



INSURANCE AUSTRALIA GROUP

SUBMISSION

To

PRODUCTIVITY COMMISSION INQUIRY INTO THE RELATIONSHIP BETWEEN THE AUSTRALIAN MOTOR VEHICLE SMASH REPAIR INDUSTRY AND THE MOTOR VEHICLE INSURANCE INDUSTRY

13 October 2004

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EXECUTIVE SUMMARY

- In IAG's view, the Preferred Smash Repairer (PSR) scheme reduces the cost of insurance and improves the functioning of the Australian smash repair industry.
- Membership of IAG's PSR scheme is open and transparent. Application to join the scheme is open to all repairers who meet the required criteria and IAG's business needs. Membership of IAG's PSR scheme remains contestable at all times.
- IAG notes that a number of Government Inquiries and Reviews over recent years have examined the preferred supplier arrangements between the insurance industry and the smash repair industry and found these supplier arrangements *not* to be in breach of the *Trade Practices Act 1974* or any other legislation.
- IAG would be concerned if any Inquiry recommendation was that IAG should not be able to choose, based on business needs and commercial and probity considerations, with whom it wants to do business to secure smash repair services to meet its contractual obligations to its motor insurance customers. IAG would also be concerned if there were to be any recommendation that its commercial decisions about with whom it will do business in a competitive market, made within the law, should be subject to third party review.
- IAG believes any additional legislative or regulatory intervention regarding the relationship between the motor vehicle smash repair industry and the insurance industry is unnecessary and inappropriate as the existing provisions deliver comprehensive protection to Australian consumers and provide smash repairers and insurers with a balanced operating environment.
- Customers of smash repair services have a right to expect that businesses offering smash repair services have the skills and standards to safely and professionally repair their vehicle - wherever in Australia they have an accident. The need for safety and probity does not change at State or Territory borders. For this reason, IAG supports the development of a nationally consistent licensing regime for smash repairers that sets minimum standards for smash repairers to operate. These standards should be developed with Governments, smash repairers, consumer groups and insurers, as major customers of smash repair services.

INTRODUCTION

Insurance Australia Group (IAG) welcomes the Productivity Commission Inquiry into the relationship between the Australian motor vehicle smash repair industry and the motor vehicle insurance industry (the Inquiry) announced by the Federal Government.

IAG is particularly encouraged by the fact that the Federal Treasurer in announcing the Inquiry stated *“This Government is about ensuring that we have vigorous competition in markets to drive good outcomes for customers. And a key element of a vigorous market is informed parties and transparent commercial arrangements.”*

IAG believes it is essential to ensure that Australia’s competition laws remain in step with the competitive pressures faced by the Australian economy and businesses. IAG agrees with the Australian Government that Australia’s competition laws should be *“distinguished from industry policy and should not be seen as a means of achieving social outcomes unrelated to the encouragement of competition, or of preserving businesses that are not able to withstand competitive forces.”* (Australian Government response to Senate Inquiry into the effectiveness of the *Trade Practices Act 1974* in Protecting Small Business).

Who is Insurance Australia Group?

IAG is the largest general insurance group in Australia and New Zealand (by reference to premium written in these countries). It provides personal and commercial insurance products under some of the most respected and trusted retail brands including NRMA Insurance, SGIO, SGIC, CGU and Swann Insurance in Australia, and State and NZI in New Zealand.

IAG’s core lines of business include:

- Home insurance
- Motor vehicle insurance
- Business insurance
- Consumer credit insurance
- Product liability insurance
- Compulsory third party (CTP) insurance
- Workers’ compensation insurance
- Professional risk insurance

IAG has a crucial interest in the long-term viability of insurance as a product valued by the Australian community. IAG believes that there are four principal ways in which the insurance industry can best meet these objectives. These are:

- Investing in robust risk control frameworks and mechanisms that protect policyholders and provide certainty to shareholders;
- Pricing products realistically;
- Ensuring that customers understand what they are buying when they purchase a policy, and that products do not arbitrarily advantage or penalise particular individuals or groups; and
- Committing to, and supporting, on a continuing basis, a comprehensive and clearly defined regulatory framework that facilitates more affordable premiums and more predictable claims costs.

What is IAG's Interest in the Current Inquiry?

IAG is Australia's largest general motor insurer, with in excess of 5.2 million motor risks in force nationally (details of IAG's market share in the motor vehicle insurance market by State and estimates of IAG's collision repair work market share are outlined in Commercial In Confidence Appendix A). IAG manages approximately 372,000 collision claims nationally. If damage to vehicles arising from fire, hail damage etc is included, this figure rises to approximately 439,000 motor vehicle claims in total.

Under the current terms of the insurance policies issued by IAG, where an insured vehicle is damaged and the policyholder is entitled to and does make a claim, IAG will be liable to:

- Repair the vehicle at its expense; or
- Indemnify the policyholder for the fair and reasonable cost of repairing the vehicle; or
- If the vehicle is unable to be repaired, or the cost of repair exceeds the agreed/market value of the vehicle specified in the policy, replace the vehicle or pay the policyholder the agreed/market value of the vehicle.

Currently, IAG has 838 Preferred Smash Repairers (PSRs) nationally, supported by over 1,300 Associate Smash Repairers (ASRs) and 16 Preferred Towing Operators (details of IAG's PSRs and ASRs by State are outlined in Commercial In Confidence Appendix B). It also transacts business with a range of non-accredited smash repairers and towing contractors across Australia.

IAG introduced its Personal Insurance Preferred Smash Repairer scheme relatively recently – in November 2000. The decision to set up the scheme was based upon a clear business need for IAG to be able to offer customers improved service. The scheme attempts to identify and select better repairers, who provide high quality repairs at competitive prices and offer IAG's customers excellent service. As well as quality, probity, customer service and cost benchmarks, all PSRs and ASRs are appointed by IAG based on business need (see Chapter 3).

IAG's PSR scheme also allows IAG to provide support to the Australian smash repair industry through business management training, apprenticeship sponsorship and the Preferred Smash Repair Advisory Committee, as well as technology support for on-line repair management and web-based repair management (see Chapter 3).

IAG's Investment in the Smash Repair Industry

IAG continues with its programme to embed sustainability across its brands in order to deliver clear business benefits such as efficiencies, reduction in repairer operational costs, employee motivation and retention and increased community trust. Some of the main achievements during 2003-04 relevant to the current Productivity Commission Inquiry include:

- Development of the "Risk Radar" for the Australian smash repair industry, a key supplier to IAG. This was developed co-operatively with smash repairers. This product represents one of IAG's first customer-facing sustainability related product initiatives;

The "Risk Radar" is a CD-Rom based learning tool available to all smash repairers to assist them in improving their environmental management and safety performance with regards to both employees and the environment. For a flat fee, IAG's PSRs and ASRs receive the "Risk Radar" and subsequent training;

- Specific commercial underwriting factors have been taken into account so that if the smash repairers can demonstrate auditable improvement in their practices, they will qualify for an insurance premium discount for insuring their business. In addition, IAG's key community partner, St John Ambulance, also offers first aid kits at a reduced rate to PSRs;
- Continued investment in IAG's JumpStart national training programme, incorporating the JumpStart Autobody Scholarships for school leavers, and the JumpStart Autobody Traineeships for Year 11 and students, which encourage high school students to begin a career in the smash repair industry. This programme will provide about 400 smash repair traineeships and scholarships over the next four years. It demonstrates a comprehensive approach to sustainable business benefiting the broader community, key suppliers (smash repairers) and IAG, by ensuring that smash repairers can continue to provide services in the future.

The Economic Effects of IAG's Preferred Smash Repairer Scheme

IAG believes that the PSR scheme has served to improve service to customers, reduced the cost of insurance and improved the functioning of the Australian smash repair industry. To assess these impacts, IAG commissioned Network Economics Consulting Group (NECG) to conduct an independent assessment of the effects of the PSR scheme.

NECG advises corporate and government clients on all economic aspects of regulation, competition policy, trade practices, intellectual property and related issues in many industries (www.necg.com.au/). The NECG report *Analysis of the economic effects of IAG's preferred smash repairer scheme* (May 2004) (NECG PSR Report) is at Commercial In Confidence Appendix C.

The NECG PSR Report:

- Draws on economic theory to explain how the PSR scheme is achieving efficiency improvements and how IAG has strong incentives to pass on some of these efficiency improvements to its policyholders;
- Presents estimates of cost savings that the PSR scheme is generating;
- Demonstrates that the PSR scheme has not led to a deterioration in the quality of repairs; and
- Presents an assessment of the potential for overall cost savings if all insurers in Australia were to introduce a PSR or similar scheme.

IAG submits that the NECG PSR Report will assist the Commission as it addresses a number of the *Terms of Reference* of the Inquiry.

CHAPTER 1:

THE AUSTRALIAN MOTOR VEHICLE INSURANCE INDUSTRY

1.1 Overview

The Australian motor vehicle insurance industry is part of the general insurance industry. The Australian Prudential Regulation Authority (APRA) reports that there are currently “111 general insurers authorised to write new business in Australia, with another 32 licensed only to undertake the run-off of existing portfolios. In recent times, the number of authorised insurers in Australia has declined, as a consequence of industry rationalization and the added impetus of regulatory reforms designed to improve safety and soundness” (*APRA Insight, 1st Quarter 2004*).

APRA reports that for the five largest general insurance groups, 70% of premium is from short-tail business such as motor and householder cover and 30% from long-tail business such as indemnity or liability cover.

The Australian general insurance industry is viewed as having low barriers to entry in short-tail classes of insurance - limited to the national regulatory requirements, including APRA’s minimum capital and solvency requirements and Australian Securities and Investment Commission (ASIC) licencing requirements. While new entrants to the industry experience problems in obtaining relevant information concerning the risks they wish to insure “...much of the required information about risk can be inferred from the premiums charged by other companies. This information is publicly available and can be assembled at a low cost. New entrants also face costs associated with developing the business to a scale where it can compete profitably with the premiums offered by established firms.... However, firms wishing to enter most industries face analogous problems, and it is doubtful whether such costs can be construed as significant entry barriers. There has been some entry and exit from the industry over recent years, but much of this is as a result of structural adjustment within the industry (i.e. mergers and rationalisations)” (Industry Commission, 1995 <http://www.pc.gov.au/ic/inquiry/43vehicl/finalreport/index.html>).

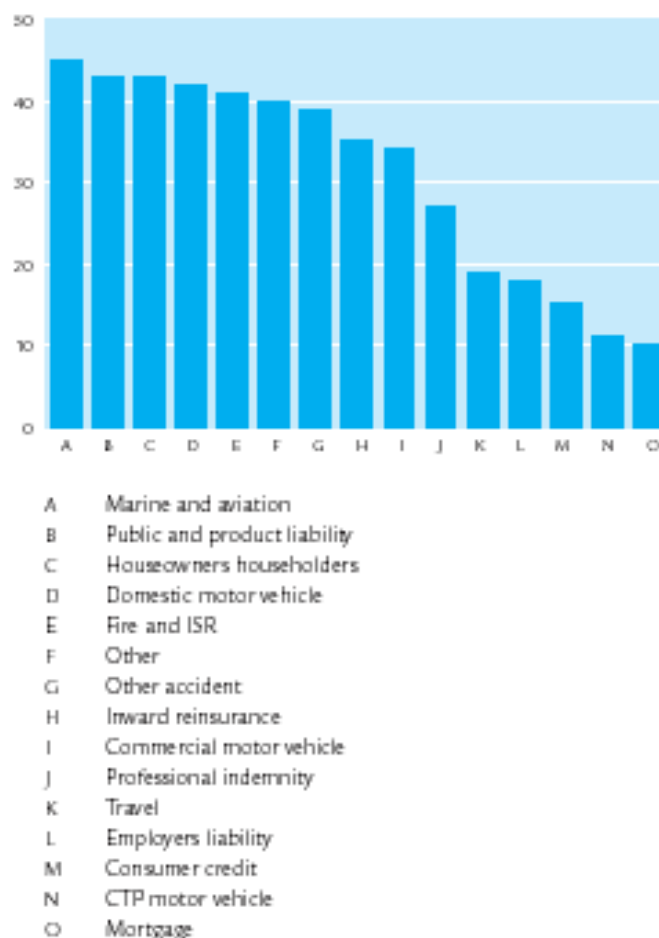
1.2 Regulation of the General Insurance Industry

General insurers are subject to the corporate regulatory regime that applies to Australian incorporated businesses generally. This includes the legislative regimes of the *Corporations Act 2001*, the *Trade Practices Act 1974*, State fair trading legislation and, for public listed companies, the requirements of the Listing Rules of the Australian Stock Exchange.

