
AAMI Submission
to
Productivity Commission Inquiry
into
Motor Vehicle Insurance and Crash Repairs

October 2004

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Executive Summary

The announcement of the Productivity Commission Inquiry into the relationship between motor insurers and smash repairers comes at a time when the repair sector is in the midst of substantial structural change and rationalisation. It follows a number of years of aggressive and concerted lobbying by the repair sector. In calling for assistance or protection from Governments, claims of:

- detrimental outcomes for consumers around customer choice, repair quality and safety; and
- unfair outcomes for repairers around profitability, hourly rates and preferred supplier arrangements;

have been made.

That there is tension between the smash repair sector and insurers, and some insurers in particular, is undeniable. It is also undeniable that the repair sector has been very effective in obtaining the interest of some politicians and the media. However, this submission establishes that the claims being made are demonstrably wrong, unsubstantiated and/or provide no basis for the reforms called for by some in the repair sector. It also shows the claims are unfair to the many hard-working repairers providing competitively priced, quality repairs. Moreover, the claims seem to be designed to hide the real issue; namely the desire of some to create an environment that insulates repairers from competition and props-up poorly performing businesses.

During the course of the inquiry the Commission will find that the repair sector acknowledges:

- there is an oversupply of repairers;
- the oversupply is impacting repairer profitability;
- the true hourly rate is substantially more than \$23-\$30;
- some repairers would be better closing their doors;
- it will be difficult for the inefficient shops to survive;
- the better shops will survive and do well;
- insurers are striving to work with the better repairers; and
- if you are working with insurers you are more likely to be profitable.

The contradiction in the repair sector's simultaneous contentions that, on the one hand, insurance work is desirable and profitable but on the other that insurers' practices promote 'cutting corners' and 'poor quality work', and 'unfair' rates of return is a critical consideration for the Commission. Box A provides a sample of comments by the repair sector and trade commentators.

References for the source material contained in the Executive Summary are contained in the body of the submission.

Structural change

Following years of poor performance, the Australian insurance industry experienced unprecedented levels of structural change and consolidation through the 1990s. Today, only a relatively small number of insurers compete in each geographic market. They are all fiercely competitive and focussed on ensuring customer satisfaction to retain market share. In pursuit of improved quality and cost outcomes, insurers have endeavoured to play a more active role in the claims process. This is hardly surprising with 70 to 80 cents in every premium dollar going to repair costs and claims.

Box A: Comments by the repair sector and trade commentators

At the moment, we still have too many crash repairers.

Currently, insurers have too much choice when it comes to repairers simply because there are too many repairers. It is not realistic to expect insurers to keep an oversupply of repairers profitable on moral grounds. Insurers are in a competitive market which demands they buy at the best price. While the insurer/repairer numbers remain as they are, so will the skinny profit margins being earned by most repairers.

The condition of our roads and weather conditions will play a part. Other rules and regulations in our society will play a part. For instance, driving laws – drink driving, speed cameras and speed limits – have had a dramatic effect on the number of crashes. Clearly, the number of accidents is reducing. Cars are safer. There are fewer drunks on the road crashing vehicles. The roads are better. ... The fact that we're in a drought has reduced the number of crashes, because they're not as wet.

In an industry with shrinking profitability and increasing competition, excessive Government regulation and charges are the last straw for some body shop repairers.

I think there are some repairers out there who would be well advised to shut their doors. There are a lot of very good crash repairers and they're doing well and they're going to continue to do well. There are also many crash repairers who are developing good businesses and who will ultimately do very well.

The repair shops that are doing well are probably making very good use of technology. They have good business practices. They would have their accounting practices and procedures well under control. They would know what each job is costing them. Many repairers simply do not know what a job is costing them. There are repairers who do know if they're making a profit or a loss out of each job they do....

There are those who are running professional businesses, including the presentation of that business. They're the ones who are also attracting insurance company business. And if you're doing a lot of insurance work, generally, you'll be one of the more profitable crash repairers....

These preferred repairer networks will contain a reduced number of repairers because they only want to deal with as few repairers as possible ... and only very good ones.

What repairers have to do is make sure they get into the repairer networks. They must be seen to be using technology, have good work practices and procedures, and be seen to have good premises and be professional outfits. And only when they do those sorts of things will they have a chance.

... 65 per cent of repairers identified growth as their overall expectation for the coming year. The great majority of these thought such growth would be slow whereas 6 per cent identified rapid growth as their expectation for the next 12 months.

Encouragingly, a large proportion of respondents (40 per cent) foresaw minor increases over the next year in sales, capital expenditure, utilisation of capacity and profits. ... 15 per cent of repairers forecast a minor decrease in sales turnover and 20 per cent forecast a minor decrease in profits in the coming year.

Greater insurer involvement is now exposing the chronic oversupply of repairers that has existed for many years. Until very recently the oversupply was sustainable due to the lack of interest or willingness on the part of insurers, the major insurers in particular, to tackle inflated repair costs. The resulting redefinition of the customer-insurer-repairer relationship has collided with the unusual business model developed by repairers based on ‘capturing’ repair work by:

- ‘competing’ with other repairers by offering a variety of inducements (e.g. loan cars, undertaking non-claim-related work); and/or
- ‘competing’ with other repairers at the accident scene through links with or ownership of tow trucks.

It has also exposed a range of illegal and illicit practices.

Some repairers now find themselves attempting to compete for a limited supply of repair work with a business model that is no longer relevant or effective. Although these repairers have the opportunity to source work from those insurers that offer choice, some have persisted with campaigns against those insurers that play an active role in the repair process. Other repairers have anticipated and responded to the changing role some insurers are playing. They have chosen to focus on their business, finding efficiencies and investing in technology to ensure they deliver quality repairs at a competitive cost. These repairers have also sought to develop stronger relationships with insurers.

The level of smash repair oversupply is not clear. Currently, with approximately 1.2-1.5 million repair opportunities Australia-wide, and in the order of 5000 smash repairers, there is an average of around five to six repairs available per shop per week. While views vary as to the volume of repairs required to provide adequate returns, it is generally accepted that five per week is simply not enough. General estimates suggest the volume should be approaching 10 vehicles per week. International comparisons also suggest the Australian market is over-serviced with repair capacity.

The oversupply problem has been exacerbated by a general reduction in the volume of smash repair work as a result of factors such as the drought, more stringent policing and better roads. A generally tougher regulatory environment (e.g. OH&S, environmental laws, GST) and increased technology and skill demands have also imposed additional cost pressures on repairers.

There is some evidence of rationalisation in the sector. Repair shop numbers have decreased from around 6700 in 1992 to around 5000 today. Average shop throughput, turnover, productivity and profitability look to be on the rise, at least for some shops. There is also evidence of investment, reflecting actual or anticipated profit. And some repairers are looking for, or have found, other sources of income (e.g. restoration, warranty related repairs, spray painting such as polyurethane kitchens).

Policy considerations

The structural change pressures faced by the repair sector are real and serious. The pressures are clearly relevant to the Commission’s considerations. The repairers that emerge through the structural change will be part of a more efficient, dynamic and profitable sector. Consumers will benefit from ongoing quality repairs and through competitive premiums (the

result of competitively priced repairs delivered by an efficient repair sector). At a broader community level, bringing the level of investment in repair capacity more closely into line with the level of real demand will also bring benefits in terms of efficient resource use. These outcomes, which are market driven, are consistent with the Commission's broader policy objectives.

From an economic policy perspective, it is clear that any reforms that stymie or distort this structural reform process will come at a cost to consumers, efficient repairers and the community more generally. Great care must be taken to ensure that the pressures of structural reform are not confused with the claims surrounding choice, repair quality, repairer profitability and preferred supply arrangements.

From a social policy perspective, the Government may wish to consider some form of structural adjustment assistance for the repair sector given the structural adjustment pressures that are evident. In the case of the smash repair sector, financial assistance to either facilitate exit and/or to improve business acumen (something that key players in the repair sector acknowledge is a problem for some repairers) appear worthy of consideration.

Customer Choice

Consumers have a wide variety of opportunities to exercise their choice in relation to choice of repairer. They can:

- choose to self-insure their own vehicle, including taking third party insurance, allowing them to manage the repair of their own car as they see fit;
- choose an insurer that provides for choice of repairer – many mainstream insurers provide for choice of repairer;
- choose to cancel their policy during the cooling-off period if, after reviewing the policy or considering the offer, they decide they would prefer a different cover, including the ability to select the repairer under a claim;
- choose to cancel their policy and receive a refund, less any administration fee, if for any reason they decide they require a policy that provides repairer choice and they have purchased a policy that does not provide that option;
- in the event of an accident, choose to manage the repair themselves. This may happen if they are at-fault and the value of the claim is below the excess. Alternatively, it may happen if they are not-at-fault, where they have a right at law to recover the cost of repairs from the at-fault party; and
- choose upon renewal to change company if they decide they would like a policy that provides for repairer choice and their current policy/insurer does not provide that option.

Insured's also have the option to utilise the free internal dispute resolution (IDR) and external dispute resolution (EDR) processes should they be unhappy with their interactions in relation to any of the choices noted above. The requirements for these dispute resolution procedures are prescribed by Government.

The available evidence suggests that consumers should be well informed about those matters relevant to the purchase of motor insurance:

- the transaction costs associated with shopping and obtaining the relevant information (and advice if necessary) are very low;

- the cost of switching insurers is low;
- mainstream insurers advertise ‘choice of repairer’ as a policy feature;
- during the past two decades the repair sector and Trade Associations have been actively informing consumers (through advertising, brochures, help lines, bumper stickers, advertisements and so on) to select the ‘right’ insurer if they value or require choice;
- for those consumers who have their ‘own’ repairer, they can obtain advice from that repairer on which insurers to select; and
- there are also legal obligations on insurers to disclose key policy features as well as cooling off, cancellation provisions and IDR and EDR procedures.

These matters aside, the evidence is that choice of repairer is not an issue for the majority of consumers. Research shows the primary factor driving the insurance choice is price:

- The research commissioned by a State MTA shows price is the greatest factor when choosing an insurance company for motor vehicle insurance (43 per cent), followed by reputation of the insurer (30 per cent) and word of mouth / friend’s recommendation (19 per cent). Recommendation by a repairer is consideration for two per cent of people.
- AAMI has grown at an average unit growth rate of more than 10 per cent per annum during the past decade while disclosing its repair process. And during this period, AAMI was subject to public campaigns by the repair sector where consumers were advised not to insure with AAMI if they wanted choice and other insurers were recommended.
- Independent research conducted for AAMI shows that price (73 per cent), policy features (17 per cent) and superior service (6 per cent) are the primary factors driving selection of an insurer.

