick with the old contracts after they have endeavored to develop the newest contract form.

As shown by the following email, the practice in Germany is similar to that in the UK: the newest OMI contracts are used fairly consistently. The IUMI officer contacted the German representative (German Insurance Association, GDV) with the same question we asked about the UK and got the same answer. That is, German OMI usually uses the German domestic form for contracts except as required by the UCP 600 (Uniform Customs and Practice for Documentary Credits 600) to avoid any legal conflicts arising from the English law. Otherwise, German OMI uses the 2009 version. This is also a reasonable situation.

⁶ Held covered at a premium and on conditions to be arranged subject to prompt notice being given to the Underwriters

⁷ This must be notified promptly to insurers for rates and terms to be agreed. Should a loss occur prior to such agreement being obtained, cover may be provided but only if cover would have been available at a reasonable commercial market rate on reasonable market terms.

⁸ E-mail from Hendrike Khl hendrike.kuehl@iumi.com (05 October 2020 18:33)

Dear Professor Jung, Herewith [is] the response from our German member, GDV. Sorry. We do not have any stats or counts for this. In general, German insurers far overwhelmingly prefer German standard conditions in insurance contracts, avoiding English law and practice as stipulated in the Institute clauses. As far as I understand, the 2009 version will be applied to insurance certificates when ICC A is required by ERA 600. I hope this is helpful. Best wishes, Hendrike Kühl, Policy Director⁹

According to Satoshi Nakaide (2019, 2020), the situation in Japan is also similar to that in the UK. In Japan, the MAR Form (2009 contract) has become popular since 2009, when Japanese non-life insurers collectively began to promote the newest policy based on their judgement of the mutual benefits available in those contracts.¹⁰

4. Use of OMI Contracts in Korea

4.1. Data and Basic Questions

Fortunately in Korea, unlike the UK, Germany, and Japan, we could obtain historical data about OMI contracts from the Korean Insurance Development Institute (KIDI). The data include information about the number of contracts, total premiums, average premium per contract, number of accident claims, total loss payments, and loss ratio across a ten year period (2009–2018). Those data allow us to answer the following questions, which have not previously been addressed.

- A. How many contracts were concluded in each year? Among them, how many used the old (1963), new (1982), and newest (2009) contract forms? (Interestingly, a short answer is that the old one (1963) dominates the Korean market, very different from the UK, Germany, and Japan.)
- B. Among those contracts, which one is more beneficial (profitable) for OMI insurers? In that sense, are the insurers rational or biased in their preference for the status quo? What is the value of each contract type to the insureds?
- C. Are there any trends in the ten-year data in terms of the behavior of the insureds or insurers? Are there any trends across the different contract forms?

4.2. Usage Analysis

4.2.1. General Trends

The old contract form is used more extensively than the new or newest ones.

Table 4 to Table 7 summarize the domestic use data provided by KIDI for the old and new

⁹ E-mail from Hendrike Kühl hendrike.kuehl@iiumi.com (06 October 2020 2:17)

¹⁰ 中出 哲「海上保険」有斐閣、2019年 114頁 日本では、貨物海上保険の領域では、1982年のMARフォームと協会貨物約款ができてからも約20年以上は、ロイズS.G. 保険証券様式に協会貨物約款を加える方式が利用されてきた。しかし、2009年の協会貨物約款改定以降は、しだいに新書式による引受けが広がり、現在では、信用状で指定がある場合などの例外を除くと、ほぼMARフォームと協会貨物約款2009年改定版に基づく新書式が利用されている。そのため、以下では、新書式に基づく方式を対象としてその内容を解説する。

clauses during the 10 years beginning in 2009. As the tables show, the old contract form (1963) is widely used and more popular in Korea than the new 1982 form or the newest 2009 form, which is not used at all.

All-risk type contracts are more popular than partial coverage ones.

In terms of coverage levels, the ICC (A/R) of 1963 and ICC (A) of 1982, which offer so-called all-risk coverage, are more popular than the ICC (WA), ICC (FPA), ICC (B) or ICC (C) partial coverage contracts. The popularity of the all-risk contracts has usually been attributed to the convenience of wider coverage, their affordable price, and low burden of proof (La Gong-Woo, 2013).

All-risk contracts are more valuable to insureds in terms of loss ratios and also to insurers in terms of the ratio stability¹¹. Thus, the argument that partial coverage contracts are more valuable for insureds is invalid.