General insurers are also subject to a range of industry specific regulations at Federal (eg *Insurance Act 1973*, *Insurance Contracts Act 1984*), State and Territory levels. These regulations subject insurers to prudential supervision. They also deal with aspects of market conduct and consumer protection and the various statutory insurance schemes, which operate in each State and Territory. A detailed analysis of the regulatory arrangements associated with providing insurance in Australia was outlined by the HIH Royal Commission - <http://www.hihroyalcom.gov.au/finalreport/index.htm>.

APRA data indicate the number of insurers writing each class of business varies significantly. The market for comprehensive motor vehicle insurance is serviced by a large number of insurers, providing a wide range of offerings to customers. In this market there is intensive price, service and product competition. Customers have access to a healthy range of products from which to choose. They are able to take advantage of special features such as loyalty and multi-policy discounts. This market is considered to be a stable market, being a consolidated market that is quite disciplined in risk-based pricing of its products. Details of the number of insurers by class of insurance is outlined below.

Number of active insurers by class of business
(as at 30 September 2003)



Source: APRA Insight, 1st Quarter (2004)

The domestic motor class is the largest of the APRA classes of insurance representing 21% of total gross written premium and 22% of policies written. The commercial motor category accounts for 6% of total gross written premium and 3% of policies written, while Compulsory Third Party represents 10% of total gross written premium and 14% of policies written (*Australian Competition and Consumer Commission (ACCC), Insurance Industry Market Pricing Review (2002)*).

The Australian Competition and Consumer Commission (ACCC) stated that one of the primary concerns of insurers is to ensure that “there is a competitive market, that they are able to offer customers competitively priced premiums and, in the event of a claim, that quality repairs are carried out in a timely manner” (*ACCC, Issues Paper, 2003*).

1.3 Insurance Premiums

Details of insurance industry premium rate movements over 2002 and 2003 and estimates for 2004 and 2005 and a comparison with movements in Consumer Price Index (CPI) and wages are detailed below. Insurance industry expectations see insurance premiums increasing by 2-3 percentage points above the prevailing rate of inflation for the domestic motor vehicle class of insurance in 2004 and 2005.

Change in Premium Rates 2002, 2003 and Expectations for 2004 and 2005 (%)

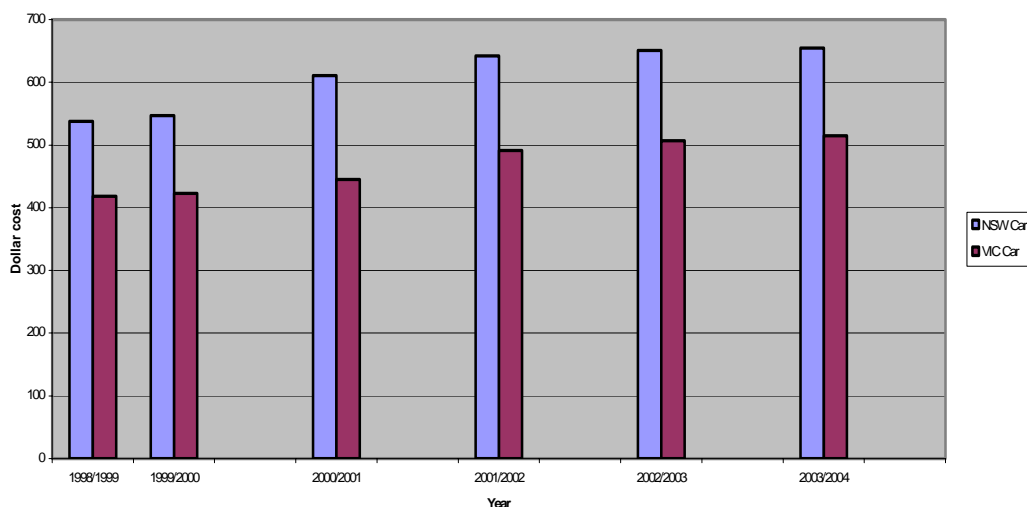
Insurance Class	2002	2003	2004	2005
Domestic Motor Vehicle	11	7	5	4
Householders	11	7	6	5
CTP (NSW)	5	-1	5	5
CTP (QLD)	na	12	5	1
Workers' Compensation	5	-6	-4	0
Fire & ISR (Property)	45	14	9	-1
Commercial Motor Vehicle	11	5	0	1
Public & Product Liability	51	27	11	6
Professional Indemnity	51	29	18	10
Directors & Officers	32	26	14	11
CPI	2.9	3.1	2.25	2.0
Wage Cost Index	3.1	3.1	3.75	3.75
GDP	3.9	2.9	3.75	3.5

Source: JP Morgan/Deloitte, *2003 General Insurance Industry Survey*, December 2003. JP Morgan/Deloitte, *2002 General Insurance Industry Survey*, December 2002. 2004-05 Federal Government Budget 11 May 2004. Forecasts for CPI, wage cost index and GDP relate to financial years.

During 2003-04 IAG average premiums have tended to be flat or down in the major portfolios reflecting improved claims outcomes from cost savings, portfolio mix and environmental factors.

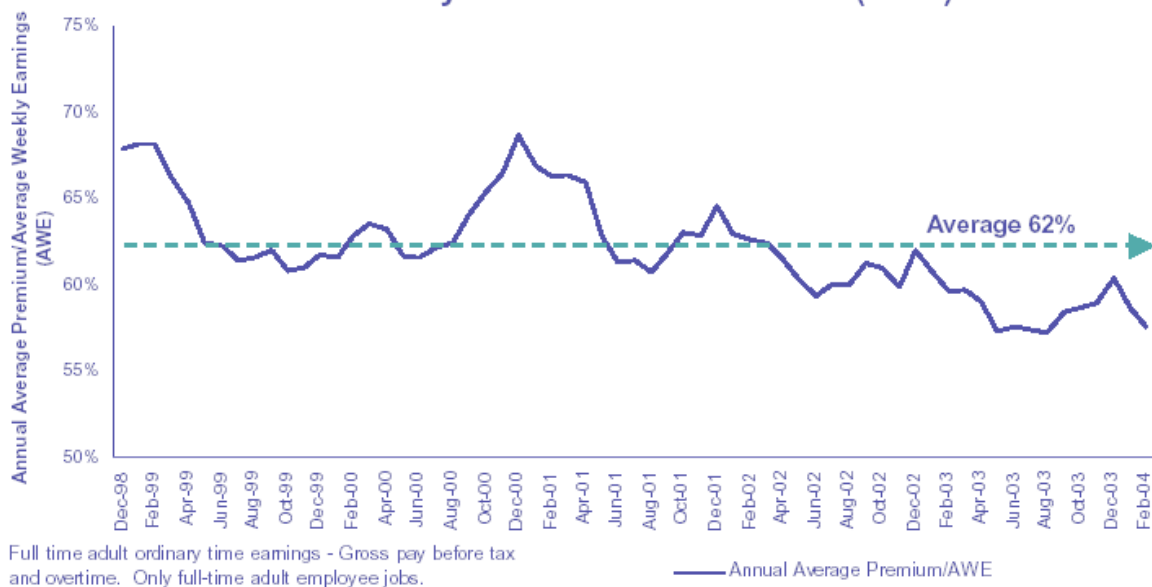
The following graph provides context around the trend in IAG's average premium by measuring affordability for motor vehicle insurance. It measures the annual cost of an average premium for a NSW motor comprehensive policy against average weekly earnings and shows affordability is 8% cheaper as at February 2004 compared to same period two years ago, and is 2% cheaper than at December 2003.

Changes in IAG's NSW and Victoria Motor Vehicle Premiums



Source: IAG

Affordability of NRMA Car Insurance (NSW)



Note: On average, 62% of the average weekly earnings covers a 12 month insurance policy.

Source: IAG

CHAPTER 2

THE AUSTRALIAN MOTOR VEHICLE SMASH REPAIR INDUSTRY

2.1 Overview

Australian Bureau of Statistics (ABS) data indicate there were 13.2 million motor vehicles registered in Australia in 2003. The passenger motor vehicle fleet accounted for 10.4 million in 2003. New South Wales had the largest share of the Australian motor vehicle fleet with 3.9 million vehicles (30% of the total) registered, followed by Victoria with 3.5 million (27%) and Queensland with 2.6 million (19%). The Northern Territory had the smallest share with 0.1 million vehicles (0.8%) registered. The average age of all vehicles registered in Australia in 2003 was 10.4 years (*ABS, Motor Vehicle Census, Australia, Cat. No. 9309.0*).

According to the ABS, there were 5,594 smash repair businesses in Australia in 1998-99 (latest available), employing 32,659 persons with a total income in excess of \$3.0 billion (*ABS, Retail Industry, 1998-99, Cat. No. 8622.0*).

The Australian smash repair industry obtains most of its work from insurance repairs. According to IBISWorld Pty Ltd (2003), the insurance sector accounts for 75% of turnover for the Australian smash repair industry (*IBISWorld Pty Ltd (2003), Smash Repairing in Australia*).

As highlighted in the ACCC *Issues Paper* (2003) the number of vehicles per bodyshop in Australia is significantly less than the US and the UK. Moreover, there has been a decrease in the number of motor accidents across Australia which has led to less smash repair work being available for the number of smash repairers.

Country	Number of bodyshops	Total passenger vehicles	Vehicles per bodyshop
USA	53,000	130 million	2,453
UK	5,300	25 million	4,717
Australia	5,308	9.7 million	1,925

Source: ACCC, *Issues Paper* (2003)

NECG PSR Report (2004) notes that:

“the average number of vehicles serviced in smash repair shops in Australia is low relative to the United States and the United Kingdom. These statistics do not take into account important differences between these markets, including customer density advantages in the United States and United Kingdom markets relative to the Australian market. Nevertheless, this result suggests there may be scope for rationalisation of the Australian smash repair industry to achieve economies of scale”.

The ACCC also noted in its submission to the Senate Economics References Committee Inquiry into the Effectiveness of *the Trade Practices Act 1974* in Protecting Small Business (2003) (*Senate Small Business Inquiry*):

“Many issues between repairers and insurers arise as a product of various structural changes in the industry, changes in the market for insurance products, improvements in technology and training and improvements in efficiency and quality.”

2.2 Regulation of the Motor Vehicle Smash Repair Industry

Apart from New South Wales there are no regulatory barriers to entry to the motor vehicle smash repair industry.

In New South Wales, licensing is required with respect to the licensing of repair businesses and the certification of repair tradespeople under the *Motor Vehicle Repairs Act*. Loss assessors fell under the same terms until 1996 when a decision was made that it would be better for the industry if loss assessors were self regulated. To hold a licence, a repairer must meet criteria set down by the Motor Vehicle Repair Industry Authority (MVRIA). This includes having specified equipment in the workshop and employing only certificated tradespeople to carry out repairs. Repairers who carry out repairs generally below an acceptable standard or who are guilty of dishonesty, can be disciplined and their repairer's licence suspended or revoked.

Full details of New South Wales licensing requirements are available at http://www.mvria.nsw.gov.au/industry/ind_lic.htm

In the other States the Motor Traders' Associations have introduced a number of accreditation programmes as a condition of Association membership. Participating members are required to satisfy minimum equipment levels and abide by the Association's Code of Ethics.