Consumer groups advised the ACCC that the primary issues for consumers are the cost of motor vehicle insurance as well as the quality and timeliness of repairs. It is also worth noting that on average, a motorist will have an accident every seven to eight years – they are unlikely to have their ‘own’ repairer.

Finally, and significantly, the legal position is that the repair contract is between the insurer and the repairer, and the insurer and the customer but not the customer and the repairer. Policies that provide for the insurer to select the repairer when authorising repairs came under the consideration of the Federal Court in *Australian Automotive Repairers’ Association-v-Insurance Australia Limited* in which Justice Lindgren stated:

Upon a proper analysis, there is never any question of the insureds acquiring goods or services from a (repairer)...

and later in the same judgement:

The insureds do not ... acquire repair services from the (repairer); they acquire them from (the insurer).

While recognising that consumer choice is not a key issue for most consumers when taking out insurance, it is also important to note that the market place provides numerous alternatives for those consumers who do require such an option. Customers wishing to select their own repairer can insure with a company that provides this option such as Allianz, GIO, CGU, Suncorp and Budget Direct. A number of companies actively promote repairer choice as a key feature of their policy offering.

Despite all reasonable evidence to the contrary, and the legal position, some in the repair sector continue to seek measures to:

- limit insurer involvement in the repair process, including guiding repairer choice; or
- to preclude the right of the insurer to select the repairer altogether.

Such measures would create paramount value in ‘capturing’ the car because the ‘capture’ of the car would dramatically increase the prospect, or even guarantee the entitlement (depending on the precise approach), to repair. Some of the likely consequences are:

- Many repairers would quickly activate inducements and involvement with tow trucks as the primary and most effective mechanism for securing accident repair work. Much of the focus would move away from shop efficiency (cost and quality), a positive dynamic under the current structural change, towards capturing repair work and securing the highest possible price for that work.
- Those repairers that had committed to delivering competitive costs and a quality service, built relationships with insurers through preferred supplier type arrangements, and generally invested in their business, would find their business model was no longer relevant.
- The cost of inducements and tow trucks would be passed on in the form that the cost of repairs and premiums would increase.
- The increased prospect of securing repair work would directly undermine State Government policies designed to overcome the unruly and inappropriate behaviour that has been associated with tow trucks and at accident scenes.
- No longer ‘responsible’ for repairs, insurers would dismantle or detune their frameworks designed to lift or maintain quality. Lifetime guarantees would be removed. And insurers would be likely to move to cash settlement. This would leave the repair process entirely in the hands of the customer, who typically has no knowledge of smash repairs. The Government would find itself responsible for quality issues having to introduce frameworks to protect consumers.

It would be easy to scoff at this scenario or consider it melodramatic, however, Australia’s own experience, as well as insights from the US, suggest otherwise.

AAMI’s Approach

AAMI takes the principles of transparency, consistency and natural justice very seriously. In relation to the sales process:

- there is clear disclosure during the sales process and in the Product Disclosure Statement and policy that AAMI retains the right to obtain competitive quotes and select the repairer;
- staff are thoroughly trained and monitored to ensure the appropriate disclosures are occurring;
- customers have a cooling-off period during which time they may cancel the policy should they find any aspect of the policy does not meet their needs; and
- customers are entitled to cancel their policy at any time and receive a refund less a \$20 administration fee.

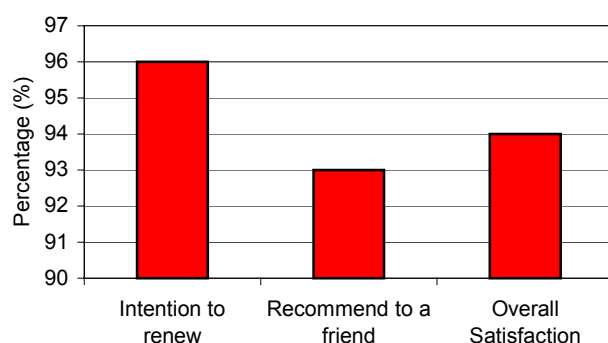
AAMI accepts that its claims and repair process may not meet the needs and requirements of all customers, but AAMI is not targeting all customers. It is targeting those customers that accept that AAMI will obtain competitive quotes, manage their repairs and in the process provide them with various benefits. Indeed, it is through AAMI's involvement in the market that AAMI has been able to offer among the most competitive premiums in the market, while delivering industry-leading service and providing superior returns for shareholders – see Box B. If customers wish to take advantage of these superior price and service offerings, they must accept the accompanying processes. Afterall, it is these processes that have made these benefits available in the first place.

Box B: AAMI's performance for customers and shareholders

A recent independent study of motor insurance premiums by JP Morgan found:

AAMI is the most price competitive insurer followed by IAG. Although on average AAMI was 4% cheaper than IAG ...Across the 360 profiles tested, the average price difference between the lowest quote and second lowest quote was 14%, and the average difference between the lowest quote and the highest was 43%. This reinforces the saying that "it pays to shop around".

Customer Claims Satisfaction

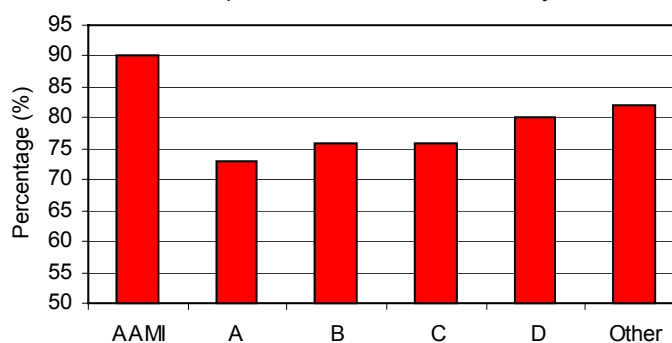


The level of satisfaction with AAMI's claims service is such that:

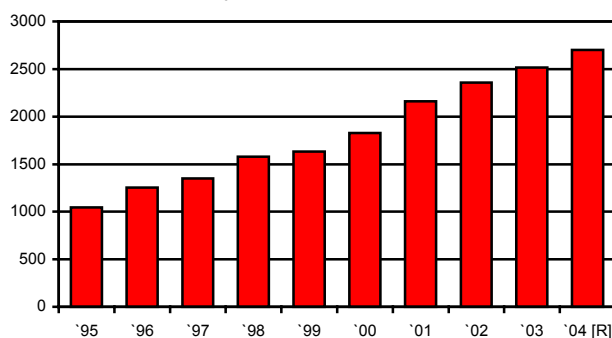
- 96 per cent intend to renew after experiencing the claims service;
- 93 per cent of AAMI customers that have experienced the claims process are prepared to recommend AAMI to a friend; and
- 94 per cent of AAMI customers that have experienced the claims service are satisfied.

AAMI's claims service also ranks favourably against major competitors – many who offer choice of repairer.

Comparative Claims Satisfaction by Insurer



Policy Growth ('000 policies)



By any measure, AAMI's performance for shareholders has been outstanding. Over the past ten years AAMI achieved:

- organic per annum growth in policies of 11 per cent in a market growing at less than 5 per cent; and
- an average post-tax return on capital of almost 20 per cent whilst the market averaged well less than 10 per cent.

While we would contend most customers do not have their ‘own’ repairer, and cite our market growth and customer satisfaction levels in support of this contention, AAMI is not seeking to insure a customer who wants to select their repairer when they have an accident. Consequently, AAMI clearly discloses to customers that we retain the right to obtain competitive quotes and select the repairer of our customer’s vehicle when they make a claim under their AAMI policy.

For the financial year ended 30 June 2004, and in the context of approximately 200,000 claims, AAMI’s Customer Ombudsman received six complaints from customers regarding choice of repairer. The Customer Ombudsman upheld AAMI’s decision in all of these matters. One of these customers chose to refer the matter to General Insurance Enquiries and Complaints Scheme (IEC – the independent EDR body for the industry). IEC also upheld AAMI’s decision.

The extremely low level of complaints would suggest the overwhelming majority of our customers are clear on the terms of the policy they have bought. Moreover, they are happy when making a claim to allow AAMI to manage the repair process for them, as they are confident AAMI has the expertise to provide them with quality repairs in a timely fashion.

Finding

Within the highly competitive insurance market consumers are free to choose whether to insure or not and, if so, whether they wish to take out a policy with a company that allows them to choose the repairer. The repair sector has gone to great lengths to inform consumers about the importance of selecting the ‘right’ insurer if they want to choose the repairer under an insurance claim. The ease of shopping and comparison, coupled with the disclosure requirements and the cooling-off and cancellation provisions allow consumers to make an informed decision as it relates to choice of repairer. As with any contractual arrangement, the time to determine what is required in an insurance policy is at the time of purchasing that policy – not at the time of making a claim. For those consumers who require or value choice of repairer, insurance products are available.

There is no case for measures that preclude or restrict insurer involvement in the repair process. Such measures would introduce unnecessary regulation where market dynamics and existing regulatory mechanisms are already serving to ensure that consumer choice issues are adequately addressed. Moreover, the unintended consequences associated with such measures would impose a substantial cost on customers, efficient repairers and the community more generally. They would also undermine existing Government regulation (e.g. towing-associated regulation) and require the Government to invest in frameworks to maintain repair quality.

Policy considerations

There is no evidence of an endemic or even partial market or regulatory failure in relation to choice. There are perhaps issues around information asymmetry if insurers are not complying with relevant disclosure-oriented legislation. To the extent that this is a concern, the Government should direct ASIC to undertake a review to confirm insurer’s disclosure practices in relation to the following matters:

- choice of repairer;
- cooling-off periods and cancellation provisions; and
- availability of IDR and EDR.

Consumers are well served by the current disclosure of policy features, benefits and entitlements, irrespective of whether they are driven by market dynamics or regulatory requirements. An area where disclosure may not be as effective or forthcoming, concerns intended and actual parts requirements of insurers.

There are three categories of parts that can be used to repair a vehicle – genuine/original equipment manufactured (OEM) parts; non-genuine (or parallel or non-badged) parts and recycled or second-hand parts. The quality of the non-OEM parts, most of which are produced overseas, is not clear.

Insurers have different policies regarding the type of parts they will authorise for repairs. Given the variances in insurance company practices regarding parts supply and usage, the need for insurers to fully disclose to consumers the parts being used to carry out repairs is vital. ASIC should confirm that the disclosure practices of insurers in relation to parts use are adequate.