The loss ratios of ICC (A/R) and ICC (A) terms are high and stable, which means that, unlike the claims of previous domestic studies, ICC (FPA), ICC (WA), ICC (B), and ICC (C) contracts are sure to be more expensive than the all-risk policies. In terms of loss ratio volatility, on the other hand, ICC (A/R) and ICC (A) contracts are more stable than the others. Therefore, ICC (A/R) and ICC (A) contracts can be considered to be more desirable for both the insured, who can benefit from the higher loss ratio, and insurers, who can enjoy more stable loss ratios, unlike the findings of La Gong-woo (2013).

On average, an ICC (A) policy is around 10% more expensive than an ICC (A/R) contract, and the former has a higher loss ratio than the latter. Other things being equal, that means that the former contracts are more valuable than the latter in terms of coverage and value.

Table 4. Comparison of domestic use of ICC (A) and ICC (A/R) contracts

	Number of contracts		Premium income (million won)		Average loss ratio (%)		Loss frequency(%)	
	ICC (A)	ICC (A/R)	ICC (A)	ICC (A/R)	ICC (A)	ICC (A/R)	ICC (A)	ICC (A/R)
2009	252,816	1,033,238	42,388	140,044	20.0	48.2	0.4501	0.6641
2010	288,405	1,213,504	53,403	157,531	43.7	91.5	0.3616	0.5845
2011	378,141	1,335,724	56,630	160,083	20.2	49.5	0.2544	0.5631
2012	418,227	1,284,394	61,508	151,938	27.7	57.1	0.3505	0.5821
2013	468,082	1,284,297	50,824	139,218	123.9	24.3	0.7591	0.5178
2014	499,800	1,328,509	52,371	134,541	310.8	25.9	0.8197	0.4172
2015	522,555	1,315,150	49,987	119,668	-	90.3	0.5402	0.4904
2016	553,965	1,343,175	43,062	110,294	65.8	107.9	0.6565	0.4132
2017	500,019	958,581	56,184	103,356	50.2	72.4	0.6458	0.4517
2018	571,577	1,665,120	57,413	121,886	43.0	93.6	0.3887	0.3722
Total	4,453,587	1,276,1692	52,3770	1,338,560	67.9	64.3	0.5427	0.4990

Source: KIDI General Insurance Team. (Note: some values are missing for unidentifiable reasons.)

¹¹ The frequency of OMI accidents with each contract is very low (0.04–0.5%), and their loss ratios are between 10% and 70% during the data period, substantially lower than the IUMI ratios given above, which implies that Korean OMI insurers have high profitability.

According to the statistics from 2009 to 2018, an ICC (A) contract is about 10% more expensive, on average, than ICC (A/R) contracts in terms of average premium, but the loss ratio of the former is 3% higher, and its accident rate is 0.04% higher than the latter. In other words, the new contract provides wider coverage at a lower premium rate than the old contract.

Table 5. Comparison of domestic use of ICC (B) and ICC (WA) contracts

	Number of contracts		Premium income (million won)		Average loss ratio (%)		Loss frequency (%)	
	ICC (B)	ICC (WA)	ICC (B)	ICC (WA)	ICC (B)	ICC (WA)	ICC (B)	ICC (WA)
2009	8,203	11,860	4,142	382	61.9	-	2.7673	0.0169
2010	7,873	11,094	4,347	358	1.4	-	1.5623	0.0631
2011	8,927	9,803	4,340	594	57.1	6.5	1.1874	-
2012	8,791	8,237	4,062	319	26.3	124.2	1.4333	0.0607
2013	8,887	6,662	3,177	288	36.8	83.2	1.1702	0.0300
2014	9,146	6,170	2,936	251	3.1	-	0.6998	0.0972
2015	10,399	5,569	2,652	163	88.7	64.2	0.9712	0.0898
2016	9,981	3,591	2,277	112	33.7	23.3	0.9618	0.0557
2017	7,853	3,241	2,586	119	69.7	-	0.8150	0.0933
2018	7,068	2,686	2,658	80	84.3	39.9	0.5659	0.0745
Total	87,128	68,886	33,176	2,665	44.1	20.6	1.2063	0.0494

Source: KIDI General Insurance Team. (Note: some values are missing for unidentifiable reasons.)