“The ACCC believes that the establishment of the preferred repairer schemes has introduced a number of significant benefits for customers. The ACCC recognises that insurers have a commercial right to limit membership of these schemes depending upon each insurer’s needs and requirements” (ACCC, Issues Paper, p.9, 2003).

CHAPTER 3:

PREFERRED SMASH REPAIRER SCHEMES

3.1 Background

A comprehensive description of IAG’s PSR scheme is outlined in the NECG PSR Report.¹

Prior to the introduction of the Competitive Partnering program in 1998 and then the Preferred Smash Repairer (PSR) scheme in about November 2000, IAG (then known as NRMA Insurance Limited) for many years maintained a list of Known Repairers. Known Repairers were repairers that IAG was prepared to, and did, authorise to undertake for it repair work on insureds’ vehicles. Known Repairers invoiced IAG, and IAG paid Known Repairers, for such repair work.

Known Repairers

Repairers that were not IAG Known Repairers were referred to as Unknown Repairers. IAG insureds could elect to have their cars repaired by Unknown Repairers if they wished. However, rather than engaging the Unknown Repairers to undertake the repairs and then paying the repairer directly for the repairs, IAG would satisfy its obligations under the insurance policy by paying the insured an amount that IAG assessed as equal to the reasonable cost of the repairs required to return the vehicle to a state of good repair. In this scenario, the insured was responsible for engaging the repairer, supervising the repairs and paying the Unknown Repairer. This process, whereby IAG satisfies its obligations under the insurance policy by paying the insured for the reasonable cost of repair (rather than by organising and paying for the repair of the vehicle) is known as “cash settling” the insured.

Prior to the introduction of the Competitive Partnering program, IAG added to its list of Known Repairers any repairer that:

- (a) met certain basic levels of competency;
- (b) carried out a certain number of repairs from IAG to a satisfactory standard; and
- (c) had not been found by IAG to be dishonest.

¹ IAG’s PSR scheme was also considered by the Federal Court in the case of *Australian Automotive Repairers’ Association (Political Action Committee) Inc v Insurance Australia Limited (formerly NRMA Insurance Limited)* [2004] FCA 700. http://www.austlii.edu.au/au/cases/cth/federal_ct/2004/700.html

The question was essentially whether the PSR scheme involved an exclusive dealing in breach of s 47(1) of the *Trade Practices Act 1974* (Cth). The Federal Court held that, on the evidence, the PSR scheme did not breach s 47(1) of the Act. The case is on appeal to the Full Federal Court. The appeal will be held in November 2004.

That is, the list was effectively open-ended. In 1998, just prior to the implementation of the Competitive Partnering program, there were approximately 1,800 Known Repairers in New South Wales, with which IAG dealt.

There were a number of problems with the Known Repairer program. First, because such a large number of repairers were Known Repairers and thus able to undertake work for IAG, it was difficult for IAG effectively to monitor and performance manage the repairers. Performance management involves identifying repairers who are providing good quality repairs in a timely manner and at a competitive cost, and seeking to reward them by referring more work to them. Performance management also involves identifying under performing or badly performing repairers, raising with them the areas in which they are under performing and, where an area of concern is not addressed to IAG's satisfaction, seeking to direct less work to them. Second, under the Known Repairer model, there was little or no direct competition between repairers for IAG work. Once a vehicle was delivered to a Known Repairer, IAG obtained a quote from the Known Repairer only (the "one quote" model).

As a result of these problems, IAG formed a view that it should seek to develop alternative models, which would introduce greater competition into IAG's dealings with motor vehicle repairers. The goal was to develop and implement a model that would result in IAG securing high quality repairs in a timely manner and at a competitive cost.

The first initiative of IAG was the trial of a program known as "Quality Repair System" or QRS. QRS was trialled by IAG in Wollongong, New South Wales in 1997. For a variety of reasons, this system was very unpopular with parts of the smash repair industry. As a result of intense industry pressure, in 1999 IAG ceased to operate QRS in Wollongong, and did not attempt to introduce the system into other regions of New South Wales.

Competitive Partnering

As it became apparent to IAG that QRS was unlikely to be accepted by the motor vehicle smash repair industry, IAG developed and trialled a new program called Competitive Partnering. Under Competitive Partnering, IAG agreed to appoint repairers as "Partnered Repairers" and to refer work to them. This was the first time that IAG introduced a system of referring work to particular repairers. In return, Partnered Repairers were required by IAG to maintain their facilities and standards of service to an agreed level and ensure that quotes they provided to IAG were competitive, that is, they resulted in a lower than average cost.

Competitive Partnering was introduced throughout NSW during 1999. IAG adopted a policy under

which it appointed as a Partnered Repairer any repairer who:

- had been a Known Repairer with IAG for a period of time;
- agreed to enter into a written contract, known as a Competitive Partnering agreement, with IAG; and
- satisfied IAG that its premises and its levels of customer service met the prescribed standards.

In June 2000 IAG undertook a review of the Competitive Partnering program, with the aim of developing the program to deliver improved customer service and reduced costs. It was concluded that Competitive Partnering had resulted in some improvement in customer service and repair quality, compared to the Known Repairers program. However, Competitive Partnering had, at best, only limited success in reducing repair costs. It was further concluded that improvements in customer service and repair quality could be realised and average repair costs better managed if IAG identified those repairers who performed high quality work at a competitive cost, and then dealt primarily with those repairers.

Preferred Smash Repairer Scheme

In light of the conclusions referred to above, IAG developed the PSR scheme. The scheme involved IAG appointing from the ranks of Partnered Repairers a smaller sub-group of repairers as PSRs. PSRs were to be appointed from the better performing Partnered Repairers and IAG would enter into contracts with the PSRs, pursuant to which IAG would engage the PSRs to undertake smash repair work for it.

In about October 2000 to June 2001, the Claims and Assessing segment of IAG assessed each of the repairers that IAG had dealt with over the previous 12 months, based on certain criteria (which are set out below). Data from the previous 12 months were used in the assessment. Only repairers who had repaired at least one vehicle for IAG in the 6 months prior to the assessment were included in the assessment. For each criterion the repairer was given a score. The scores from criteria (a) and (b) were based on calculations from historical data possessed by IAG from its previous dealings with the repairer over the previous 12 months. The scores for the other criteria were determined by the Assessing Manager for the area in which the relevant repairer was located. IAG provided guidelines to its Assessing Managers regarding how the criteria were to be applied.

The criteria referred to above are as follows:

(a) **Weighted Average Repair Cost**

Measure: Average finalised repair cost of the individual repairer compared to a weighted branch average.

(b) **Volume of Variations**

Measure: Repairer's average number of variations per claim. A "variation" is a supplementary quote increasing the estimated cost of repair submitted by a repairer after the original quote has been submitted and authorised.

(c) **Capability**

Measure: Ability of the repairer to complete an acceptable quality of work to vehicles within all categories.

(d) **Quality**

Measure: The overall rating of the repairer's quality of work from poor to good, regardless of which category or type of work the repairer completes.

(e) **Current Relationship**

Measure: Repairer's current business relationship with IAG rated from poor to good.

(f) **Strategic Need/Location**

Measure: Does IAG have a strategic need for the individual repairer in that region/branch/location?

(g) **Potential**

Measure: The potential of the repairer's business to expand.

Following the assessment of the repairers, IAG identified the highest scoring repairers in each region of New South Wales and the Australian Capital Territory. On the basis of the assessment, IAG decided in each area how many and which repairers to offer to appoint as PSRs. To accept the offer, IAG required the repairer to enter into a written contract with IAG that would govern the provision of repair services from the repairer to IAG (the Preferred Smash Repairer Agreement).

In November 2001, IAG proposed to create a new category of repairer known as Associated Smash Repairers (ASRs). Under this proposal, all Partnered Repairers who were not PSRs, and all Known Repairers, were invited to become ASRs. To accept the offer, IAG required the repairer to enter into a written contract with IAG that would govern the provision of repair services from the repairer to IAG (the ASR Agreement). The ASR Agreement imposes various contractual obligations on repairers in relation to repair work, and dealing with IAG customers and staff. Known Repairers had not previously had to commit to performance standards or obligations.

In mid 2003, IAG offered new standard PSR and ASR Agreements to those repairers it wished to appoint as PSRs and ASRs respectively.

The Agreements are of a 12-month duration, and in June of each year, IAG decides whether to offer a new Agreement to each PSR and ASR for the next 12 months, based on their performance during the prior year.

Full details of IAG's *National Preferred Smash Repairer Agreement* and *National Associate Smash Repairer Agreement* and accreditation criteria are outlined in Appendices G and H.

Online Repair Management

Online Repair Management (ORM) involves repairers submitting quotes, variations to quotes, digital images of damaged vehicles and other information to IAG in electronic form via the Internet. Repairers use a current version of a certified quoting package, of which there are currently 9 packages available in the Australian market, which communicates to IAG's software through an Internet connection. ORM also involves repairers receiving notification that a vehicle has been allocated to the repairer for repair, authorisations to commence repair and other information from IAG in electronic form via the Internet. ORM was introduced in 2000.

ORM provides the system support for the efficient direct exchange of vehicle repair quotes between smash repairers and IAG. This provides excellent customer service by improving repair turn-around times and supports the repair industry through the speedy automated payment of approved invoices.

Web-Based Repair Management

Web-based Repair Management (WRM) is the system that allows repairers to provide tenders for smash repair work via the Internet to nine sites in Queensland, South Australia and Western Australia. Customers are greeted at the Repair Management Centres by IAG staff and assisted through the process of assessment, repairer selection and repair.

Key measures of the progress of these models are as follows:

- As at June 2004, ORM has almost 1,500 repairers nationally on-line. In Victoria, the number of repairers operating on ORM has doubled to 462 at September 2004, with 74% of all work completed through this system. ORM is also being rolled out in South Australia, Western Australia and Queensland, in both metropolitan and rural locations, with a current penetration rate of 35%.

- This on-line process is also used for payment and means faster payment turnaround times for ORM repairers, who receive electronic payment on average four days after IAG's receipt of invoice.

WRM has been fully rolled out across Queensland, South Australia and Western Australia and is handling over 80% of all IAG's drivable metropolitan work. There are nine sites now operating, with three in each state covering the Perth and Adelaide metropolitan areas, as well as the Brisbane metropolitan and Gold Coast areas. The Repair Management Centres distribute work to IAG's PSRs through an on-line tender system.

Performance Plans, Monitoring and Ranking of PSRs

The PSR Agreement provides for IAG and the PSR to negotiate and enter into a performance plan. The performance plan specifies the goals of the PSR, how the PSR's performance against those goals will be measured, and details steps the PSR will take to achieve the goals.

ASRs may enter into a performance plan with IAG, but are not required to do so. A performance plan provides a framework in which IAG and the ASR can work together to improve in those areas where an ASR is not yet at a level to be considered for PSR status. At any point in time only a minority of ASRs have entered into performance plans with IAG. As at December 2003, approximately 30% of ASRs have entered into a performance plan.

IAG actively monitors the performance of its repairers. As well as reviewing individual quotes as they are submitted, IAG monitors the average repair costs of its PSRs and ASRs. Further, IAG from time to time undertakes "Performance Investigations" of individual PSRs and ASRs. The PSR Agreements and ASR Agreements provide for such "Performance Investigations". In a Performance Investigation, IAG reviews (in respect of the repair of at least 3 vehicles) any or all of:

- The cost of repair or the amount quoted;
- The quality of repair work; and
- The standard of service provided to IAG customers.

IAG also conducts 3 and 6 monthly reviews of a repairer's performance against its performance plan. Based on the results of these reviews and any other Performance Investigations, IAG ranks PSRs as "gold", "silver", "bronze" and "red". Gold and silver PSRs are the better performing PSRs. Bronze and red PSRs are not performing to the expected PSR standard and are usually in breach of their performance plan targets. Unless a bronze or red PSR improves its performance, IAG will review whether it wishes to terminate the PSR Agreement with that repairer for breaching the performance plan targets. ASRs who have entered into a performance plan with IAG are similarly ranked "gold", "silver", "bronze" and "red".