Repair Quality and Safety

By its very nature, repairing a collision-damaged vehicle is not a simple exercise. When repairing an accident-damaged vehicle the aim is to ensure the vehicle is properly repaired. Clearly, this will require consideration of the age and condition of the vehicle (including normal wear and tear) as well as the manufacturer's original specifications. Within the repair sector, views as to the quality of repair vary and what is acceptable to some is not acceptable to others. In part, this arises because it is generally accepted that there are tolerances associated with repair. And it is worth noting that even new vehicles directly off the production line are not perfect, and will exhibit problems with paint finish, panel gaps and general fitment. Another complication is that smash repairers do not have the equipment nor the materials available to manufacturers who use robotics, production-line techniques, electro-static painting and so on.

Notwithstanding these difficulties, the level of quality issues in the industry, by any standard, is low. The insurance industry's independent dispute tribunal, IEC, averages approximately one complaint per month in relation to repair quality issues. State Offices of Fair Trading and Consumer Affairs record few complaints regarding problems with smash repair work.

- New South Wales: The Motor Vehicle Repair Industry Authority (MVRIA) investigates complaints that are considered to be below usual trade standards and "In any one year there are less than 10 such investigations [by the MVRIA]".
- Victoria: "... the industry is mostly free from complaints."
- Tasmania: One complaint between 1 January 2003 and May 2004.
- Australian Capital Territory: Between Nov 2001 and June 2003, six repair complaints. None since.
- Queensland: Less than twenty complaints across 2003.
- South Australia: No specific data on smash repairers, but a total of 97 for all motor repairs and servicing in 2002-03.

It is also noteworthy that the MTA-commissioned survey found that satisfaction with insurers was running at 85 per cent. This result would be expected to reflect that the repair outcomes being received by customers are favourable.

State road transport authorities and the Commonwealth Government's Australian Transport Safety Bureau also assess the cause of fatal accidents. The contribution of 'poor quality repairs' to fatal accidents is captured in the broader category of 'vehicle malfunction', which also includes malfunctions arising from poor vehicle maintenance (e.g. worn tyres, faulty brakes etc). In the States where vehicle malfunction is recorded the contribution to fatal accidents is between 1-2 per cent (NSW 0.8 per cent, QLD 2 per cent and SA 1 per cent). The Australian Transport and Safety Bureau (ATSB) advise that critical malfunction was a major causal factor in about 3.5 per cent of fatal crashes. The Australian Transport Safety Bureau advises that:

...the majority of these critical vehicle malfunctions would be due to the vehicle not being properly maintained by the owner.

When the customer complaints figures and the fatal crash data are considered in the context of the estimated 1.2-1.5 million motor vehicle repair each year, the only conclusion that can be drawn is that consumers, and the community more generally, is well served by the current market and regulatory arrangements.

AAMI's Approach

AAMI's claims process provides many protections for consumers, particularly those who do not wish to be involved in the repair process:

- only qualified assessors are used;
- repairers are required to use OEM parts;
- a Lifetime Guarantee is provided (which is honoured even if the vehicle is sold);
- the repairers AAMI works with obtain regular feedback on their quality and timeliness performance;
- the Customer Charter reinforces the robustness of the service guarantees;
- customers can nominate a repairer to submit a complete and competitive quote; and
- free IDR and EDR processes are available in the event a customer has concerns.

AAMI's customers clearly value the service provided – see Box B.

AAMI has never been approached by an authority with concerns about repair quality following an accident. We have not been approached by motor vehicle registration authorities. The ACCC, ASIC and State Fair Trading Departments have never approached AAMI with concerns about AAMI's processes and the implications for repair quality. AAMI's Consumer Ombudsman recorded six complaints relating to repair quality in the financial year ending June 2004.

Finding

The nature of smash repairs is such that not every repair will be perfect. However, insurers and repairers that are part of a preferred repairer arrangements have strong incentives to get repairs right. And recognising the importance of repair quality to their reputation and survival,

most insurers invest heavily in systems and processes aimed at supporting the delivery of high quality repair outcomes for customers. Many insurers back their processes with lifetime guarantees and all customers have access to free dispute resolution procedures if they are not satisfied. Other important indirect checks on repair quality are provided through vehicle maintenance and registration procedures. Overall, the claims by some in the repair sector that the practices of insurers are forcing repairers to do poor quality repairs is simply not supported by the evidence. Consequently, any policy reforms based on concerns about repair quality and safety based on the practices of insurers would be misplaced. More generally, if the Government wishes to make further in-roads into accident and injury rates, it would be far more effective to focus on the major contributing factors (e.g. youthful exuberance, speed, drink- and drug-driving and fatigue).

Repairer profitability

In large part, the profitability pressures faced by repairers is due to the chronic oversupply of repairers. Despite this oversupply, there are mixed views as to whether the smash repair sector is profitable. The most recent data from the ABS suggest smash repair sector profit margins are favourable when compared to other automotive sector participants – a 5.4 per cent profit margin versus 1.9 per cent profit margin. Indeed, the return for smash repairers is only slightly below the service industry average of 6.1 per cent.

Other survey evidence also suggests that at least some in the repair sector are achieving reasonable returns and have a relatively positive outlook for the future as evidenced by actual or intended investment. The repair sector itself acknowledges that some repair shops are doing well and that others will do well. However, these tend to be the better run and more efficient shops. It also acknowledges that repairers working with an insurance company are more likely to be profitable.

AAMI's Approach

AAMI does not determine a repairer's profitability. AAMI normally asks repairers to submit a quote in competition with one other repairer. They can arrive at their repair cost by whatever mechanism they wish. Repairs are then authorised to the repairer who submits the most complete and competitive quote. Under AAMI's Standard and Code framework repairers can secure their ongoing profitability by consistently producing quality and timely repairs, and running an efficient shop and submitting competitive quotes.

Finding

There is a chronic oversupply of smash repair capacity. As with any market, this oversupply is putting pressure on profitability. That said, there are mixed views on repairer profitability. It would seem repairers who are part of a preferred repairer scheme, or who have developed a niche market for themselves, are more likely to be doing well. Indeed, the repair sector itself acknowledges that it can be profitable to work with insurance companies and that the better, more dynamic shops are doing well and will continue to do well. There is evidence to support this contention. Ultimately, while the chronic oversupply remains there will be some repairers whose returns will be under considerable pressure.

Hourly rates

The debate over hourly rates has been raging since the introduction of the times and rate manual approach in the 1960s. By its very nature, the time and rate manual approach forces both parties into opposing positions:

- insurers trying to control costs, or at the very least slow the increase in repair costs to minimise the impact on premiums; and
- repairers trying to drive pricing up to maximise their returns.

This has caused widespread manipulation and abuse of the times and rate approach by both insurers and repairers. Today, neither the hourly rate nor the time allowed for repairs in anyway reflects reality. The use of the times manual for deriving a cost of repair is known by all involved as ‘funny money, funny times’, whereby rates have been held to artificially low levels with hours being grossly exaggerated.

AAMI’s Approach

AAMI does not have an hourly rate, instead we ask repairers to quote in dollar terms and allow them to arrive at their repair cost by whatever mechanism they wish, applying whatever rate is appropriate for their business. Repairs are then authorised to the repairer who submits the most complete and competitive quote. It is AAMI’s view that market forces are a more reliable determinant of a competitive repair cost than an artificial and inaccurate times and rate mechanism, which can never reflect that multiplicity of factors that will give rise to a cost of repair. In this context, it is worth noting that under AAMI’s approach, repairers are responsible for determining their own profitability.

Finding

The time and rate manual approach is known to all in the industry as ‘funny money, funny times’. The times and rates reported in no way reflect reality. Most repairers will acknowledge, and the available evidence suggests, the true hourly rate is somewhere in the range of \$56 to \$96 dollars per hour – much more than the \$23-\$30 per hour mischievously claimed by some. A number of insurers such as AAMI do not use a time and rate manual approach allowing repairers to submit a quote on the basis they see as appropriate. More generally, the proposal that a real time and rate approach can be developed is fundamentally flawed. Moreover, the universal application of any such approach would be tantamount to price fixing for repairs and would be detrimental to not only consumers, but also efficient repairers. If times and rates are to be used by some insurers they should broadly reflect reality.

Preferred supplier arrangements

While not all insurers have preferred supplier arrangements, many do. Through these arrangements insurers are endeavouring to build closer relationships with repairers for the benefit of consumers, insurers and repairers (e.g. greater supply certainty, ability to exploit scale, streamlined operating practices). For many repairers, being in a preferred supplier arrangement is preferential to relying on ‘capturing’ opportunities through inducements or relying on tow trucks.

Having preferred supplier arrangements with a supplier or group of suppliers is normal commercial practice throughout all industries and the arrangements insurance companies enter into with their repairer networks are no different. Governments themselves use preferred suppliers not only for smash repair work but also for all aspects of their activities (e.g. stationery, computer equipment, furniture, defence equipment).

At a general level, insurers would be expected to target better performing repairers for preferred supplier status. While it would be expected to vary from company to company, considerations are likely to be:

- the ability of the repairer to consistently deliver high quality and timely repairs at a competitive cost;
- the appearance of the repair shop; and
- the professionalism and behaviours of the proprietor and staff.

That insurers have targeted the better repairers for preferred supplier status is something that the repair sector acknowledges. The location of repairers relative to the insurer's customer (claims) base would also be a factor.

By their very design, all preferred supplier arrangements limit access to the available work. It is no different when it comes to preferred supplier arrangements for smash repair work under insurance claims. In order to be effective, the preferred repairers must have access to a reasonable volume of work opportunities. This provides value in the relationship and a basis for constructive business interactions including feedback to the supplier on performance.

The unfortunate reality is that the mismatch between repair capacity and available repair work is so severe that it is not possible for all repairers to be part of a preferred repairer arrangement if those arrangements are to deliver the desired outcomes for all stakeholders. Spreading the available work equally across all repairers would see each repairer receive around five to six repairs per week from a variety of different insurers. It is unlikely that any stakeholder would truly benefit from such an outcome.

AAMI's Approach

The AAMI Standards and Code framework provides a solid foundation for AAMI's relationship with repairers. The framework, which was developed in consultation with the ACCC and repairers, was introduced in 2001. The framework has been updated to incorporate the recommendations made by the ACCC in 2003.

There are no set criteria for entry. Repairers are expected to maintain general industry standards, and abide by all existing regulations, but we do not prescribe how they equip or set-up their businesses. New repairers are only added to the repairer panel when necessitated by repair volumes. Typically, these offers are extended to repairers that have previously approached AAMI.

AAMI sets down clear performance targets for repairers, and provides regular feedback on performance against these targets. Repairers are not told how to run their business; AAMI simply measures their outputs – their performance results. Under this framework, repairers have the opportunity to consider their own particular business circumstances and source work on the basis of their ability to run an efficient shop, consistently produce quality and timely

repairs and submit competitive quotes. Within this framework, repairers have primary control over their profitability and their right to retain status as an AAMI repairer.