Table 6. Comparison of domestic use of ICC (C) and ICC (FPA) contracts

	Number of contracts		Premium income (million won)		Average loss ratio (%)		Loss frequency (%)	
	ICC (C)	ICC (FPA)	ICC (C)	ICC (FPA)	ICC (C)	ICC (FPA)	ICC (C)	ICC (FPA)
2009	6,302	38,215	714	4,816	7.5	24.9	0.0793	0.1047
2010	9,858	37,564	956	5,085	9.0	173.1	0.0101	0.2263
2011	12,720	33,794	1,412	4,790	9.3	373.4	0.0865	0.6540
2012	12,126	31,946	1,177	5,472	31.7	71.4	0.0907	0.1252
2013	13,189	32,067	1,028	4,278	-	-	0.0303	0.1060
2014	12,056	32,968	651	3,743	20.1	-	0.0332	0.0607
2015	9,268	33,836	432	2,798	34.9	118.2	0.0755	0.1123
2016	9,632	33,729	421	2,453	-	-	0.0104	0.0415
2017	8,033	25,532	415	2,845	17.5	63.1	0.0249	0.0470
2018	7,062	22,463	355	2,661	41.5	8.0	0.0425	0.0312
Total	100,249	322,114	7,531	38,940	14.5	72.6	0.0489	0.1586

Source: KIDI General Insurance Team. (Note: some values are missing for unidentifiable reasons.)

Table 8 shows that, on average, the new contracts are more expensive in absolute price, but they provide more benefits (i.e., higher loss ratio) than the old contracts. The judgment favoring the new contracts is supported by their higher accident frequency.

Table 7. Comparison of domestic use of ICC (Air) and ICC (A/R Air) contracts

	Number of contracts		Premium income (million won)		Average loss ratio (%)		Loss frequency (%)	
	ICC (Air)	ICC (A/R Air)	ICC (Air)	ICC (A/R Air)	ICC (Air)	ICC (A/R Air)	ICC (Air)	ICC (A/R Air)
2009	93,985	375,580	4,679	12,160	36.8	20.3	0.1043	0.1401
2010	180,825	321,203	6,166	12,688	9.7	39.0	0.0791	0.1432
2011	213,407	322,257	6,595	14,274	37.1	69.4	0.0768	0.2079
2012	217,318	317,637	6,277	10,044	12.9	70.5	0.0594	0.2594
2013	240,728	313,202	6,820	8,113	14.8	46.3	0.0552	0.2439
2014	259,859	326,395	6,640	7,450	50.5	79.1	0.0562	0.2711
2015	263,774	346,385	8,759	5,961	19.5	61.2	0.0891	0.2116
2016	286,902	385,411	7,096	8,031	4.4	108.3	0.0491	0.1450
2017	259,699	393,283	6,568	12,123	15.3	34.7	0.0385	0.0742
2018	281,979	242,902	7,213	4,384	68.5	50.0	0.0997	0.1284
Total	2,298,294	3,344,255	66,815	95,227	26.2	54.4	0.0683	0.1802

Source: KIDI General Insurance Team. (Note: some values are missing for unidentified reason.)

Table 8. Comparison of the old and new clauses during the 10-year period

	New clauses	Old clauses	Average in 10 years	Notes
Average insurance premium per policy	0.117606	(>) 0.104889	Old one cheaper	The larger the premium is, the greater the coverage (in general).
Accident frequency	0.5427	(>) 0.499	Old one lower	The coverage of the new clauses seems to be wider.
Loss ratio	67.9	(>) 64.3	Old one lower	More cost-effectiveness in new clauses for the insured

Source: Authors' own calculations.

The data analysis above shows that the Korean OMI market has strong SQB toward the old OMI contracts, with the newest contracts (2009) never used. Comparison of the two contract types in use reveals that the old one offers smaller coverage and a lower absolute premium rate, with lower a loss frequency or loss ratio. In other words, the old contracts are more beneficial to insurers than to the insureds overall. Nevertheless, this finding cannot be interpreted as profit maximizing behavior because the old contracts with partial coverage are also less profitable than the corresponding new ones. Therefore, the only consistent interpretation of the phenomenon is SQB toward the old form for all types of contracts.

In the following section, we address important questions about SQB in the OMI market.

5. Interviews with OMI Underwriters and a Survey of Insureds

5.1. Focus-group Interviews with OMI Underwriters

Although previous research on behavioral finance has explained what drives SQB in general, we conducted written focus-group interviews with four major OMI underwriters in

Korea¹² via KIDI to answer the following questions.