IAG informs repairers of their ranking as gold, silver, bronze or red, so that repairers know how they are performing against IAG's expectations. There are also practical consequences to the rankings. IAG gives priority to gold and silver PSRs in the referral of work over bronze and red PSRs.

Further, IAG has introduced expedited payment of the invoices of good performing PSRs and ASRs. Approved invoices of gold and silver PSRs and ASRs are paid by IAG within one day; those of bronze PSRs and ASRs within 7 days and those of red PSRs and ASRs within 14 days. For ASRs who have not entered into a performance plan (and so are not ranked gold, silver, bronze or red), if the ASR participates on ORM, IAG pays the invoice within 14 days. In other cases, the invoice is paid within 21 days. Prior to the introduction of the PSR scheme, IAG did not have policies setting out time limits within which IAG is to pay repairer invoices. It was not unusual for IAG to pay repairer invoices 30 days or more after receiving the invoice (see also Chapter 4).

Performance problems and breaches of performance targets are communicated to repairers for rectification. This includes IAG's motor repair consultants working with repairers to rectify problems. Repeated breaches generate warnings as per the contractual agreement (see Appendices G and H). There are provisions relating to terminating agreements for poor performance. There are other grounds for termination as outlined in the termination clauses (see Appendices G and H). If a new agreement will not be offered following the expiry of a current agreement, IAG's motor repair consultants would usually have discussions with the repairer prior to the expiration date, depending on the circumstances. If the repairer refuses to rectify the performance issues the repairer is notified that IAG is reviewing their status and then the file is then sent through a review process before the final decision is made.

Prior to any decision to terminate a PSR Agreement or an ASR Agreement, IAG follows a procedure for the review of all relevant facts in relation to the repairer and the conduct giving rise to the possibility of a termination of the agreement. That procedure includes:

- (a) A written submission by the relevant Motor Repair Consultant to the relevant Assessing Manager, who in turn refers the matter to the Operations Manager for review.
- (b) The Operations Manager will, if he or she considers it appropriate, refer the written submissions and relevant documentation to Motor and Home Strategy in Head Office for review by the Repairer Review Panel.
- (c) If the Repairer Review Panel agrees with the proposed termination of the ASR Agreement or the PSR Agreement, the relevant documentation is forwarded to external lawyers for review.

If it is considered that the relevant conduct does give rise to an entitlement on the part of IAG to terminate the relevant ASR Agreement or PSR Agreement, IAG's external lawyers may be instructed to send a letter to the repairer advising it of the termination of the ASR Agreement or PSR Agreement.

If such a letter of termination is sent, the termination will usually take effect from 3 business days after the date of the letter.

In the event of the termination of a PSR Agreement the repairer will, in appropriate circumstances, be invited by IAG to complete an application to enter an ASR Agreement.

The following table shows the change in status of IAG's PSRs and ASRs in the last 12 months.

Relationship Change (previous to current)	Number of changes
ASSOC to NONAC	39
ASSOC to NONAC to PREFS	2
ASSOC to PREFS	73
NONAC to ASSOC	314
NONAC to ASSOC to NONAC	1
NONAC to ASSOC to PREFS	5
NONAC to PREFS	48
NONAC to PREFS to ASSOC	1
PREFS to ASSOC	30
PREFS to ASSOC to NONAC to ASSOC	1
PREFS to NONAC	2
PREFS to NONAC to ASSOC	2
Grand Total	518

Changes for last 12 months

PREFS = Preferred Smash Repairer

ASSOC = Associate Smash Repairer

NONAC = Non-accredited Smash Repairer

Source: IAG

The above table indicates instances where a repairer has been made a PSR from Non Accredited status. This has occurred with the rollout of our PSR program to remote and rural locations where we had no geographical coverage of our program historically. All of these repairers met the minimum criteria and were made PSR's to ensure IAG's rural customers have the same opportunity to use a PSR as metropolitan customers.

In NSW where the PSR model has been in place for some time IAG received 80 applications from Non Accredited repairers in the last year to become ASR's. Of these approximately 15% were accepted to become ASR's.

3.2 Advantages of the Preferred Smash Repairer Scheme

The aim of the PSR scheme, when established, was to improve IAG's ability to performance manage smash repairers by dealing predominantly with a smaller number of repairers. IAG also hoped to realise cost savings, introduce greater efficiencies in its dealings with smash repairers and improve the average quality of repairs by referring, to the extent it was able, work to PSRs. For example, by referring the majority of work to a smaller group of repairers, IAG hoped to reduce the costs and delays associated with assessors having to visit a large number of repair premises to assess and authorise a small number of jobs at each repairer.

In addition to PSRs, IAG maintains a network of ASRs for several reasons. First, having relationships with ASRs as well as PSRs enables IAG to offer customers a very comprehensive range of repairers through which IAG can affect repairs to vehicles. This helps IAG to effect the repair of a customer's vehicle with minimum inconvenience to the customer, for example, by allowing the customer to nominate a repairer in a convenient (for the customer) location. Also, IAG monitors the performance of ASRs, which allows it to identify good or improving performers who merit PSR status. For example, IAG needs to monitor a newly established repairer before it knows whether to offer it PSR status. Further, where an ASR wishes to put in efforts to improve its performance, IAG will work with the ASR to help to achieve the improvement. This is done, for example, by entering into a performance plan with the ASR, which identifies the goals of the repairer and specifies actions the ASR needs to undertake to achieve these goals. As a result of the ASR program, there is a pool of repairers about which IAG is relatively well informed and from which it can select repairers to offer to appoint as additional or replacement PSRs as the need arises. Finally, the existence of the ASRs and their possible promotion to PSR status helps to maintain competition within the PSR scheme. This helps to ensure that PSRs, when undertaking work for IAG, continue to provide high quality, cost competitive, customer-focused work.

It is important to note that although membership of IAG's PSR scheme is limited, application to join the scheme is open to all repairers who meet the required criteria and IAG's business needs. As the Industry Commission, *Vehicle and Recreational Marine Craft Repair and Insurance Industries* (1995) noted:

"Given that repairers can opt not to become an approved repairer — indeed the majority of repair shops do not have "approved" status — there seems little wrong in insurers specifying conditions

of entry to a scheme, providing that the conditions do not infringe the Trade Practices Act. It is to be expected that insurers will apply conditions to schemes as a quid pro quo for the benefits received by the repairers (eg higher work volumes and quicker financial settlements). Repairers will presumably only apply to join the scheme (and remain members) if the expected benefits to them exceed the costs (i.e. they also share in the gains from the arrangements).

Approved repairer schemes can give an insurer greater control over costs by directing work to those repairers who have demonstrated that they can perform work to the company's requirements. Conversely, it can be argued that they are intended to prevent individual policyholders directing work to highly visible, relatively high cost "prestige" repairers, or repairers who have not performed satisfactorily in the past. While insurance companies argue that this is part and parcel of their responsibility to control costs, it undoubtedly restricts the choice of repairer available to their policyholders.....

.....The MTAA expressed concern that not all eligible repairers are able to become "approved". However, one reason for establishing a scheme is to build up the relationship between an insurer and its repairers by developing a network of repairers that undertake a significant proportion of work on behalf of the insurance company. Clearly, this cannot be achieved in the insurance industry (or elsewhere) if the number of designated suppliers is so large that the company's business is a relatively minor part of the overall workload of any one repairer. It also needs to be recognised that meeting an insurer's technical requirements for access to an approved repairer scheme does not guarantee that it will be possible to form close working relationships.

Approved repairer schemes are consistent with strategies adopted by many other industries to improve relationships with their suppliers. The schemes have the potential to improve productivity and so benefit both insurers and repairers. To the extent that repair costs are reduced, customers will also benefit (in the form of lower premiums)."(Page 71-72).

Importantly, the NEEG PSR Report (Commercial In Confidence Appendix C) indicates that the PSR scheme is "an important market-based mechanism for addressing market failure in the smash repair industry. The market failure is related to information asymmetry. That is, smash repairers are in a position to know more about the quality of their work and the value of their services than are the customers of repair services. Some smash repairers are able to exploit this situation by providing poor or inconsistent quality of service and/or low value for money to customers of repair services". There is also a risk of over servicing.

The NEEG analysis indicates the PSR scheme improves economic efficiency by:

1. Improving the average quality of repairs and helping to bring about more uniform quality performance.
2. Improving utilisation and management of resources in the smash repair services industry and, as a consequence, improving the productivity of the industry.
3. Reducing the costs of monitoring and assessing the quality of smash repair services.

These improvements mean that the smash repair industry will be both more efficient and more commercially successful once the scheme has been established and given time to address implementation issues.

As is the case with the operation of market forces generally, the changes will place pressures on less

efficient smash repairers. In response to these pressures, some smash repairers will improve their performance, while some of those who fail to do so may exit the industry. However the possible exit of some smash repairers from the industry and the entry and growth of others are likely to be necessary if industry-wide efficiency improvements are to be realised on a significant scale.

The emergence of the PSR scheme is IAG's response to continuing competitive pressures within the general insurance industry, which are generating strong incentives for IAG to improve its performance over time and pass on the benefits of improved performance to customers in the form of lower motor vehicle insurance premiums.

The PSR scheme will provide incentives for smash repairers to improve their performance to ensure they are participants of the scheme. Other insurers face similar incentives to develop such schemes or other means of addressing information problems and improving performance in the smash repair industry. These are pro-competitive and pro-efficiency market developments.

Statistical analysis indicates that the introduction of the PSR scheme is likely to have had two separate cost reducing effects. First, the scheme has reduced the real average cost of preferred repairers. Secondly, IAG's total collision repair costs have been further reduced by increasing the share of collision repairs that are referred to (lower cost) preferred repairers.

Importantly, the cost savings generated by the PSR scheme are not being realised at the expense of deterioration in quality. IAG has demonstrated a strong commitment to improving and monitoring quality in the implementation of the PSR scheme.

3.3 Non-Accredited Smash Repairers

Non-accredited smash repairers (Non-Accredited Repairers) are those repairers with whom IAG does not have a business relationship. In practical terms, Non-Accredited Repairers are those repairers who are currently not a party to either a PSR Agreement or an ASR Agreement with IAG.

Where an insured selects to have his, her or its vehicle repaired by a Non-Accredited Repairer, IAG applies the following policies and processes to the assessment of the claim, the authorisation of repair work and the payment for repair work.

If the vehicle requires towing, IAG either itself tows the vehicle to the repairer (using a towing subcontractor) or indemnifies the insured for the cost of towing the vehicle to the Non-Accredited Repairer, provided the cost of the towing is reasonable in the circumstances.

As IAG does not have a business relationship with Non-Accredited Repairers, its usual policy is not to engage those repairers to undertake smash repair work for it. Instead, IAG pays (or "cash settles")

the insured an amount which it regards as representing the fair and reasonable cost of repairing the vehicle (the Cash Settlement Amount). Under the cash settlement process, all payments are made by IAG to the insured, and not to the repairer.

To determine the fair and reasonable cost of repairing the vehicle, IAG needs to inspect the vehicle prior to the commencement of any repair work. This is effected in any of the following ways:

- (a) An IAG assessor inspecting the vehicle at the premises of the Non-Accredited Repairer. In some rare cases, IAG may refuse to inspect the vehicle at the Non-Accredited Repairer's premises. This may occur, for example, where IAG is of the view that its assessor may experience threatening, intimidating or otherwise unacceptable behaviour if the assessor visits the premises of a particular Non-Accredited Repairer, or if the state of the repairer's premises is such that IAG concludes there is an unacceptable occupational health and safety risk for its assessor.
- (b) An IAG assessor inspecting the vehicle at a location other than the premises of the Non-Accredited Repairer, such as the home or work premises of the insured.
- (c) IAG directing the insured to take the vehicle to the premises of a PSR or ASR so that the PSR/ASR can prepare, for IAG, a quote for the repair of the vehicle. If the vehicle requires towing, IAG arranges for the vehicle to be towed from and to the Non-Accredited Repairer's premises. The cost of towing is borne by IAG.