The performance management system is clearly specified, simple and transparent – the same as that for AAMI staff. Counselling, verbal and written warning protocols are followed before a repairer is removed. Repairers can appeal to the independent Code Executive Director. The Code Executive Director also reports on the application of the Standards and Code. This report is publicly available.

While AAMI has a commitment to existing repairers, and the available volume of work dictates that not all repairers can be part of AAMI's panel, we have undertaken to respond within 28 days to every application to join our panel.

Not all repairers can belong to AAMI's network. AAMI was involved in the management of almost 200,000 cars in 2003. If this work were shared among Australia's 5000 repairers, each would receive approximately 0.75 repairs per week. No one would benefit by such an arrangement. There would be no basis for a business relationship, the increased competition would drive costs down (at a time when some repairers claim they are not being paid enough), and the ability to maintain repair quality and timeliness would disappear.

Finding

Preferred repairer schemes are valid business practice because:

- they improve the productivity and economic performance of the repair sector and insurance industries;
- they reduce or limit the need for Government regulation in areas such as repair quality;
- they encourage the development of efficient and competitive repairers and insurers;
- at a time when there is a chronic oversupply of repair capacity and structural change is under way, they provide for those repairers that are members and can meet the requirements, some certainty about their business prospects going forward; and
- they do not impinge or jeopardise the broader community's rights or interests in relation to choice or repair quality.

Overall, there are no substantive policy issues in terms of the merits and rights of insurers:

- to have preferred repairer type arrangements;
- to limit membership of these schemes according to each insurer's needs; and
- to structure their preferred repairer arrangements around their particular business strategies and operational practices.

Codes

The ACCC concluded that the issues between insurers and repairers relate to the relationship between small and big business. It also recommended that any future developments focus on the issues arising between insurers and repairers rather than other issues (e.g. consumer choice). AAMI agrees with this statement.

A number of reviews have suggested that some form of code may be helpful in resolving some of the tensions between insurers and repairers.

Some insurers have introduced corporate codes (e.g. AAMI, Allianz, IAG). The repair sector has claimed that insurers' corporate codes are lacking in that they do not specify standards for repairers, have an inadequate dispute resolution mechanism and fail to provide guidance on customer service.

At least in the case of AAMI's framework these claims are demonstrably incorrect. AAMI would also note that during its discussions with State-based MTAs and repairers these issues have not been raised. Indeed, the peak body, the MTAA, has not yet taken up AAMI's offer to discuss our Code and Standards framework.

VACC, on behalf of the repair sector, has promoted its own Code of Conduct, known as the Automotive Body Repair Industry Code. The Code seeks to guide dealings between insurers and repairers. It has been proposed that the Code form the basis of a voluntary or indeed a mandatory Code under the *Trade Practices Act* (TPA). In support of a mandatory Code under the TPA, the repair sector has argued that the insurance industry, in direct contradiction to findings from numerous reviews, has refused to engage in discussions to find ways to resolve tensions between insurers and some repairers. This is simply untrue.

The Automotive Body Repair Industry Code was first advanced three to four years ago. The insurance industry (via the ICA) had numerous interactions in relation to the Code including a submission to the Victorian Government in February 2001. AAMI understands there has been no response to the issues raised by the insurance industry.

VACC's Code and related provisions, seek a return to an environment where repairers compete against each other to 'capture' the damaged vehicle and, once in possession of that car, have an almost guaranteed right to repair it. It goes well beyond attempting to improve business relationships and seeks to change the way insurers conduct their business for the benefit of certain repairers. These objections were raised from the outset and each version of the Code that has been circulated has included provisions that provide for these outcomes. In this respect, the Code ignores the ACCC's suggestion that future developments should focus on the relationship between insurer and repairer issues and not consumer issues. As such, it provides no basis for either a mandatory or a voluntary code. More generally, this fundamental impasse has made discussions with the repair sector on insurer-repairer relationships problematic.

Policy considerations

That there is tension between insurers and repairers is unquestionable. Of course there is tension in all business relationships. However, the repair sector is also facing serious structural change pressures. In this environment, it is clearly incumbent upon insurers to ensure dealings with repairers are transparent, consistent and conscionable. AAMI has gone to great lengths to ensure that its behaviours are appropriate.

The case for a mandatory code has not been established. There is no demonstrable market or regulatory failure. The existing mechanisms are delivering benefits to consumers and efficient repairers. That said, neither a mandatory code nor a voluntary code can solve the structural change pressures faced by the industry, unless there is a preparedness to insulate the sector from these pressures. Such a course of action would come at a cost to consumers, efficient repairers and the community more generally.

Were the repair sector prepared to accept an insurers right to play a role in the repair process and direct repairs, it may be possible to make some progress. Indeed, AAMI believes its code and Standards framework has shown the way. That said, it is difficult to conceive how the balance of the issues raised by the repair sector can be dealt with in a voluntary code. These matters include things such as parts requirements (e.g. OEM or other), payment terms, goodwill provisions, arrangements for dealings with non preferred suppliers, dispute resolution approaches, repairer versus insurer liability under lifetime guarantees and so on.

Insurers' approaches to these matters vary substantially. Consequently, any attempt to incorporate such provisions in a voluntary code would be fraught with problems. By necessity, a single voluntary code would need to be high-level and deal with generalities. It could not drill down to the detail required to allow repairers to deal with their specific issues with specific insurers. Indeed, AAMI would contend that many repairers would acknowledge that their concerns in relation to these matters are only associated with particular insurers. This would suggest these matters are best dealt with in corporate codes (and related frameworks). To this end, the recent reforms to the TPA regarding collective bargaining for small business provide an avenue for repairers to elevate these issues.

The prospect for reducing the tensions with the repair sector, be it through a voluntary code or corporate codes, is limited if the sector continues to argue for undertakings from insurers that repairers should be entitled to open access to repair work and repair any car they are able to 'capture'. Most insurers will not provide such undertakings and will certainly argue strongly against any reforms facilitating such outcomes. These outcomes would be to the detriment of consumers, efficient repairers and the community more generally.

Concluding comments on AAMI's Approach

AAMI has for many years taken the view that if the customer is to get the benefit of the guarantees offered by AAMI and a high quality service at a competitive premium, then AAMI simply has to be involved in the repair process. AAMI has made all reasonable efforts to ensure consistency and transparency for stakeholders. AAMI's market share growth during the past decade is the ultimate proof that the company's approach to doing business has been extremely successful, delivering significant benefits not only to AAMI's customers, but also to its repairers and shareholders. Sustaining these benefits would not have been possible if AAMI was imposing on our customers a repair process they did not want; if AAMI was treating repairers in anything less than a professional manner; and if AAMI was repairing cars with scant concern for repair quality.

Chapter 1 Introduction

This submission is presented by Australian Associated Motor Insurers Limited (AAMI).

It has been prepared in response to the Productivity Commission's request for submissions for the inquiry into the Australian motor vehicle smash repair industry and the Australian motor vehicle insurance industry.

AAMI is a part of the Promina Group (Promina), which is Australia's third largest insurance company. AAMI is focussed on the personal lines of Motor, Home and CTP insurance, and will write almost 3 million policies in 2004 with gross written premium of over \$1.2bn. Motor insurance is a substantial component of AAMI's business.

AAMI is a direct distributor, with no intermediary involvement. It provides insurance for the general population, including younger people through its non-standard risks agency, Just Car Insurance Agency Pty Limited (JCIA). AAMI now operates in all Australian states except Western Australia and the Northern Territory, and has a network of over 50 branches and service centres.

This submission is structured as follows.

Chapter two provides a brief overview of some of the market dynamics that have shaped the motor insurance industry, the smash repair sector and the relationship between the two over the past 70 to 80 years. These dynamics have given rise to a consolidated motor insurance industry that now takes a strong interest in the quality and cost of smash repairs. The dynamics have also exposed a chronically oversupplied smash repair sector.

The chapter also highlights some of the issues raised by the repair sector in response to efforts made by insurers, particularly AAMI, to take a greater interest in managing repair quality and costs. These issues, which date back almost two decades, include 'customer choice' and 'repair quality and safety'. The repair sector is making the very same claims about these issues today in its lobbying for Government assistance and protection.

Chapter three outlines AAMI's approach to motor insurance. It overviews AAMI's processes for sales, claims, interactions with repairers and the disputes resolution mechanisms available to customers. The chapter also highlights the benefits of AAMI's approach for key stakeholders including customers, repairers and shareholders. Some of the direct or indirect criticisms of AAMI's approach are also covered.

Chapter four takes a broader perspective and considers the claims made by the repair sector in the broader context of the insurance industry. The following issues are considered:

- consumer choice;
- repair quality and safety;
- repairer profitability; and
- hourly rates.

The chapter demonstrates that many of the claims made by the repair sector as it relates to these issues and in support of Government intervention cannot be substantiated.

Chapters five and six consider the following issues in a policy context:

- structural change;
- consumer choice;
- preferred supplier arrangements; and
- the role of codes in improving relationships between insurers and repairers.

In considering these issues, AAMI has taken into account the Commission's broad policy guidelines as defined in legislation.

Chapter 2 Historical and Competitive Context

This chapter provides a brief overview of some of the market dynamics that have shaped the motor insurance industry, the smash repair sector and the relationship between the two over the past 70 to 80 years.

These dynamics have given rise to a consolidated motor insurance industry that now takes a strong interest in the quality and cost of smash repairs – something much of the industry did not do until very recently.

The dynamics have also exposed a chronically oversupplied smash repair sector. Many in the repair sector are today finding that their business model, which can only be described as unusual, has not kept pace with the structural changes in the insurance market, and a generally tougher regulatory and business environment. The resulting structural change and rationalisation pressures faced by the repair sector are serious. However, they are not unlike the pressures faced by other small-business segments (eg grocers, pharmacies, service stations, corner-stores, milk bars, butchers, local auto mechanics etc).

Understanding these dynamics is a critical prerequisite to:

- the analysis of the claims by both the insurance industry and the repair sector; and
- the consideration of any policy reforms.

The chapter also highlights some of the issues raised by the repair sector in response to efforts made by insurers, particularly AAMI, to take a greater interest in managing repair quality and costs. These issues, which span almost two decades, include ‘customer choice’ and ‘repair quality and safety’. The repair sector is raising the very same issues today in its lobbying for Government assistance.

2.1 Setting the scene – 1930s-1970s

For many years, being part of the Australian insurance business was akin to being part of a cosy club. There was little government regulation. Market activity was strictly guided by an insurance company cartel of companies known as ‘the Tariff’. There was effectively no competition or a desire to compete. Price and policy benefits were almost identical, being dictated by the Tariff with the main point of differentiation between the many players involved being the relationship that existed between the customer and the selling agent.