- 1) Why are the old clauses more accepted than the new ones?
- 2) Is there any difference between Korea and other countries in the choice of OMI clauses?
- 3) Why are all-risk contracts more popular than partial coverage contracts?

5.1.1. Why are the old clauses more accepted than the new ones?

- A OMI insureds prefer the old clauses (1963 version) and feel unfamiliar or uncomfortable with the new clauses (1982 version). This current situation will never change unless the old clauses disappear.
 - B In the case of umbrella (e.g., large) insureds, they stick to the old ones because they feel no major difference between the old and new clauses. Small insureds, however, do not know that the new ICC (A) covers all-risk. Moreover, when issuing L/C, banks require us to include the ICC (A/R) conditions only, without knowing that either ICC (A/R) or ICC (A) is acceptable. Also, no one wants to change their OMI coverage.
 - C When signing an OMI contract, various clauses, together with the expected premium, are offered to the insureds, who cannot tell the difference among them. Very few read and compare all the English clauses before making a decision. In addition, insurance is often sold, not bought, in trade practice by insurers who just want to follow the requirement written by the bank's L/C department. For insureds, only the feeling that the cargo can be secured for full-coverage matters, with no attention paid to any possible differences between options.
 - D There may be some differences in choosing clauses, without any particular trend.
-

5.1.2. Is there any difference between Korea and other countries in the choice of OMI clauses?

- A There are some differences between Korea and other countries.
 - B While foreign insureds do not know the differences well, their insurers prefer the new clauses, which offer clearer coverage than the alternative.
 - C Although it varies by country, it is well-known that most countries except Korea mainly use the 2009 ICC, as the foreign insurers explain the difference and recommend the new one to uninformed stakeholders such as banks or traders in the insurance market with information asymmetry.
 - D The purposes in transforming the old clauses into the new clauses are to 1) improve readability by deviating from obsolete and difficult expressions, and 2) resolve disputes caused by various coverages or exemptions. The ICC 2009 are seldom used in Korea.
-

¹² Although four underwriters seems to be too few for an adequate sample size, they represent Korean OMI insurers fairly well because they represent Samsung, Hyundai, KB, and Meritz, which account for 60% of all premiums written for non-life insurance in Korea. Furthermore, Korean non-life insurers hire only a few OMI underwriters, who then work in the profession for years. That is, the total population of OMI underwriters in Korea numbers some tens at the most, and obviously, their replies are as professional as can be imagined. Please refer to the Insurance Statistics Yearbook (2019), Korea Insurance Development Institute, p.326, published in October 2020.

5.1.3 Why are all-risk contracts more popular than partial coverage contracts?

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- A ICC (A/R) is preferred because the difference in insurance premiums is not that large, with other things being virtually equal.
 - B Insurance premiums for cargo insurance are cheap, so the difference in premium between ICC (A/R) or ICC (A) and the others, ICC (WA), ICC (FPA), ICC (B), and ICC (C), is not so significant.
 - D ICC (A/R) and ICC (A) offer comprehensive or virtually full coverage, indemnifying all loss or damage except for a few specified risks, whereas the other clauses cover less, obviously. Naturally, insureds choose the wider coverage even if they have to pay a bit more in insurance premiums.
-

The responses of OMI underwriters reveal that they recognize both the difference between the overseas market and the Korean one in terms of SQB and the advantages that the new clauses have over the old ones. Seemingly, they pass part of the responsibility for using the old clauses to insureds or banks issuing L/Cs.¹³

5.2 Supplementary in-depth interview with one underwriter

After the focus-group interviews with OMI underwriters, we conducted an in-depth interview in November 2020 with the underwriter from company C, who offered a highly detailed reply demonstrating expertise in both domestic and foreign OMI markets. He confirmed that the 2009 ICC is generally used in most countries and agreed that Korean insurers demonstrate SQB by hesitating to deviate from the older contract forms because they are largely indifferent to profit, terms, or conditions, choosing to focus mainly on their size or market share. In Korea, he said, not only insurance companies but also other stakeholders care and know little about the OMI clauses. OMI is perceived as a simple requirement for trade rather than as something needed to cover the transportation risks of trade *per se*. He also added that many foreign traders use the old clauses because Korean banks usually require ICC (A/R) conditions when issuing L/C, probably without knowing that the new ICC (A) could play a similar or better role than its old form.