It is not unusual for the insured or the Non-Accredited Repairer to organise a second quote on the vehicle from a second repairer or a third party vehicle assessor and forward that quote to IAG.

After inspecting the vehicle, or obtaining a quote on the vehicle from a PSR or ASR, or considering the second quote provided by the insured, or a combination of the foregoing, the IAG assessor determines the Cash Settlement Amount. The assessor then discusses with the insured the amount IAG will pay as the fair and reasonable cost of repair, and usually reiterates IAG's recommendation that the vehicle be repaired by a PSR.

If, following the discussion with the assessor, the insured still elects to have a vehicle repaired by a Non-Accredited Repairer, then IAG pays the Cash Settlement Amount to the insured. The insured is not obliged to apply these monies to the repair of the vehicle. IAG does not authorise the quote of the Non-Accredited Repairer or otherwise engage the Non-Accredited Repairer to undertake the repair work for or on behalf of IAG.

It is important to note that Non-Accredited Repairers are open to receive work from IAG companies through the Choice of Repairer policy option (see Chapter 6) where IAG customers decide who they want to repair their damaged vehicle. When an IAG assessor determines that repairs can be authorised, the lifetime guarantee offered under this option is the same as that offered by IAG if the motor vehicle is repaired by a PSR or ASR.

Non-Accredited Repairers are open to apply to enter the IAG PSR network, based on their cost of repairs, quality of repairs, customer service, probity and IAG's business need.

Non-Accredited Repairers are afforded the same protection as other suppliers and businesses under the *Trade Practices Act* and appropriate Federal and State legislation.

It is of note that the House of Representatives Standing Committee on Economics, Finance and Public Administration, in its report "Competing Interests: Is there Balance? Review of the Australian Competition and Consumer Commission Annual Report 1999 –2000" – 17 September 2001, stated:

"The committee raised several matters of concern relating to the difficulties of small businesses in the smash repair industry. The most important of these concerns claims that small panel beating businesses are being driven out of business because the National Roads and Motorists Association (NRMA) and the Royal Automotive Club of Victoria (RACV) provide a limited range of choices to members needing smash repairs. The ACCC said this type of complaint has been investigated but the evidence does not indicate that what is being done is either unlawful or unconscionable.

Legal advice given to the ACCC indicated that the key issue is that it is the NRMA (or RACV) that engages the contractor to repair a vehicle, not the owner. Consequently, those organisations cannot be said to have forced policyholders to use a particular firm's services and there is no breach of section 47 of the TPA. Nor do they appear to have breached the unconscionable conduct provisions of the Act, even though some clients may see their actions as inflexible, unfair or unreasonable. On the basis of their legal advice, it has decided that, without additional supporting evidence, it is unable to take any action on these issues." (p.23-24).

The ACCC Issues Paper (2003) also stated:

"Complaints received from repairers have been about insurers directing motor vehicle repair work to repairers who are part of a preferred repairer network. These circumstances do not amount to a breach of the third line forcing provisions of the TPA since the repair services are generally obtained by the insurer rather than the policy holder, and therefore the policy holder enters into a single contract with the insurer.

The ACCC has also closely examined a number of allegations of unconscionable conduct and misleading and deceptive conduct in the smash repair industry. These complaints are generally of an individual nature and are considered on a case-by-case basis. There might be circumstances in which a collective group alleges that another party has engaged in unconscionable conduct. The TPA includes provision for the ACCC to take a representative action on behalf of such a group. These matters will be assessed on their individual circumstances." (p.3)

3.4 National Preferred Smash Repairer Criteria

Customers of smash repair services have a right to expect that businesses offering smash repair services have the skills and standards to safely and professionally repair their vehicle - wherever in Australia they have an accident. Safety and probity do not change at State or Territory borders.

For this reason, IAG supports the development of national preferred smash repairer criteria which is supported by a nationally consistent licensing regime for smash repairers that sets minimum standards for smash repairers to operate. The criteria should be developed with Governments, smash repairers, consumer groups and insurers, as major customers of smash repair services.

The criteria could include the following:

- Probity should be set as a minimum benchmark;
- Safety of repairs could also be set as a minimum benchmark; and
- Being a licensed smash repairer could also be set as a minimum benchmark

“While some repairers report that they suffer from unnecessarily delayed payments the ACCC has not been provided with any specific evidence to substantiate allegations of unfairness or unconscionable conduct” (ACCC submission to Senate Economics References Committee Inquiry into the Effectiveness of the Trade Practices Act 1974 in Protecting Small Business (2003) p.44).

CHAPTER 4: SMASH REPAIRERS AND INSURANCE COMPANIES

4.1 Preferred Smash Repairer Scheme in Practice

Rates paid by IAG for smash repair work

IAG encourages smash repairers to be cost effective, however, quality is a significant priority in the overall repair work. The final cost of a smash repair job is set by the marketplace, with repair shops competing to use the cost of labour, capital and their organisational effectiveness to obtain work. In this environment, the final cost of a repair job is the major factor.

The operating dynamics of IAG's repairer models are specifically structured to promote and reward best practice repair methods. The best performing smash repairers demonstrate a desire to complete a quality repair in the most cost effective and efficient way possible. This essentially means that the most cost effective, quality driven and customer-focused repairers are rewarded with increased referrals of business. Ultimately repairers determine the cost of the repair by taking into consideration all of the above factors.

The hourly rate is one part of a complex estimate process that repairers use to justify their “bottom line” costing of a job. Other factors in how a repair job is costed in a repair shop include:

- Fixed expenses (rentals vary dependent on locality); division of labour within each facility; productivity of staff; workshop efficiencies; buying power and discounts obtained; cost of labour and staff incentive schemes; average cycle time; leasing versus purchase of equipment; specialisation in vehicle category; on selling of additional services.

Again, it is the total cost of a repair job that is important.

Information on benchmark labour and paint times is available at www.repairnetwork.com.au

Timeliness of decision making on contractual issues

IAG's contractual arrangements with PSRs detail the way that changes to the contracts and procedures can be made e.g. by written agreement signed by both parties. If a change is to be effected by notice (rather than by agreement) then at least 30 days notice will be given. However, the actual period of notice may be longer having regard to what is appropriate in the circumstances. IAG actively encourages PSRs to seek independent legal advice before they sign their agreements. IAG provides a copy of the agreement and a reasonable period of time for the repairer to do this.

Payment times

The issue of *perceived* late payments by insurers to smash repairers has been a recurring theme in the business relationship between insurers and smash repairers. While the issue has been the subject of a number of inquiries by the ACCC and Parliament, specific evidence to substantiate allegations of unfairness or unconscionable conduct has not been evident.

It is of note that the ACCC stated that:

"The ACCC has not been provided with specific examples where payment has been unreasonably delayed by insurers. Further details of any examples might assist the ACCC in assessing this issue in further detail." (Issues Paper, p.13)

Moreover, the Senate Economics Legislation Committee, *Late Payment of Commercial Debts (Interest) Bill 2003* noted:

"The Body Repair Division of the Victorian Automotive Chamber of Commerce (VACC) has made an effort to collate more reliable data in relation to late payments. It publishes, on a periodic basis, responses to surveys regarding the prompt payment of bills. A number of these reports were provided to the Committee as attachments to the VACC's submission, including the latest report dated June 2003.....

.....27.4% of respondents indicated that they were paid later than 40 days after the issue of their invoice. However, a number of caveats must be applied to this data. First, while the report considers 30 days to be an appropriate period of time for payments, this 30-day threshold is not reflected in the data above. It is not possible to say what proportion of the payments in the '22 to 40 days' category would have been later than 30 days. Consequently it is not possible to arrive at a firm figure for late payments.

Second, the Committee has examined the survey form provided to respondents. Question 2 of that questionnaire is the source of the data presented in the above chart. It asks respondents the following question, with respect to each listed insurer: 'For each time range indicated below, what percentages of all payments by this insurer were made within each range?' Respondents are then invited to register a percentage for each period of time, against each insurer they deal with.

The survey does not obtain information about the actual numbers of claims dealt with in those periods of time, and it is impossible to determine the extent to which the percentages supplied by respondents reflect calculated figures or estimations.

As a result, the Committee was reluctant to use the VACC surveys as a source of detailed evidence; however despite these caveats, the surveys indicate widespread perceptions of a late payments problem within this industry.” (p 5-6).

The ACCC noted in its submission to the Senate Economics References Committee *Inquiry into the Effectiveness of the Trade Practices Act 1974 in Protecting Small Business* (2003) that:

“Many small businesses suffer liquidity problems because their larger trading partners delay settlement of accounts. Small businesses suffer embarrassment when they have to delay paying their own bills because of money outstanding.

Some business groups allege there is a deliberate strategy by big business to use money they owe to invest in the short-term money market or in the business for short-term purposes. The ACCC has not been provided with evidence to substantiate such allegations.

Of itself, slow payment would be unlikely to constitute unconscionable conduct within the meaning of Part IVA of the Act. Such a matter would ordinarily be viewed by the ACCC as a contractual matter to be resolved between the parties.

In some industries such as the motor vehicle body repair industry small businesses, which are not members of an insurer’s repair network, have alleged that they do not receive payment on the same terms as those within the scheme. The Victorian Automobile Chamber of Commerce has surveyed a number of smash repairers on this issue.

While some repairers report that they suffer from unnecessarily delayed payments the ACCC has not been provided with any specific evidence to substantiate allegations of unfairness or unconscionable conduct. Evidentiary issues aside, the ACCC notes that larger businesses delaying payments to smaller businesses in circumstances that evidence bad faith, or other elements of section 51AC to which the courts may have regard, may risk contravening the Act. “(p.44)

As highlighted in Chapter 3 page 17, IAG payments to smash repairers are based on performance. IAG’s PSRs have payment terms of 14 days or better and as at September 2004, 81% of PSRs have payment terms of 24 hours. ASRs have payment terms of 14 days if they use the Online Repair Management (ORM) system or 21 days if they do not use ORM. 100% of ORM payments go through an automatic payment solution and 86% of these payments are made without human intervention, the other 14% are work listed and paid within 48 hours (unless disputed) following the matching of the invoice with the authorised payment. IAG believes its payments terms are some of the best in the insurance industry.

It is worth noting that payments for work done by non-accredited repairers are currently not made to repairers (refer to the Choice of Repairer policy option as explained in Chapter 6). Instead, customers are “cash settled” directly and discharge the responsibility of managing the repair and paying the smash repairer.

In response to concerns raised by repairers in relation to the issue of late payments, IAG sought independent advice to investigate suggestions that there may be financial benefit to be gained by an insurer in the late payment of invoices, whether to smash repairers or other suppliers.

PriceWaterhouseCoopers (PWC) examined the financial effect of an insurer delaying payments and concluded that “insurers have very little incentive to delay claim payments and every incentive, in terms of maximizing reported profit and efficiency of capital, to speed up claim payments”. PWC has identified a combination of actuarial, prudential and accounting regulations operating on insurers since 1 July 2002 which inhibit the generation of any financial benefit from delaying claim payments. Full details are outlined in Commercial In Confidence Appendix F.

IAG has given careful consideration to the concerns raised by smash repairers and is developing a number of initiatives that will enhance the transparency of business issues associated with our preferred smash repairer network. In October 2004, IAG released on its website <http://www.iag.com.au/pub/iag/sustainability/delivering-strategy/suppliers.shtml> the independently reviewed IAG payment times to smash repairers. These published payment times will be independently reviewed on a quarterly basis.

Claim Lodgement and Recommendations of PSRs

The majority of claims under IAG motor vehicle policies are lodged over the telephone by the insured calling an IAG call centre. Currently, IAG’s policy is that the call centre telephonist, using a script, recommends to the insured that the vehicle be repaired by a PSR or ASR. The insured is not obliged to agree to have a PSR or ASR repair the vehicle, and may opt to have the vehicle repaired by a repairer who is neither a PSR nor ASR. The Choice of Repairer policy option (see Chapter 6) will alter this approach from November 2004.