The Tariff had its foundations in the insurance market-place of the late 1800s, which was beset with regular price-wars resulting in collapses and considerable consumer hardship. In order to prevent this situation from recurring, the Tariff was instituted whereby insurers agreed amongst themselves matters such as pricing for individual risk, product benefits, policy wordings and the size of each company’s agent distribution system. Like many other insurance products, motor insurance was caught in the Tariff net.

The uncompetitive atmosphere was further blurred by the relatively minor proportion of motor business written by insurers up to the 1960s. Certainly, prior to then many mainstream insurers tended to only provide motor insurance as an ‘accommodation’ line to satisfy the needs of existing insureds (eg Home or Life Insurance customers).

2.2 1960s to early 1990s

Cracks started to appear in the Tariff world in the late 1960s when the Commonwealth Parliament passed the *Restrictive Trade Practices Act 1965*. Although it was fairly restrictive in scope, it sounded a warning bell to cartels like the Tariff that the days of anti-competitive practices were numbered. In 1973, the *Insurance Act* was introduced following a series of insurance company collapses. The *Insurance Act* imposed a whole new system of regulation and prudential supervision on the insurance industry. This put further strains on the Tariff and finally, in 1974, the Whitlam Government introduced the *Trade Practices Act*. This was the end of the anti-competitive Tariff world.

By this time insurers had begun to compete for motor insurance customers as they had come to the gradual realisation that motor insurance was an important and growing business. The increasing use and ownership of cars was being fuelled by the advent of Hire Purchase in the 1960s combined with the rampant consumerism born of full employment and low interest rates. The motor vehicle was quickly becoming an important part of day-to-day life.

Competition between insurers followed very traditional lines. It was mostly price-related, with some minor variation in the product. Like other insurance lines, much of the interest in motor insurance was around obtaining an up-front premium payment and investing the money in order to make investment income. There was very little interest in claims and claims costs, even though claims costs (and more particularly repair costs) easily comprised the most significant component of every premium dollar. Getting the opportunity to make investment income from premiums was the focus of insurance companies – dealing with claims was little more than an incidental annoyance!

As a consequence of this tardiness, the insurance industry lost money at the underwriting line year after year (see Table 2.1). The investment income that was secured softened the impact of the shortfall between premiums and costs. However, even with this offset, returns were poor and well below that which might be reasonably expected.

Under any normal circumstances, the ongoing poor performance would have lead to a crisis. However, insurers did not have to face the commercial reality of their financial mismanagement because they were insulated.

- Most, if not all, insurers were suffering the same plight. As such, it was relatively easy to pass the losses on in the form of increased premiums.
- Many insurers had other product lines and investment income through which they could smooth their results and make up for losses incurred in their motor portfolio.
- Perhaps most significantly, the motor insurance market was dominated by the motor clubs such as the NRMA and RACV, other mutuals, and by Government Business Enterprises ('GBE's') such as GIO. There was no real profit expectation and there was a pool of funds that could be drawn upon to make up for any shortfalls.

Table 2.1: Motor Vehicle Insurance Industry, Selected Statistics, Australia 1984 – 2002 (\$ Million)

Private Sector	1983- 1984	1984- 1985	1985- 1986	1986- 1987	1987- 1988	1988- 1989	1989- 1990	1990- 1991	1991- 1992	1992- 1993	1993- 1994	1994- 1995	1995- 1996	1996- 1997	1997- 1998	1998- 1999	1999- 2000	2000- 2001 ^a	2001- 2002 ^a
Earned Premiums	962.9	1,045.7	1,223.7	1,410.9	1,702.7	1,828.9	2,046.1	2,153.4	2,289.3	2,524.7	2,644.0	3,111.9	3,366.3	3,738.3	3,630.4	3,640.5	3,246.9	2,676.2	3,053.1
Claims Incurred	756.6	856.1	1,175.8	1,376.2	1,405.7	1,580.9	1,912.9	1,985.3	1,924.3	2,046.5	2,203.4	2,665.2	2,970.2	3,176.9	3,030.5	3,092.4	2,771.4	2,103.7	2,311.5
Expenses	236.5	251.7	319.8	365.0	436.6	477.0	543.8	563.3	586.5	570.5	630.7	645.5	693.3	789.9	758.5	782.2	637.0	516.8	600.7
Underwriting Result	-30.2	-62.1	-217.9	-330.2	-184.6	-229.1	-410.6	-395.2	-221.5	-92.2	-190.0	-198.8	-297.3	-228.5	-158.6	-234.1	-161.5	55.7	141.0
Public Sector	1983- 1984	1984- 1985	1985- 1986	1986- 1987	1987- 1988	1988- 1989	1989- 1990	1990- 1991	1991- 1992	1992- 1993	1993- 1994	1994- 1995	1995- 1996	1996- 1997	1997- 1998	1998- 1999	1999- 2000	2000- 2001	2001- 2002
Earned Premiums	248.1	262.1	276.5	317.9	380.2	418.9	439.3	464.7	465.3	174.6	179.0	196.0	195.5	40.7	7.9	9.3	10.3	11.0	11.0
Claims Incurred	191.1	217.0	258.6	280.2	307.0	338.9	392.6	414.4	427.9	169.1	222.6	421.1	172.5	34.9	8.9	8.1	11.8	9.9	8.5
Expenses	55.2	62.5	70.9	80.9	92.0	100.2	110.0	81.6	56.0	39.6	34.6	52.9	77.1	1.9	1.9	1.5	2.3	2.7	2.3
Underwriting Result	1.9	-17.3	-53.1	-43.2	-18.8	-20.2	-63.3	-51.4	-18.6	-34.1	-78.2	-277.9	-54.1	3.9	-2.8	-0.3	-3.8	-1.6	0.3
Total	1983- 1984	1984- 1985	1985- 1986	1986- 1987	1987- 1988	1988- 1989	1989- 1990	1990- 1991	1991- 1992	1992- 1993	1993- 1994	1994- 1995	1995- 1996	1996- 1997	1997- 1998	1998- 1999	1999- 2000	2000- 2001	2001- 2002
Earned Premiums	1,211.0	1,307.8	1,500.2	1,728.9	2,082.9	2,247.7	2,485.5	2,618.1	2,754.6	2,699.3	2,823.0	3,307.9	3,561.8	3,779.1	3,638.3	3,649.8	3,257.1	2,687.2	3,064.1
Claims Incurred	947.6	1,073.0	1,434.4	1,656.4	1,712.6	1,919.8	2,305.5	2,399.6	2,352.1	2,215.6	2,426.0	3,086.2	3,142.8	3,211.9	3,039.4	3,100.6	2,783.1	2,113.6	2,320.0
Expenses	291.6	314.2	390.7	445.9	528.6	577.2	653.8	645.0	642.5	610.1	665.2	698.4	770.4	791.8	760.4	783.6	639.3	519.5	602.9
Underwriting Result	-28.3	-79.5	-271.0	-373.4	-203.4	-249.3	-473.9	-446.5	-240.0	-126.3	-268.2	-476.8	-351.4	-224.6	-161.5	-234.4	-165.3	54.1	141.3

^a These two years were affected by a stop-loss policy purchased by NRMA.

Sources: Insurance & Superannuation Commission, General Insurance Group Selected Statistics On The General Insurance Industry, 1993-1997
Australian Prudential Regulation Authority, Selected Statistics on the General Insurance Industry, 1998-2002

- Notes::
1. Statistics relate to Inside Australia – Direct Underwriters
 2. Earned Premiums: Premium Revenue less Reinsurance Expense for Commercial and Domestic Motor Vehicles
 3. Claims Incurred: Claims Expense less Recoveries Revenue for Commercial and Domestic Motor Vehicles
 4. Expenses: Underwriting Expenses for Commercial and Domestic Motor Vehicles
 5. Underwriting Result: Underwriting Result for Commercial and Domestic Motor Vehicles

2.2.1 Smash repairers develop an unusual business model

During this era, insurers limited interest in repair costs funded lucrative returns for smash repair work. Not surprisingly, repairers set about finding ways of ‘capturing’ the limited supply of repair work – accident damaged cars – in order to get part of the action. And the repair sector was very imaginative in its endeavours.

While the Commission was presented this evidence and analysed its implications in its previous Inquiry, it is worth recapping. DVD Attachment 1.1 provides examples of some of the practices highlighted in this section. DVD Attachment 1.2 provides parallels between the motor insurance industry and the health insurance industry that contextualise the consequences of a lack of insurer (and Government) attention to costs and is worthy of consideration by the Commission.

It was, and it remains, commonplace for repairers to offer inducements in return for customer endorsement as the ‘preferred’ repairer or ‘repairer of choice’. These inducements took many forms but included:

- offering to pay insurance excesses;
- offering to perform repair work not related to the accident or the claim; and
- offering to provide a courtesy car.

Using tow trucks to capture cars at accident scenes also became another important way of securing work. Repairers would either own trucks or have access to trucks. Often tipped off by an informal system of accident scouts¹, tow trucks would race to accident scenes in a bid to secure repair work in the form of a damaged car. At the accident scene towing operators would offer inducements, tell customers they were insurance company representatives and advise customers on their insurance cover; indicating they did not have to worry about the towing charges because they were covered by their insurance. Once in possession of a damaged car, towing operators would either return to their shop or hawk the vehicle around to whichever repair shop offered the greatest commission (commonly known as a ‘drop fee’).

Such was the value in securing non-driveable repair work that accidents became unruly scenes, violence between operators often erupted, there were turf wars and standover tactics. As one commentator remarked²:

Unfortunately, many people connected to towing operators in some way attend accident scenes and are in possession of authority-to-tow books. We find perhaps 20 or 30 people with authority books milling around and jostling one another to obtain authority.

Accident towing issues have been well documented and were analysed by the Commission in the last Inquiry. The ACCC also covered issues associated with tow trucks³. Governments in almost all Australian states have been forced to regulate accident towing. Various forms of regulation remain today and Governments continually find themselves reviewing the frameworks with a view to address the ongoing problems.

¹ In return for providing information about accidents, these scouts or spotters would receive ‘spotter’s fees’.

² Spratt, W. (1967), *Competition, the answer to motor insurers’ multi-million dollar question*, Australian Insurance and Banking Record, p. 126.

³ ACCC (2003), *Discussion on the relationship between the Australian motor body/smash repair industry and the general insurance sector*, Issues Paper, September.

The ongoing need for regulation of accident towing simply reflects the value of capturing repair work. There is ample evidence of this value. For instance, accident towing plates in Victoria continue to trade for over \$100,000 and the recent NSW Government review into towing revealed a massive investment in tow truck capacity.⁴ Of course, this investment simply reflects returns. In both instances, the revenue secured from accident towing is negligible. This indicates that the return from smash repair work (or drop fees) must be substantial to justify the investment. A thorough examination of towing sector dynamics and the interconnectivity with smash repairers is provided in Attachment 1.3.