5.3 Insured Survey

For the sake of completeness in this research, we conducted a survey of insureds between July 1st and July 14th of 2020, targeting people who work for Korean trading companies and are in charge of purchasing OMI policies from the Ace non-life insurance company of Korea. In spite of the support of a managing director (Mr. Choi, Eunseok) for the survey, we received only 15 responses, who provided the following results.

Among the 15 respondents, 8 said that they used the old ICC (A/R) clauses, and 6 said that they use the new ICC (A) clauses. When asked why they chose to use that contract, 8 answered, ‘as a custom (Status Quo),’ 6 said, ‘as advised by my insurer,’ and 1 said, ‘for wide coverage), demonstrating SQB or incomplete information among the insureds. Although the average duration of the existing contract form is 3.9 years, the insureds report sticking with their current contracts for convenience (5.4/7.0), no stress (4.7/7.0), tradition (5.3/7.0), and custom (5.1/7.0), all of which indicate SQB.

¹³ According to Satoshi Nakaide, Japanese insurers began to actively recommend the newest clauses (2009) to their customers in 2009 with the belief that they would be better off with the new contracts.

6. Conclusion and Implications

In this research, we intended to fill the gap between the theory of behavioral insurance, particularly SQB, and the practice of OMI using data, emails, an interview, and a survey. It is well known that OMI revamped its standard contracts in 1982 and 2009 to revise the old Lloyd's S.G. policy for clarity, stability, and balance. Using both qualitative observation and quantitative data, we are the first to compare which OMI contract types are popular in Korea and a few other industrialized countries (UK, Germany, and Japan) and why, in terms of SQB, trade development, and even consumer protection.

Surprisingly, we found that Korean foreign traders rely on the 1963 OMI contracts, whereas the other countries all use the newest 2009 OMI contracts. We used a simple loss ratio analysis of contracts from 2009 to 2018 to show that the Korean behavior has little to do with rational profit maximization by insurers because some of the new contracts can provide higher average profits than the old contracts. The consistent use of the old contracts in the Korean OMI market reveals strong SQB among Korean exporters, importers, bankers, or insurers, which we confirmed in focus-group interviews with four underwriters, an in-depth interview with an underwriter, and a survey of fifteen insureds. For international comparison, we conducted email correspondence with experts in the UK, Germany, and Japan, and they reported that they do not keep any data about the types of OMI contracts. Despite data unavailability in foreign countries, our research has produced new findings with significant implications for the development of trade practices and policy.

First, this research is based on actual statistics from the Korean Insurance Development Institute(KIDI). Because most previous OMI research focused on legal or contractual issues, data on actual usage provides a broader perspective on this field. Second, the research shows that all-risk OMI policies provide more value to insureds, in terms of coverage given premium, than partial coverage policies, which differs from a previous research argument in Korea. Therefore, when choosing an OMI contract, insureds should consider not only insurance coverage, but also the cost and value of the contract. Third, the research demonstrates strong SQB in Korea. As the KIDI data confirm, both insureds and insurers prefer the ICC 1963 to the newer versions regardless of their price and loss ratio. The bias could be attributable to uninformed traders (insureds), informed but dull insurers, or conservative bankers.

Some scholars have argued that ICC 1963 offers wider coverage than the newer versions. However, according to our results, the average loss ratio of ICC (A) is a bit higher than that of ICC (A/R), whereas it should have been lower if it simply had narrower coverage. This evidence enables us to argue that the benefit of clearer, modernized clauses might dominate the wider coverage, if there is any, in the 1963 clauses. To further develop foreign trade in Korea, therefore, policy initiatives are needed to review the current practices in OMI contracts and move forward with the new contract forms. According to previous studies, SQB diminishes as individuals gain experience and information (Shapira and Venezia, 2008; List and Haigh, 2005), so the insured, insurers, and financial supervision agencies could diminish their SQB by obtaining more information, such as the costs and benefits of the new versions, loss ratio data, or placing a duty of explanation on insurers to compare the ICC types. The Financial Supervision Service or an academic seminar might also encourage banks and insurers to review the current practices promoting SQB.

Hopefully, this research can be continued with a formal survey with a larger sample size and wider range of respondents to explore the structure of the SQB in the OMI market in more depth and detail.

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