Assessment and Authorisation of Work Performed by PSRs and ASRs

❖ Assessment Models

The way in which an IAG assessor assesses a vehicle and quote depends upon the relationship IAG has with the repairer, and the state in which the repairer is located.

- ***Web-based Repair Management (WRM) (refer Chapter 3)***

In metropolitan areas of Queensland, South Australia & Western Australia, the insured is asked to bring their vehicle if driveable in to the Repair Management Centre, where an assessor can assess the damage to their vehicle and assist them in locating the most suitable repairer by putting their repairs out to tender on a secure website. Non driveable work in these areas is allocated directly to repairers based on performance or customer choice.

The system then calculates the most successful repairer and assigns the claim. If there are a number of quotes within a particular dollar range, the assessor has the final decision on the successful repairer. The customer's preferences are taken into consideration when determining the successful repairer.

The insured and the successful repairer are advised and the vehicle is taken to the repairer for repairs to commence. If the repairer has access to ORM (see below), they can also utilise ORM's electronic capability for invoicing and payment on these claims.

- *Online Repair Management (ORM) (refer Chapter 3)*

Once the insured agrees to have the vehicle repaired by a PSR or ASR, IAG notifies the repairer electronically that the vehicle will be delivered to the repairer for it to repair on behalf of IAG. IAG provides the repairer with information regarding the insured's identification, vehicle details and the nature of the damage to the vehicle. This information is sent electronically via the ORM system. If the repairer does not participate in ORM, the repairer is provided with the information by facsimile.

If the vehicle is driveable, IAG asks the insured to deliver the vehicle to the relevant PSR or ASR. If the vehicle requires towing, IAG either itself tows the vehicle to the repairer (using a towing subcontractor) or indemnifies the insured for the cost of the vehicle to the repairer, provided that the cost of the towing is reasonable in the circumstances.

Once the vehicle is delivered to the repairer, the repairer prepares a quote for the repair of the vehicle. This quote is then submitted electronically to IAG for assessment and authorisation, and when repairs are completed, the invoice is submitted electronically and paid automatically in most cases.

- *Field assessment*

The field assessment method involves an IAG assessor attending the premises of the repairer and physically inspecting the vehicle so as to assess the quote.

Field assessment is the traditional method of assessment, in that it was the main assessment method prior to the introduction of ORM. As the assessor physically inspects the damaged vehicle, it is the assessment method that allows IAG to conduct the most detailed and informed review of the quote.

A quote may be assessed by the traditional field inspection method for any of the following reasons.

- The repairer does not participate in ORM or is outside the WRM catchment areas. If the repairer does not participate in ORM, it cannot send to IAG digital images of the vehicle. Accordingly, an assessor is required physically to attend the repairer's premises to assess the reasonableness of the quote.
- A random field assessment of a quote is being carried out as part of IAG's performance monitoring of PSRs and ASRs.
- The repairer has recently been submitting unsatisfactory quotes to IAG, with the result that the local IAG assessing centre has decided to use field assessing as part of IAG's performance management of the repairer. As well as allowing IAG to exercise the greatest degree of scrutiny over the quote, it allows the IAG assessor to discuss with the repairer why IAG regards its quotes as uncompetitive.
- IAG has reason to believe that there may be fraudulent activity (by either the repairer or the insured) in relation to the claim.
- While IAG does not have particular reason to suspect fraud in relation to the particular claim, it falls into a category of claim that historically has a high incidence of fraudulent claims, such as stolen vehicles (which have been recovered and require repair) or arson-related (burnt vehicles) claims.

There are typically delays associated with field assessment relative to ORM or WRM. This results primarily from the need for an assessor physically to visit the repairer premises, rather than simply assess the quote electronically at an IAG assessing centre.

The process for organising a field assessment is as follows. From the list of claims that have been identified as requiring a field assessment of the quote, the assessing centre organises an "assessing run", which lists the repairer premises that an assessor will visit that day. The assessor then visits each repairer on the list in turn.

❖ **Assessing Processes**

There are a number of different processes used by IAG assessors to assess quotes. The method used depends on a number of factors, including whether the repairer participates in ORM, and the relationship between IAG and the repairer. The different methods, and when each is used, are set out below.

• **Self-assessing**

PSRs with whom IAG has a very strong business relationship and who have a proven record of providing competitive quotes may be appointed to “self-assessing” status. IAG has policies regarding which repairers are eligible to be considered for self-assessing status, with the final decision whether to appoint a repairer to self-assessing status at the discretion of the local IAG assessing centre management. The appointment to self-assessing status reflects a decision by IAG, through its local managers, that it can rely upon the repairer to submit a competitive quote which is also not at the expense of quality (see Chapter 5).

Under the self-assessing process, a repairer is still required to prepare and submit a quote to IAG. The repairer, however, is authorised by IAG to commence repairing the vehicle prior to receiving an authorisation of the quote from IAG. The quote must, however, be authorised by IAG before IAG will accept an invoice from the repairer for the work. This process requires the assessor to check essential details of the quotation only; they should not have to make any amendments to the quotation to arrive at the right method of repair and/or a fair and reasonable cost. This results in a much quicker turnaround time for the repairer and the insured in having repairs completed.

This type of assessment should only be processed through ORM.

- ***Fast-track assessing***

Fast-track assessing involves an IAG assessor reviewing only the major items on the quote and considering whether the total sum quoted is reasonable. The assessment is conducted at the assessor’s desk at the IAG assessing centre, using the digital images of the damaged vehicle and other information provided by the repairer via ORM. The assessor does not undertake a detailed review of each item on the quote. If, following this fast-track review, the assessor concludes the quote is acceptable, the repairer is sent an authorisation from IAG to commence repairs.

Where the assessor regards the proposed method of repair or the overall amount quoted as uncompetitive, the assessor will adjust the quote accordingly. The repairer is then sent an authorisation to begin repairs on the basis of the adjusted quote. If the repairer disagrees with the adjustment or otherwise wants to discuss the repair of the vehicle with IAG, then the repairer can contact the relevant IAG assessing centre.

Only repairers who have demonstrated a reliable history of submitting competitive quotes (and maintaining quality work), to IAG are eligible to have their quotes assessed under fast-tracking assessing. Reflecting the close relationship required before IAG is willing to adopt fast track assessment with a repairer, only gold or silver PSRs are eligible to participate, and an ASR is eligible only if the ASR has entered into a performance plan with IAG. IAG relies upon its general performance monitoring (including monitoring the average cost of repair by that repairer) and random audits to ensure that the repairer does not abuse the lack of detailed review of its quotes by

submitting uncompetitive quotes.

- ***Line by Line assessing***

Line-by-line assessing involves an IAG assessor reviewing each item on the quote and considering whether the amount for that item is reasonable. The assessment is conducted either at the assessor's desk at the IAG assessing centre, using the digital images of the damaged vehicle and other information provided by the repairer via ORM, or in the field at the repairer's workshop or other location. If, following this "line-by-line" review of the quote, the assessor concludes the quote is acceptable, the repairer is sent an authorisation from IAG to commence repairs.

Where the assessor regards the proposed method of repair or the amount quoted for an item as uncompetitive, the assessor will adjust the quote accordingly. The repairer is then sent an authorisation to begin repairs on the basis of the adjusted quote. If the repairer disagrees with the adjustment or otherwise wants to discuss the repair of the vehicle with IAG, then the repairer can contact the relevant IAG assessing centre.

IAG's Assessors

IAG does not pay bonuses to its assessors based on their ability to drive the costs of repairs down. For all of its 11,000 employees, IAG has in place a structured, performance-based incentive scheme, which is explicitly related to the performance of IAG as a company, the performance of the business unit to which the employee belongs (for example, Personal Insurance) and the individual performance of the employee.

An assessor can obtain up to 10% of their salary as a bonus in line with company-wide practice.

The 10% staff allocation is split into 2% for corporate and 8% for individual outcomes, the 2004-2005 weightings have been formulated as follows:

2% Corporate	- Performance of the IAG PI insurance business
4% Cost Effectiveness	- 2% Cost & 2% Other e.g. adhered to processes
2% Customer Service	- 1% Overall (as measured by external survey) and 1% Other e.g. timeliness (measured by internal systems)
1% People	
1% Sustainability	e.g. reduction in use of renewable resources

IAG has the ability to analyse repair cost fluctuations based on "impact severity". This allows IAG to understand the specific repair costs for each individual accident. In determining the cost competitiveness of a smash repairer the "impact severity model" considers the size and location of the damaged area of the car and also the type of vehicle being repaired. This provides an accurate cost measurement by repairer for each individual accident.

Cost measurement is supported by IAG's "quality repair and customer service" monitor that measures repair performance in these two key areas. IAG conducts post-repair inspections of randomly selected vehicles. IAG also surveys customers after their vehicles have been repaired. This allows IAG to "score" each repairer in the key categories of quality, service and cost. The highest "scoring" repairers receive increased numbers of referrals.

Replacement Parts

IAG notes that the Productivity Commission has sought comments regarding the implications for costs, prices and repair quality of the use of new versus second-hand parts.

IAG submits that the work undertaken by NECG, (*An economic framework to evaluate the gains from reducing reliance on badged genuine parts in motor vehicle repair* (NECG Parts Report) (Commercial In Confidence Appendix D) and IAG's Industry Research (Appendix J) will assist the Commission in understanding the costs associated with the replacement parts used in motor vehicle repairs.

IAG commissioned NECG to set out an economic framework for understanding the gains that can accrue to customers and the wider community from reducing the costs associated with the spare parts used in motor vehicle repairs. The NECG Parts Report concluded:

"The price of parts has a substantial influence on the cost of motor vehicle repairs and through that, on the cost of motor vehicle insurance.

Left to their own devices, customers are likely to over-pay for parts. This tendency will be accentuated by insurance, which reduces customers' direct exposure to high parts prices. As well as involving income transfers from customers to insurers, the resulting outcomes are economically inefficient.

Insurers can take measures aimed at limiting excess reliance on, and/or too high prices for, branded parts. These measures include providing better information to customers and repairers, using buying power to reduce the price of branded parts and prescribing the use of less expensive but technically equivalent alternatives. These measures have the potential to reduce consumer prices and increase welfare.

Attempts by insurers to control parts costs are likely to encounter resistance from the suppliers of branded parts. One instrument these suppliers can use to induce continued reliance on highly priced branded parts is to tie the validity of warranties to the use of those parts. Allowing this to occur can increase prices, harm customers and reduce competition and efficiency".

Unlike other insurers, IAG operates two smash repairer operations in Victoria and also operates its own internationally accredited Industry Research Centre in Sydney. This allows IAG to understand the true cost of autobody repairs and informs our business about competitive and quality smash repair procedures and costs. Research undertaken by IAG Industry Research (Appendix J) indicates that in 2003-04 around 3% of collision claims involved the replacement of a significant structural component. 96.1% of claims did not require the replacement of a structural part. Thus it can be said that the vast majority of repairs carried out are minor repairs that involve cosmetic parts only.

IAG also notes the findings of the Prices Surveillance Authority's Inquiry (1988) in relation to prices of passenger motor vehicle replacement parts in relation to the use of parts:

"Ultimately, the insurers' understanding that their policy holders expect and feel entitled to have new and genuine parts used in smash repairs may need to be tested: the resolution of the matter lies between the two parties to the insurance contract. The inquiry evidence did not demonstrate any universal need for new parts to be used, or any universal superiority of genuine parts for use in smash repairs; certainly as vehicles age the likelihood of availability of new and genuine parts reduces." (Price Surveillance Authority Inquiry in Relation to Prices of Passenger Motor Vehicle Replacement Parts, (1988)).