The willingness of repairers to own tow trucks, pay drop fees and offer inducements reflected the capacity to pass those costs on to the customer. Under normal circumstances, customers would be expected to query the implications of these practices on the cost of repairs. However, customers faced a classic ‘moral hazard’ dilemma as they were not paying for the repair. There was overlap between repairers and customer’s interests:

- customers benefited from the inducements (eg loan car, extra repair work) without having to pay for them; and
- repairers benefited from the repair work and could usually pass the cost of the various non-repair related costs onto the insurer in the form of inflated repair costs.

Of course, repairers would behave very differently if insurance was not involved. Hence, the repairer’s well known standard opening question: “Is it an insurance job or a private job?” Not surprisingly customers would also behave differently if they were spending their own money.

Some insurers made some effort to manage repair costs. Preferred supplier arrangements were established but insurers tended to pay little attention to the cost, quality or timeliness outcomes produced. Preferred repairer status effectively became an insurance company endorsement and assisted repairers to capture repair work. Insurers further added to the dynamic by using repairers for claims lodgement. Documentation was provided to repairers, who simply had to fill out a form and obtain the customer’s signature to secure the right to repair the car. The next task for the repairer was to secure as a high a price as possible for the repair.

Insurance company assessors were employed and charged with the task of endeavouring to arrive at a fair and reasonable cost for repairs. They had no competitive reference point against which to make these assessments. This effectively meant the assessor was left to ‘negotiate’ the best price he could with the repairer on the day. More often than not the repairer (who had control of the car and the customer on side) won.

Dealing with repairers on a regular basis made ‘negotiations’ for assessors difficult, even where it was clear the repair costs had been inflated. The introduction of times and rates manuals in the 1960s made little difference. The negotiation process became one of negotiating over the application of the manual. Indeed, in some respects, the times and rates manual was used as a basis to legitimise inflated repair costs.

4 Anderson, P. (1999), *Review of the Tow Truck Industry in New South Wales*, Final Report.

Investment in repair shops

One of the consequences of the ability to inflate repair costs, and therefore earn super profits on a repair-by-repair basis, was massive investment in smash repair capacity (and tow trucks). The investment was further enabled by low entry costs:

- only a basic level of equipment, which was inexpensive, was required to repair the cars of the time;
- there were few Commonwealth, State, or Local Government regulatory requirements;
- enforcement of the regulations that did exist was generally lax;
- tax avoidance was commonplace with no reportable payments system, PAYG or GST;
- it was relatively easy to attract tradesmen; and
- it was possible to capture repair work.

Overall, the sector was lucrative and young tradesmen were attracted. They would get a few years experience, and within a couple of years of completing their apprenticeship many were running their own business and making good money.

By any measure, the Australian car parc was exceedingly well serviced. By the early 1990s, there were some 6700 repair establishments (ABS, 1994, Cat No. 8622.0) for some eight million passenger motor vehicles. This equated to around 1200 vehicles per repairer. At a higher incidence rate of 15 per cent this equated to around three to four repairs per repairer per week. Because an average shop employing seven to eight tradespeople can repair around 20 cars per week, self-evidently this sector was propped up by inflated repair costs. There was little efficiency in repairing cars, most of the proprietor's energy was expended in securing supply (capturing the car).

2.2.2 Illegal and illegitimate practices

Some people in the repair trade were prepared to go further than simply offering inducements or accessing work via tow trucks in order to generate returns. A variety of illegal and illegitimate practices emerged, including:

- *The 'Golden Hammer'*: This practice was normally associated with non-driveable vehicles. It involved creating additional billable repair work by doing additional damage to the vehicle prior to assessment.
- *Parts substitution*: This practice involved substituting the parts quoted and billed for (eg new genuine parts) with other parts (eg recycled or non-genuine parts) and pocketing the savings.
- *Shadow repairs*: This practice involved sending invoices for work that was never performed - itemising and charging for work not done or parts not supplied.
- *Bribes*: Offering in-kind or cash inducements to assessors in return for the authorisation of inflated repair costs or turning a blind eye to the 'Golden Hammer', shadow repairs or parts substitution.
- *Recovery scams*: At the risk of oversimplification, these scams involved securing a not-at-fault accident damaged vehicle. An inflated quote and/or a quote including repairs not required or related to the accident was then prepared. This quote was normally given 'credibility' by involving an 'independent assessor' who signed-off on the quote. The repairs were then completed and the bill sent to the at-fault party or their insurer via a recovery agent. If there were delays or the bill was questioned, the demand was handed

over to a solicitor who issued proceedings. All the players (ie recovery agent, assessor, repairer, tow truck operator etc) were well compensated for their 'services'.

Most often the consumers involved in these scams were innocent victims. They happened to have an accident, which was not their fault, and they were encouraged or cajoled to use the service by the way of inducements such as courtesy cars.

- *Staged Accidents:* As the name suggests, this involved 'staging accidents'. Normally, once the accident has been staged, a third party recovery scam type process followed.

Perhaps these practices were in part driven by the excess repair capacity and the associated difficulties in capturing sufficient repair work. Certainly, insurers' limited interest in repair quality and cost allowed the practices to continue and flourish. Unfortunately, many of these practices still occur today.

2.2.3 AAMI Introduces Competition

In 1981, AAMI made a corporate decision to introduce a two-quote system, a decision that would bring the company into direct conflict with the repair sector. Unlike its competitors, AAMI had no other product lines or investment income to act as a buffer against inflated repair costs. AAMI shareholders expected an underwriting profit.

With 70 to 80 cents in every dollar of premium income spent on repairs, something had to be done to contain repair costs. In 1982 AAMI embarked on the process of injecting competition into the industry. This started in Victoria, where AAMI set up a recommended repairer group of 76 repairers (many of whom are still part of the AAMI repairer network). Repairers were provided a regular flow of work in return for competitive quotes and high quality repair work. Car owners were asked to obtain two-quotes, and to bring their driveable vehicles to the 'neutral' ground of an assessment centre. The quotes were assessed and the work awarded to the most competitive repairer. By 1984 the two-quote policy was firmly part of the company's national operating procedures and had been formalised with the customer by inclusion in the policy document.

The neutral ground of the Assessment Centre was crucial to the success of the two-quote system. It minimised the possibility of collusion between repairers on quotes; it removed the assessor from both the reward temptations and occasional hostility of the repairers; and it encouraged a stronger customer service relationship with the customer. Most importantly, it allowed AAMI to obtain more than one estimate for the cost of repair and removed reliance on the arbitrary world of the time and rate manual. AAMI management saw that the system worked – repair costs began to fall and competitive quoting became, and continues to be, central to AAMI's business strategy.

Competitive quoting for non-driveable vehicles

The real challenge, however, was obtaining two quotes on non-driveable vehicles. Historically, once a car arrived in a repair shop (by whatever means) it remained there. These were the vehicles with the greater damage and as a result they attracted the most inflated repair quotes and the repairers ability to physically 'capture' the car allowed them to include a variety of add-on costs to the actual cost of repair.

By 1986, AAMI was ready to formally extend their competitive quoting practices to non-driveable vehicles by implementing a ‘tow-out’ policy, enabling removal of excessively quoted vehicles from a repairer’s workshop, moving it to the ‘neutral’ ground of its assessment centres.⁵ Here, two competitive quotes could be obtained.

Despite vigorous opposition by some in the repair sector (detailed below) AAMI spread its competitive quoting model nationally. By the end of the 1980s repairers were generally prepared to accept AAMI’s insistence on competitive quoting, but only because there were enough other insurance companies still providing the industry with ‘profitable’ work. AAMI was tolerated by some repairers and ignored by others.

In mid-1991, however, AAMI again became the focus of repairer opposition with the establishment of All States Auto Assessing (ASA), allowing AAMI to service not only its customers but those of its shareholding companies including Royal, Sun Alliance, CIC and CU insurance. Some repairers (and the Trade Associations) viewed this as a further attack on repairer profitability fearing the spread of the two-quote system to other companies that had previously been prepared to accept inflated repair prices.

AAMI learned a number of lessons from this period. It was clear that the two-quote system delivered significant and sustainable reductions in repair costs. It also revealed (and circumvented) myriad repair cost loadings, inducements, parts substitution rackets, and illegal practices that had become entrenched in the repair sector in the absence of any sustained interest in managing repairs on the part of the insurance industry.

AAMI also realised that it needed to inform the customer about the repair process before the repairer had an opportunity to get the customer on side by offering a variety of inducements with a view to ‘capturing’ repair work (see Section 2.2.1). Although AAMI selected the repairer through the two-quote system, the inducements to customers created unnecessary tension, with customers feeling they were missing out on ‘something for nothing’. Consequently, in the early 1980s AAMI moved to a telephone claims lodgement process. This reduced the ability of repairers to get the customer on side with inducements and assisted AAMI in taking control of the repair process.

Throughout this period, AAMI met with the ACCC, ASIC and various State Government Fair Trading and Consumer Affairs Departments to discuss the two-quote system and associated matters. These agencies, whilst not endorsing AAMI’s particular approach, were supportive of efforts to introduce competition and deliver better premiums and service to customers. While competition was recognised as a normal business practice, AAMI’s efforts to introduce competitive forces to the repair industry during the 1980s and early 1990s met with sustained opposition from the repair sector, and in particular, from the Victorian Automobile Chamber of Commerce (VACC).

2.2.4 The Repair Sector Response

While the smash repair trade had viewed the introduction of competitive quotes on driveable vehicles with concern – citing reduced repair standards as a consequence, and arguing the two-quote system was anti-competitive and interfered with the customer’s ‘freedom of repairer

5 Between 1982 and 1986 AAMI situationally towed out vehicles from premises where there were concerns about grossly inflated quotes.

choice' – the general fragmentation of the sector and the use of the neutral ground of Customer Service Centres minimised any conflict.


This was not the case, however, when non-driveable vehicles were included in the competitive quoting process. Behind the scenes, those repairers who had established very lucrative tow-truck, repair and even recovery businesses based on secret commissions and other illegal practices, set about actively opposing the prospect of a level playing field.

In 1986, in response to AAMI's 'tow-out' policy on non-driveable repairs, VACC ran public advertisements advising all AAMI customers to change their insurer. This campaign was supported by a letter to all VACC smash repair members encouraging them to ensure their customers also moved their policies away from AAMI. The campaign was focussed on the issues of 'Choice' and 'Repair Quality'.

Diagram 2.1: VACC Advertisement

The Sun, Wednesday, August 20, 1986—Page 11*

CAR OWNERS LOOK OUT!



If you have an accident, is your car going to be repaired by someone you know and trust?

One Major insurance company will tell you who is going to repair your car. Although you may nominate a repairer the final choice lies with that insurance company. After an accident that's the last thing you need.

You have paid a lot of money for your car and your car insurance, and you want your car repair to be under your control.

That Major insurance company has taken away your choice of repairer. Your car may be removed from the repairer of your choice to a central depot, where quotes will be called for from other repairers.

If you are unsure whether your insurance company will allow you to determine your own repairer...

...find out now, before it's too late.

PHONE: 266 2790 During Business Hours

The Victorian Automobile Chamber of Commerce will advise you.
For advice on who to insure with, now or in the future, contact your local repairer.

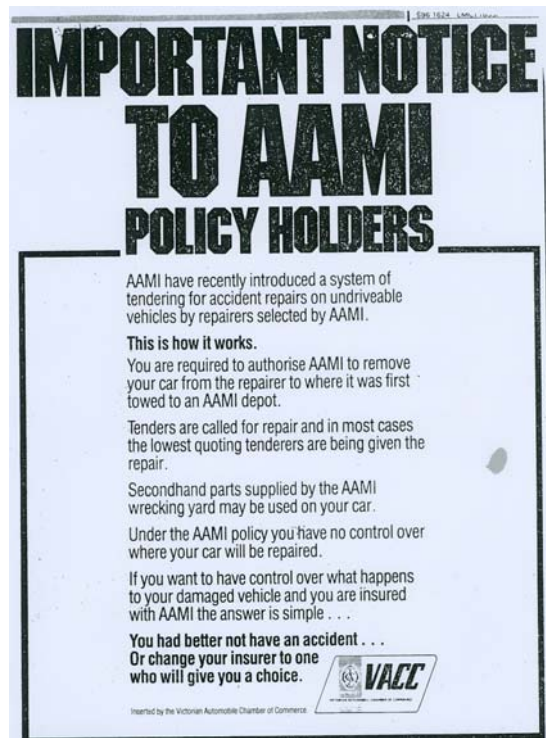
Source: The Sun (1986), Wednesday, August 20, p. 11.

Later that year, VACC moved to the second stage of their campaign, again placing advertisements in newspapers, sending posters to their members for display in their workshop and establishing a hotline to advise customers on why they should not be insured with AAMI. The same messages around 'Choice' and 'Repair Quality' were repeated. In a communication to members on 8 August 1986, the VACC Executive Director stated (see Attachment 1.4):

This campaign will be ongoing and stop only when AAMI modify their stance.

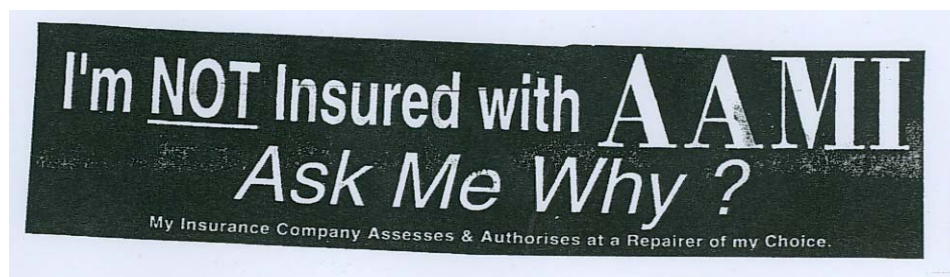
The campaign was sustained throughout the 1980s with VACC placing public advertisements (for example, see Diagram 2.2) explicitly targeting AAMI and advising their members on how to frustrate attempts to have vehicles removed from their premises (a similar process to that currently being proposed in the VACC repair industry code – Chapter 6). Repairers adopted a variety of practices in opposition to AAMI's activities ranging from distribution of bumper stickers – "I'm NOT insured with AAMI – Ask me why?" (see Diagram 2.3), placing banners over freeways, guerrilla tactics including disabling cars to prevent their removal from repairs and physical threats to AAMI staff.

Diagram 2.2: VACC Advertisement



Source: The Sun (1988), August.

Diagram 2.3: Anti-AAMI Sticker



Further examples of the material used in the campaign are provided in Attachments 1.4, 1.5, 1.6.

The predominately anti-AAMI repairer campaign culminated in a report on the ABC Investigators program May 1992, which savagely attacked AAMI's two-quote system, alleging this practice led to unsafe repairs. While these allegations were shown to be false, and a retraction was put to air within two months, AAMI's reputation had been damaged and repairers viewed this as one of their greatest victories.

Ongoing agitation throughout the early 1990s eventually led to an Industry Commission Inquiry. Notwithstanding claims around choice, quality and safety by some in the repair sector, the Commission vindicated the two-quote system.⁶

While some trade-offs are possible, insurance companies generally wish to minimise costs and preserve their reputation (and market share). The system adopted by some insurance companies to pursue this objective – the two-quote system for non-driveable vehicles – is not an unusual commercial practice. It is also widely used by insurers to assist in assessing repair costs for driveable vehicles – a practice which does not attract significant criticism from repairers. Indeed, by commercial standards, the practice of obtaining only one quote is the more unusual of the two. ...

Two-quote systems are consistent with normal business practice. They do not infringe consumer rights since consumers have the choice of insuring with those companies that do not have a two-quote policy and allow policyholders the choice of repairer. However, policyholders need to be fully informed of company policy and its implications. [Commission's bolding]

Moreover, the Commission found no systemic quality or safety issues arising as a consequence of the practices of insurers.

Following the Commission's inquiry, AAMI approached VACC with a view to establish an insurer-repairer Code. The Body Repair Division of VACC was not interested and AAMI's efforts went nowhere. Consequently, AAMI later decided to develop its own Code in consultation with the ACCC.

2.3 Early 1990s to today

The Australian insurance industry experienced unprecedented levels of change through the 1990s. By this time, the tolerance for the poor financial performance of insurers had largely evaporated. The period saw three key interrelated dynamics:

- demutualisation of a number of mutuals, the most important being NRMA;
- privatisation of the poorly performing Government Business Enterprises; and
- consolidation of the insurance market.

In terms of privatisation:

- the GIO (New South Wales) was listed in 1992;
- the SIO (Victoria) was sold to GIO in 1992;
- the TGIO (Tasmania) was sold to Fortis in 1993;
- the SGIO (Western Australia) was listed in 1994;

6 Industry Commission (1995), *Vehicle and recreational marine craft and repair and insurance industries*, Report No. 43, 15 March, p. 66.

- the SGIC (South Australia) was sold to SGIO (WA) in 1998; and
- the Queensland Government listed Suncorp through a five-year sell down process from 1996.

The Northern Territory Insurance Office (TIO) is the only remaining government owned insurer.

During this period there were also a number of other mergers, acquisitions and joint ventures which have served to consolidate the motor insurance market. The consolidation of the market has seen IAG, Suncorp-GIO, Promina (primarily AAMI) and Allianz, emerge as the key players in the motor insurance market. Other than Allianz, each of these players has a number of brands through which they compete in different markets (see Table 2.2). Each of these major players also have companies that offer repairer choice. There is vigorous competition between these players, and a number of smaller players such as Zurich, Australian Pensioners Insurance (part of the Promina Group), QBE (including Western QBE) and Budget Direct add to the competitive tension.

Table 2.2 Key players and major brands by state (other than NT)

Key Players	NSW	Vic	Qld	WA	SA	Tas
IAG	NRMA CGU	RACV (JV) CGU	NRMA CGU	SGIO CGU	SGIC CGU	NRMA CGU
Suncorp	Suncorp GIO	GIO	Suncorp RACQ (JV)	GIO	RAA (JV) GIO	RACT (JV) GIO
Promina	AAMI APIA Vero	AAMI APIA Vero	AAMI APIA Vero	APIA RACI (JV) Vero	AAMI APIA Vero	AAMI APIA Vero

2.3.1 Insurers take repairs seriously interest in

By the late 1990s, major insurers began to realise they could no longer continue to ignore repair quality and costs. This was in part due to growing expectations of improved financial performance accompanying the structural change (see Section 2.3). In response to these pressures, the larger motor insurers in particular, set about re-engineering their approach to managing repairs with a view to reign in repair costs and deliver a superior customer experience. For instance:⁷

IAG: In 1997, NRMA trialled a Repair Distribution Centre (RDC) model in Wollongong. The model involved sourcing multiple quotes from repairers at the RDC and utilising imaging and the Internet. Between 1998 and 2002, NRMA introduced and refined a number of other models (see Box 2.1). In early 1998 RACV opened two Accident Repair Centres and began repairing their own cars, in addition to maintaining their recommended repairer network. In 2003, SGIC (which competes in SA) introduced repair centres. It is understood their approach

⁷ Although some of the initiatives noted here did not necessarily occur under the stewardship of the parent companies noted (ie IAG, Suncorp, Promina) they have been grouped in this fashion for simplicity.

involves customers taking their cars to a repair centre; where preferred repairers are invited (via the Internet) to compete for work based on a scope of works prepared by an assessor (supplemented by digital photographs). A similar model is being pursued by SGIO in Western Australia.

Suncorp: In the late 1990s, GIO opened assessment centres in both NSW and Victoria. Originally, these centres endeavoured to mirror the AAMI approach. Suncorp also has assessment centres. It is understood both the Suncorp and GIO centres now use similar models. The centres are used as drop-off points and the majority of work is then allocated directly to their respective preferred repairer networks, known as ‘Gold Repairers’.

Promina: Within the Promina Group, APIA outsourced its motor claims management to AAMI in 2000. RACI (WA) introduced assessment centres in 2002. These centres act as a drop-off point and work is then allocated to a member of their repair network.

In the course of redefining their repair management models, major insurers realised that the traditional process of providing repairers with claims lodgement paperwork, and allowing customers to lodge claims at the repair shop, was facilitating the capture of the car by the repairer (see Section 2.2.1). With a view to neutralising this, many mainstream insurers introduced telephone-based claims lodgement processes. This allowed insurers to become involved in the repair process before repairers had the opportunity to get the customer ‘on-side’ and secure the repair work.