Collective Negotiation

In 2003 the Federal Government commissioned a review of some of the key provisions of the *Trade Practices Act 1974* (the Dawson Review). In relation to collective bargaining, the report of the Dawson Committee noted that:

"Collective bargaining at one level may lessen competition but, at another level, provided that the countervailing power is not excessive, it may be in the public interest to enable small business to negotiate more effectively with big business."

The Dawson Committee's report recommended that "upon acceptance of a notification by the ACCC, small businesses can collectively negotiate with larger business." This change offers small businesses a simpler and quicker process than the current requirement that ACCC "authorisation" be sought.

A Bill to enact many of the recommendations of the Dawson Committee, including the collective bargaining notification process, was introduced to Parliament on 24 June 2004 (the *Trade Practices Amendment Bill 2004*). However, the necessary regulations and ACCC guidelines to underpin the new system have not yet been developed.

The current state of uncertainty in relation to the Dawson Committee recommendations makes it difficult for IAG to make specific comments. However IAG does endorse the ACCC's proposed approach to assessing collective bargaining arrangements for the purpose of granting notifications. This approach is set out in some detail in the ACCC publication entitled "*Authorising and notifying collective bargaining and collective boycott issues paper*" (July 2004), available at www.accc.gov.au.

Guarantees

IAG companies under the NRMA Insurance, SGIO and SGIC brands offer a lifetime guarantee on all authorised repair work by a PSR and ASR. Under the IAG Choice of Repairer option, all authorised repairs by any repairer will carry a lifetime guarantee.

IAG is liable under the guarantee to the customer. Under the PSR and ASR Agreements the repairer is liable to IAG for defective repairs, and IAG will generally seek to recover the cost of honouring the guarantee from the repairer who undertook the repairs. For example, IAG may require the repairer who initially made the defective repairs to rectify the repair work at no further cost to IAG or the customer. On occasions, however, IAG is unable to recover this cost from the repairer, for example in cases where the repairer has ceased to carry on business.

CHAPTER 5:

SAFETY AND QUALITY OF REPAIRS

5.1 Quality & Safety under the Preferred Smash Repairer Scheme

It is important to recognise that IAG's PSR scheme contains various mechanisms and complementary initiatives to improve the quality of repair services. Importantly, IAG's PSR scheme does not seek to achieve reductions in the price of repair services at the expense of quality.

IAG contracts explicitly refer to the standard of parts to be used in motor vehicle repairs. The contract states that, when repairing a customer's vehicle for IAG the repairer must use parts that will conform to all relevant national standards determined under the *Motor Vehicle Standards Act 1989 (Cth)*, Australian Design Rules and Australian Standards. In addition, the parts used must not compromise the safety or the repair integrity of the vehicle, nor lower the resale value of the vehicle, must fit and operate correctly and not void or affect the warranty provided by the manufacturer of the vehicle. IAG contracts also require repairers to ensure that all repairs meet acceptable standards of quality. Breaches of safety and quality provisions of contracts and performance plans can lead to repairers having their contracts terminated.

Moreover, IAG assessors conduct spot-safety reviews to audit and ensure quality and safety. These are random audits. In 2003, 838 rectifications where repairs needed to be re-done because of quality concerns which were identified by our assessors.

IAG notes it is frequently contended that many non-genuine replacement parts threaten vehicle safety. Indeed, the Insurance Information Institute (<http://www.iii.org/media/hottopics/insurance/genericauto/>) note that in the:

"continuing debate about whether generic parts are as good as parts from OEMs, the issue of safety is in the forefront. Critics claim that using parts from sources other than OEMs could comprise safety. However, the Insurance Institute for Highway Safety (IIHS) says that with the possible exception of hoods, there are no safety implications of using cosmetic crash parts from any source. This has been demonstrated by crash tests conducted at the IIHS"

This issue is also highlighted in the IAG Industry Research Report (Appendix J).

5.2 Structural Change and Safety Concerns

IAG notes that in relation to safety concerns, where industries are undergoing structural change, concerns regarding safety are often raised by incumbents with a vested interest in the old structure. However, such concerns have been shown to be misplaced and unwarranted. For example, the *Airline Deregulation Act 1978* (USA) ended forty years of commercial passenger airline regulations (fares, schedules and routes) in the USA. Opponents² to the restructure initially argued that prices would rise (prices fell) and that flights to small cities would disappear (most small cities are now better serviced by smaller carriers)³. The failure of both arguments saw opponents pose a last ditch argument over safety. They speculated that competitive pressures would force air carriers to reduce expenditure on safety resulting in safety-related problems. Despite these arguments, virtually all statistics indicate that air safety in the United States has dramatically improved since deregulation. Whilst this might not be a direct result of deregulation, the record does not indicate that deregulation has had an adverse effect on the safety of air travel. A report prepared by the US Federal Trade Commission in 1988 titled “The Deregulated Airline Industry: A Review of the Evidence” concluded:

*Virtually all National Transportation Safety Board statistics, as well as other statistics from other agencies, show that airline safety has improved since deregulation. If, despite this improvement, airline safety is considered inadequate, then changes in safety regulations would be a more effective way to improve safety than reregulation of air fares and routing.*⁴

Commentators have pointed to the aviation insurance industry as an indicator of the immateriality of the safety concern. In 1988 one academic observed that aviation insurance companies had not lifted rates to reflect the supposed safety danger and increased accident probability⁵.

The *Motor Carrier Act 1980* (USA) ended 45 years of interstate trucking regulation (entry, pricing and operation). Opponents to Interstate trucking industry deregulation posed similar arguments to the ones used to confront airline deregulation. They argued that trucking deregulation would result in reduced services to small communities, destructive competition, confusion among shippers and unsafe trucks⁶. As stated in economic issues report by the US Federal Trade Commission in 1998:

² Opponents to the structural change typically have a vested interest in the old structure. Examples in the airline industry include airline labour who, protected by federal regulation from the marketplace, were at one point the highest paid employee group in US Industry. See Robson J, “Flying Deregulated Skies Is No Greater Hazard” *Wall Street Journal (Eastern Division)* New York 24 January 1986 p.1

³ Simon J, “Freer Skies Gave Us Better Service” *Wall Street Journal (Eastern Edition)* New York 14 October 1992 p. A14 See also the United States General Accounting Office Report to the Chairman, Committee on Commerce, Science and Transport, US Senate titled “Airline Deregulation: Changes in Airfares, Service and Safety at Small, Medium-Sized and Large Communities (1996, US General Accounting Office, Washington) p.21

⁴ Ogur J, Wagner C & Vita G, *The Deregulated Airline Industry: A Review of the Evidence* (1988, Federal Trade Commission, Washington) p. vii

⁵ Morrison S and Winston C “Air Safety, Deregulation and Public Policy” *The Brookings Review*, Winter 1988 p.10

⁶ Owen D, *Deregulation in the Trucking Industry* (1988, Federal Trade Commission, Washington) p.1

It appears, then, that the majority of studies do not find that trucking deregulation of prices and entry has decreased safety. One reason is that there is no way to ensure regulation-induced higher prices will be used to improve safety, rather than to increase profits or wages. If policy makers want to improve highway safety, safety regulation may be a more effective policy approach than renewed economic regulation.

Donald L Alexander of Western Michigan University observed that fatality and injury rates were lower in 1982 and 1987 than they were in 1977, that driving intensity had declined and “the accident rate has remained unaffected since deregulation”⁷.

⁷ Alexander D, “Motor Carrier Deregulation and Highway Safety: An Empirical Analysis” *Southern Economic Journal*, Jul 1992 p.36

“Like repairers, customers also have a choice — they can insure with a company which has an approved repairer scheme, or with one that does not. Consequently, as long as policyholders are informed of the scheme — and of its implications for the selection of the repairer — customers themselves can decide whether or not they wish to have more or less freedom of choice in selecting a repairer” (Industry Commission, Vehicle and Recreational Marine Craft Repair and Insurance Industries (1995) p.71).

CHAPTER 6:

CONSUMER CHOICE AND REPAIRERS

IAG introduced the PSR scheme as a workable model that would assist it to obtain high quality repairs in an efficient manner and at a competitive cost. However, it is important the Productivity Commission understand that it is not the only possible model. A useful approach is to consider the PSR scheme as merely one industry structure on a continuum of possibilities, at one extreme having no preferred repairers at all, and at the other, a complete integration model, where the insurance company operates a repair business and undertakes the repairs itself.

Examples of a “complete integration” model include insurer owned autobody repair shops, which operate in a number of states in the USA. An example is the Allstate Insurance Co. owned repair shop, the Sterling Autobody Center⁸. In addition, this model has been partially adopted in Victoria by Insurance Manufacturers Australia Pty Ltd (IMA). IMA is an alliance between IAG and the RACV. IMA owns and operates two large smash repair shops in Melbourne, called Accident Repair Centres (ARCs). The ARCs operate in conjunction with the PSR program in Victoria. IMA, which underwrites policies sold under the “RACV” brand, as a first preference directs work to the ARCs, which undertake approximately 11% of IMA’s smash repair work in Victoria. IMA, as a second preference, promotes PSRs and ASRs to undertake repair work. However, RACV policyholders may also opt to have their vehicles repaired by a Non-Accredited Repairer, in which case the cash settlement process outlined in Chapter 4 is applied.

On the continuum of repair models, IAG has attempted to position itself in a way which optimises consumer choice, with high quality repairs completed efficiently and cost-effectively.

6.1 Customer Choice of Repairer

6.1.1 Customer Choice

IAG’s PSR scheme provides any customer who has had an accident, and who does not have their own repairer, with a choice of one of its repairers as the smash repairer to carry out the repair of their motor vehicle. Customers receive quality repairs and customer service, and the advantage of not

having to seek multiple quotes for the repair of their motor vehicle.

Customer choice is an important element of IAG's commitment to customers in relation to the repair of their motor vehicle. IAG will nevertheless recommend a repairer to the customer. In the first instance, IAG will recommend a PSR if there is one available in an area acceptable to the customer.

If however, a customer nominates a repairer they would like to use who is not a PSR or an ASR, IAG will explain the process that will be followed and the benefits of using a PSR or ASR. If the customer still wishes to use their chosen repairer IAG will take steps to implement the relevant process.

The ACCC (2001) in the House of Representatives Standing Committee On Economics, Finance and Public Administration, Review of the Australian Competition and Consumer Commission Annual Report 1999-2000 30 March 2001 noted:

"Let me deal with the preferred repairer scheme. We have had a close look at that as well. The way that works is that, while the NRMA nominates preferred repairers, it has a couple of different categories of repairer: the first category is the preferred repairer, the second category is partnering, and the third category is, basically, others.

The way that the NRMA works is that NRMA will more or less automatically accept a quote from a preferred repairer. Quotes from other repairers, depending on what category they fall into, are subject to various amounts of checking. But there is no actual requirement or obligation on NRMA members to actually go to a preferred repairer. If there were, that would be something we would look at very closely, because that would probably sail fairly close to the wind so far as the provisions of the act are concerned. As I say, there is no obligation on NRMA members to go to preferred repairers. It is really an issue of their being able to choose their own repairer and, depending on what repairer they choose, the quote may or may not be subject to a degree of checking. There again, given that is the way the scheme works and unless we are able to find evidence to the contrary – particularly in terms of the mandatory nature of going to preferred repairers – we do not have sufficient evidence to be able to take either an unconscionable conduct or an abuse of market power under section 46 case" (EFPA 8-9).

IAG notes that the ACCC *Issues Paper* (2003) addresses the relationship between the Australian motor body/smash repair industry and the general insurance sector stated that: "The ACCC notes some concerns, which have been raised which might affect the rights of customers, particularly, in the area of consumer choice. These issues of consumer choice should effectively be dealt with under the existing Insurance Enquiries and Complaints scheme".

A survey of over 500 IAG customers conducted in the six months to July 2004 found:

- In all, 92% of IAG customers indicated they were satisfied with the work of IAGs preferred repairers.
- 87% of IAG customers said they would be likely to refer friends to NRMA Insurance as a result of their claims experience.

⁸ See Sterling Autobody Center website at <http://www.sterlingautobody.com/>
IAG Submission to Productivity Commission: Smash Repair Industry and Motor Vehicle Insurance Industry

- IAG customers rated the work of preferred smash repairers at 8.5 out of ten or above in the following areas: Quality of work (8.8); Getting repairs right the first time (8.6); Getting the work finished promptly (8.5); Living up to promises (8.6); Overall standard of customer service (8.7); Being flexible to fit in with your needs (8.5).

6.1.2 IAG Choice of Repairer Option

In response to issues raised by smash repairers IAG has reviewed its customer choice of repairer arrangements. From November 2004 an IAG “Choice of Repairer” policy option will be introduced (for NRMA Insurance, SGIO, SGIC branded policies). On purchasing or renewing a motor vehicle insurance policy, customers will be able to elect to choose their smash repairer for an additional premium. The new Choice of Repairer policy option will allow IAG customers to make an immediate and upfront decision when they purchase or renew their motor vehicle insurance policy. Customers who take out the option will receive a Lifetime Guarantee from the relevant IAG insurer on repair work authorised by it whether the customer elects to have the repairs undertaken by an IAG PSR or a repairer of the customer's choice. Repairs will still be carried out subject to the IAG insurer's approval. If a customer chooses not to take out the option, and repairs are to be carried out, the IAG insurer will select the repairer and a Lifetime Guarantee will also be provided.

The ‘Choice of Repairer’ policy option meets a specific policy remedy suggested by smash repairer representatives during the 2003 ACCC Roundtable discussion process. The ACCC *Issues Paper* noted the suggestion of repairers that a ‘two tiered pricing system’ operate to give effect to customer choice. The *Issues Paper* stated:

“Repairers groups have called for consideration of a two tier pricing system. This price system will offer customers the choice of paying two separate prices for motor vehicle insurance. One price will enable the consumer to choose any repairer to perform insurance related repairs to the vehicle. The other price will enable the consumer to go through the insurers normal method which may and may not include a preferred repairer scheme.”

The estimated cost of the ‘Choice of Repairer’ policy option is as follows:

NSW	\$69.30
ACT	\$72.60
QLD	\$46.20
SA	\$48.84
WA	\$48.40
TAS	\$47.52

These figures are inclusive of GST and Stamp Duty.

Factors taken into account when determining the additional premium include:-

- Weighted average repair cost for a Preferred Smash Repairer or Associate Smash Repairer versus the Non-Accredited Repairer;
- Cost of offering a Lifetime Guarantee on the repair work of a Preferred Smash Repairer or Associate Smash Repairer versus the Non-Accredited Repairer; and
- Claims administration costs (eg. Increased assessing costs)

Apart from the additional premium, there will be no other expense to insureds as a result of taking out the Choice of Repairer Policy rather than the Standard Policy. For example, there will be no differential treatment of insureds under the Standard and Choice of Repairer Policies with respect to excesses or no claim discounts.

IAG believes the Choice of Repairer option is likely to enhance efficiency and consumer choice in the motor vehicle insurance and smash repair markets. It is relevant to note that it would not appear rational for IAG to seek to lessen competition in the market for motor vehicle repair services. A competitive market in motor vehicle repair services is likely to result in lower repair costs. Given IAG is an acquirer of smash repairer services, it is in IAG's interest to seek to ensure that the market for motor vehicle services is as competitive as possible.

6.2 Other Consumer Choice Issues

6.2.1 Impact of Motor Vehicle Manufacturer Exclusive Repairer Arrangements

Other issues the Inquiry may wish to examine include the effects on economic efficiency and consumer welfare of the maintenance of exclusive and near-exclusive authorised body repairer arrangements by luxury vehicle producers. IAG commissioned NECG *Economic analysis of the impact of motor vehicle manufacturer exclusive repairer arrangements* (NECG Exclusive Repairs Report) to examine the potential impact of exclusive repairer arrangements on motorists in Australia and appropriate policy responses that could be used to mitigate adverse impacts.

The NECG Exclusive Repairs Report sets out an economic framework and quantitative analysis for understanding the effects on economic efficiency and consumer welfare of the introduction of exclusive and near-exclusive authorised body repairer arrangements. Estimates are also made of the impacts on efficiency and consumer welfare if highly exclusive authorised body repairer arrangements were adopted by all manufacturers of luxury vehicles sold in Australia. The NECG Exclusive Repairs Report is available at Commercial In Confidence Appendix E.

CHAPTER 7:

DISPUTE RESOLUTION

7.1 IAG's Preferred Supplier Code of Practice

IAG's *Preferred Supplier Code of Practice* (Appendix I) has been developed and implemented after close consultation and discussion with our preferred business partners. Importantly, the Code responds to the increasing demands from our customers to commitment to environmentally sustainable business practices, a commitment to business development and the strong desire for commercial activities to be immune from criminal behaviour.

The essential elements of the Code of Practice are that IAG:

- Strives for the highest quality in our products and services;
- Respects commercially sensitive information;
- Makes payments in fair trading terms- usually 30 days of invoicing;
- Expects our preferred suppliers to comply with environmental laws and to minimise environmental risk;
- Is committed to compliance with anti-discrimination and equal opportunity and other laws. Will not knowingly engage a supplier who employs bonded labour or uses any form of coercion;
- Expects our suppliers to share our concern for the health and safety of all staff and to reflect this in working conditions; and
- Will not knowingly deal with suppliers who breach the law in any way in their delivery of products and services.

IAG's *Code of Practice* complements and does not replace our contracts or arrangements with preferred suppliers. It gives our preferred suppliers an understanding as to how we do business, what they can expect from us and what we expect from them.

As part of IAG's *Code of Practice*, our preferred smash repairers have access to a dispute resolution procedure. The inclusion of an internal dispute resolution process is recognition on our part of concerns identified by the smash repair industry.

We encourage preferred suppliers to adhere to a three-stage dispute resolution process as follows:

Stage 1 (*Local manager*)

Preferred suppliers should first raise their concerns with their local or regular IAG Personal Insurance representatives. If concerns are not resolved at this level then preferred suppliers may give formal notice of the complaint to be heard by the Internal Dispute Resolution Committee under Stage Two.

Stage 2 (*Internal Dispute Resolution Committee*)

The Internal Dispute Resolution Committee will hear any complaints referred to it by a preferred supplier under this Code of Practice, and will make a determination that is binding on IAG but is not binding on the preferred supplier. The Committee must not hear any complaint unless the dispute process has been exhausted under Stage One. If the matter is not resolved satisfactorily or not resolved at all at this level, preferred suppliers may ask the matter be heard by the External Dispute Resolution Group under Stage Three.

Stage 3 (*External Dispute Resolution Group*)

The External Dispute Resolution Group will review the determination of the Internal Dispute Resolution Committee if asked by a preferred supplier under this Code of Practice, and will make a recommendation to IAG Executive, Personal Insurance. Although the External Dispute Resolution Group is a review body, it will explore options with a view to achieving a speedy resolution.

The External Dispute Resolution Group will make a recommendation to IAG Executive, Personal Insurance, who will make a determination on the matter. The determination of IAG Executive, Personal Insurance, following consideration of the External Dispute Resolution Group's recommendation, is binding on us but is not binding on the preferred supplier.

In the interests of resolving disputes as quickly as possible IAG Personal Insurance will seek to make a determination at Stage Two and Stage Three within 30 days of the dispute being referred to that stage.

IAG's External Dispute Resolution Group comprises former ACCC Small Business Commissioner, Mr David Lieberman and former New South Wales Small Business and Consumer Affairs Minister, the Hon. Wendy Machin.

To date, the External Dispute Resolution Group has only had cause to review two cases. Neither case concerned issues associated with the IAG PSR scheme.

7.2 Non-Accredited Repairers

IAG trusts that the Inquiry recognises that in instances where IAG customers exercise their right to choose a smash repairer of their choice, who is not a preferred or associate smash repairer, IAG “cashes out” the cost of repairs with our customers. In these instances, IAG has no business relationship or dispute with the repairer as this relationship has passed to the customer. For these reasons, the issue of a dispute resolution between IAG and a customer’s chosen repairer is not a business interest nor concern of IAG. These disputes are most appropriately adjudicated by the appropriate fair trading legislation in each of the States and Territories.

7.3 Insurance Enquiries and Complaints Ltd. (Scheme)

The General Insurance Enquiries and Complaints Ltd (Scheme) is a national dispute resolution scheme developed by the Insurance Council of Australia to handle enquiries and complaints and to resolve disputes which come within the Terms of Reference of the Scheme. The Scheme is approved by the Australian Securities and Investments Commission (ASIC) in accordance with the *Corporations Act 2001*. The Panel, Referee and Adjudicator operate as the determination arm of the Scheme. Full details of the schemes operation are available at: <http://www.iecltd.com.au/index2.html>

Suppliers do not have access to the IEC, as the Scheme is designed to resolve disputes between individual consumers and their insurer.

CHAPTER 8:

DIRECTIONS FOR THE FUTURE

The fundamental premise that underpins competition policy is that all sectors of the economy should be subject to competition unless it could be shown that there is a net public benefit not to do so. IAG continues to oppose any legislative or regulatory reform that results in legitimate competitive conduct between insurance companies and smash repairers being prohibited or stymied to protect some businesses from facing fair competition.

The Australian Government in its response to the recommendations of the Dawson Review stated the competition provisions of the *Trade Practices Act 1974* are designed to protect the competitive process rather than a specific market structure or individual competitors. Similarly, the Business Council of Australia noted “an important achievement of the Dawson reforms is that they draw a clear line between a strong Trade Practices Act that protects competition, and an Act that is changed to protect some competitors from competition. This distinction has been lost in some of the recent debate about the Trade Practices Act.” IAG agrees strongly with these statements.

IAG believes that its PSR scheme, by lowering costs and enhancing IAG’s ability to set competitive premiums is likely to increase, rather than decrease, competition in the market for motor vehicle insurance. IAG notes that a number of Government Inquiries and Reviews over recent years have examined the preferred supplier arrangements between the insurance industry and the smash repair industry and found these supplier arrangements *not* to be in breach of the *Trade Practices Act 1974* or any other legislation.

IAG would be concerned if any Inquiry finding was that IAG should not be able to choose, based on business needs and commercial and probity considerations, with whom it wants to do business to secure smash repair services to meet its contractual obligations to its motor insurance customers. Or, that its commercial decisions about with whom it will do business in a competitive market, made within the law, should be subject to third party review.

IAG remains opposed to any form of industry-wide Code with the smash repair industry. Individual insurers through their own relationships and processes and the existing legislative and regulatory environment are addressing issues raised by smash repairers.

IAG believes any additional legislative or regulatory intervention regarding the relationship between the motor vehicle smash repair industry and the insurance industry is unnecessary and inappropriate as the existing provisions are adequate. These provisions, which already deliver comprehensive protection to Australian consumers and provide smash repairers and insurers with a balanced

operating environment include:

- the General Insurance Industry Code of Practice;
- the Insurance Enquiries and Complaints Scheme;
- IAG's *Preferred Supplier Code of Practice*;
- the relevant provisions of the *Trade Practices Act 1974*;
- State and Territory consumer and fair trading legislation;
- *Financial Services Reform Act 2001*; State and Territory towing legislation and regulations;
- *ASIC Act*
- *Corporations Act* and
- the *Insurance Contracts Act 1984*

However, customers of smash repair services have a right to expect that businesses offering smash repair services have the skills and standards to safely and professionally repair their vehicle - wherever in Australia they have an accident. The need for safety and probity does not change at State or Territory borders.

For this reason, IAG supports the development of a nationally consistent licensing regime for smash repairers that sets minimum standards for smash repairers to operate. These standards should be developed with Governments, smash repairers, and consumer groups and with insurers, as major customers of smash repair services.

The standards should preclude licence to trade to smash repairers that fail to meet minimum standards of:

- Probity;
- On-site occupational health and safety;
- Safety of repairs.