2.3.2 The Repair Industry Response – Part Two

The repair sector’s response was to launch a series of situational campaigns, in support of their original, ongoing freedom of choice campaign:

- Fearing NRMA would extend the Wollongong trial to the rest of NSW, including Sydney, the repair sector launched a comprehensive campaign. Funds were raised and repairers ran a freedom of choice campaign on television as well as taking out full page advertisements in both Wollongong and Sydney newspapers. Protests were organised including marches on the NRMA office in Wollongong and in Sydney (to coincide with the NRMA AGM), tow truck blockades in many of the streets of Sydney and a rally march on Parliament House. In addition, both the MTA and repairers carried out extensive lobbying of local and federal members. NRMA abandoned the model after less than 12 months.
- In Victoria in 1998, a campaign was launched with media advertising and distribution of posters, glove box leaflets and a customer information campaign. The campaign outlined a series of initiatives for members and was directed at a number of insurance companies who were implementing initiatives that involved taking greater control of the repair process with a view to improving repair costs and quality (see Box 2.2). VACC advised in a letter to repairers (June, 1998):

We ask that you urge all of your customers to consider the insurance company they place their business with when their policy comes up for renewal. We ask that you distribute this material at appropriate family or social gatherings so as many people as possible are aware that some Insurance companies are adopting tactics that may stop you being able to repair the car of those you know and who trust in your work.

While the material published by VACC advocated a moderate approach, repairers in practice were more aggressive in ‘advising’ customers where they should insure, leading RACV to place advertisements in major newspapers explaining their position to their members and customers. More information is provided in Attachment 1.5.

Box 2.1: NRMA Repair Models

Prior to 1998, NRMA Insurance maintained a list of ‘Known Repairers’. These were repairers NRMA Insurance authorised to undertake for it repairs of its insureds’ vehicles. The Known Repairers invoiced NRMA Insurance and were paid by NRMA Insurance. If an insured elected to have the vehicle repaired by a repairer other than a Known Repairer, NRMA Insurance would pay the insured a sum it assessed to be the reasonable cost of the repairs. In those circumstances, it was a matter for the insured to engage and pay a repairer, and any dispute over the repairs was one between the insured and that repairer.

In 1998 NRMA Insurance developed and trialled a new scheme known as ‘Competitive Partnering’, which was introduced throughout New South Wales in 1999. NRMA Insurance agreed to appoint selected Known Repairers as ‘Partnered Repairers’ (sometimes called ‘Competitive Partners’) and to refer work to them. In return, these Partnered Repairers were required by NRMA Insurance to maintain their facilities and standards of service at an agreed level and to ensure that quotes which they provided to NRMA Insurance were ‘competitive’. The Competitive Partnering scheme was reviewed in 2000. As a result, the PSR scheme was developed. NRMA Insurance was to appoint from the pool of Partnered Repairers a smaller group – the PSRs.

Following an assessment of repairers in the period October 2000 to June 2001, NRMA Insurance identified those Partnered Repairers it regarded as appropriate for PSR status by reference to various criteria, including cost, quality of repairs, relationship with NRMA Insurance, ‘strategic need’ and ‘potential’. That status was conferred upon the making of a National Preferred Smash Repairer Agreement (‘PSR Agreement’) between NRMA Insurance and the PSR. The first of the PSR Agreements was made in late 2000. Accordingly, at that time (late 2000) there were PSRs, other Partnered Repairers remaining from the Competitive Partnering scheme, other Known Repairers remaining from the Known Repairers scheme, and, of course, repairers who had not been part of any scheme.

In November 2001 NRMA Insurance proposed to create a new category of repairer known as ‘Associate Smash Repairers’ (‘ASRs’). The remaining Partnered Repairers and Known Repairers were invited to become ASRs. To accept the offer, a repairer was required to enter into an ‘Associate Smash Repairer Service Level Agreement’ (ASR Agreement). In late January 2002, NRMA Insurance forwarded copies of that form of agreement to the remaining Partnered Repairers and Known Repairers. The result achieved was that from 1 March 2002 there were only two categories of repairer ‘recognised’ by NRMA Insurance – PSRs and ASRs. Smash repairers with whom NRMA Insurance has no established business relationship, that is to say, who have not entered into either a PSR Agreement or an ASR Agreement, are referred to by NRMA Insurance as ‘Non-Accredited Repairers’ (‘NARs’). Prior to about June 2003 they were referred to as ‘Unauthorised Repairers’.

NRMA Insurance monitors the ‘performance’ of PSRs and ASRs. As well as reviewing quotes as they are submitted, it monitors a PSR’s or ASR’s ‘average repair costs’. NRMA also undertakes, from time to time, ‘Performance Investigations’ of individual PSRs or ASRs, in which it reviews any or all of: ‘the cost of repair or the amount quoted’; ‘the quality of repair work’; and ‘the standard of service provided to NRMA Insurance customers’. NRMA Insurance ranks PSRs as ‘gold’, ‘silver’, ‘bronze’ and ‘red’. Repairers ranked gold or silver are considered the better performers and those ranked bronze and red are considered not to be performing to the expected standard. Unless a bronze or red rated PSR improves its performance, NRMA Insurance will consider terminating the PSR Agreement with that repairer. ASRs who have entered into a performance plan with NRMA Insurance are similarly ranked. It follows that about 70% of ASRs are not in a position to attract the benefits of a gold or silver performance rating. NRMA Insurance informs repairers of their rankings. An ASR may be ‘promoted’ to the status of PSR.

Source: Lindgren, J in *AARA v NRMA [2004] FCA 700*.

- In early 2001, the VACC launched a Code of Conduct that purported to “promote the efficient operation of a competitive motor vehicle repair industry in Victoria”.⁸ This Code was distributed to all insurers and a series of meetings were held. At the core of the Code were provisions that effectively precluded insurers from determining where a car would be repaired, thereby enabling repairers to resume practices (such as capturing the car) that had largely been eliminated since insurers had turned their attention to repair cost and quality issues. As VACC was adamant that such provisions would not be negotiated, there was no common ground and no further dialogue on the Code (see Chapter 6).

Box 2.2: Extract from VACC Letter to Members on Freedom of Choice Campaign

FREEDOM OF CHOICE CAMPAIGN

MEMBER ADVICE

Members Must Read And Abide By The Following Instructions

1. Display the posters in appropriate locations. Inside the workshop is not practical if the motorist is unlikely to see it.
2. Hand them to your suppliers, and/or anyone with prominent display point.
3. Mail out the brochures to your customers.
4. Hand the brochures out personally. Talk your customers through the points when you do so.
5. Use the decals where they will have the greatest affect, the workshop ute, your car, your employees cars, give them to people who will be able to tell the motoring public what the decals mean.
6. At all times be scrupulously honest with any advice you give to the insured motorist.
6. Do not make statements that cannot be substantiated.
7. Do not offer personal opinions, state only facts.
8. If unsure of what to say, contact VACC for advice before speaking.
9. You have suggested media releases, contact your local paper and place an advertisement. While you are at it, speak to a reporter. Tell them what you know, not what you think. Stick with the information given on your press release.
10. If you have local radio in your area, do the same with them as you would with the newspaper.
11. Do not at any time, ‘knock’ an insurance company, it is poor business tactics to speak negatively. Speak only good about the companies who do allow the customer to choose his own repairer.
12. If challenged as to the veracity of your comments, call us immediately.
13. Do not attempt to interpret a customers insurance policy for them, it won’t be necessary, just give the options, refer to your kit under, “Insurers offering to assess and authorise at the premises of the motorists chosen repairer.
14. Do not treat insurance company assessors any differently to the way you do now.
15. Do not attempt to convert a customer to another insurance company before the term of the policy expires. Not only is it illegal to do so it is morally wrong and for our campaign to succeed, we must never act in a manner that is inconsistent with fair and reasonable business practices.
- 16 Remember what you are involved in right now is just part of the overall campaign, we still need examples of unfair trading practices, so keep them rolling in.

Source: VACC (1998), Extract from letter to members, 3 June. (Attachment 1.5)

- In 2001, the VACC, together with their sister trade associations nationally (under the MTAA) embarked upon on a well coordinated grass roots lobbying exercise to gain the

8 Automotive Body Repair Industry (Fair Dealing) Code of Conduct, 2002 p. 3

support of local members of parliament, and in particular Small Business Ministers. In part this involved providing their members (May 2001) with standard letters to be sent to their local MPs (see Attachment 1.6):

The Executive Committee has suggested we forward copies of letters to you which we have prepared, for you to send to your local politician. There are two versions from which you can choose, each has a slightly different emphasis.

At present, negotiations are continuing regarding the next meeting with the Government and Insurers and it could be an opportune time to send in a few reminders.

- In Western Australia, the MTA recently launched a campaign. The campaign was multi-faceted including newspaper articles and advertisements (see Diagram 2.4).

Diagram 2.4: MTAWA Advertisement

SEVEN THINGS YOU NEED TO KNOW ABOUT MOTOR VEHICLE INSURERS

Depending on which insurance company you insure with; did you know that if your car is damaged in an accident;

- You will most likely be told to drive to an assessment centre which may or may not be convenient for you;
- Your car is likely to be placed on the Internet and shopped around for the cheapest quote;
- Your vehicle damage and the method of repair may be assessed by an employee of the insurer, not by an expert specialist smash repairer;
- In some cases you will not have a choice of who repairs your vehicle and if you insist you may be threatened with cancellation of your policy;
- In some cases you will only have a choice of who repairs your vehicle if:
 - your repairer provides the cheapest estimate, or
 - your chosen repairer matches the cheapest estimate, or
 - you accept a cash settlement;
- You will have no say as to whether new, genuine or recycled parts are used in the repair;
- You will have no say in the method of repair used and in some cases never meet the repairer.

If you want to have a say in how repairs are performed on your vehicle and by whom, be careful in selecting an insurance company.

CHOOSE A COMPANY THAT ALLOWS YOU REAL CHOICE OF REPAIRER AND SOME CONTROL OVER HOW YOUR VEHICLE IS REPAIRED

MTA WA

For further information talk to your local smash repairer

Submitted on behalf of concerned smash repairers in Western Australia by the Motor Trade Association of WA (Inc)

Source: The West Australian (2004), Friday 30 January, p. 4.

- In New South Wales, a group of repairers, formed a company, the Australian Automotive Repairers Association (Political Action Committee) Inc. (AARA) and mounted a Court challenge against Insurance Australia Ltd (NRMA) alleging the insurer's Preferred Smash Repairer scheme breached the exclusive dealings provisions of the *Trade Practices Act*. In

handing down his ruling in June 2004, Justice Lindgren found no breach of the Act, concluding NRMA's right to direct work to their PSR's or to cash settle owners who wished to make alternate arrangements for the repair of their car.⁹ AARA are appealing this ruling.

The response by many in the repair sector was not surprising. Indeed, the nature of the response to the insurance industry efforts to introduce competitive disciplines with a view to manage costs and quality had been forecast some thirty years earlier:¹⁰

It is difficult, perhaps impossible, for one company or even one segment of the insurance market to eliminate inflated repair charges through competition. The 'odd company out' could expect to encounter considerable opposition from panel beaters generally....

That said, it is worth noting that while the general sentiment towards many insurers was one of anger, a significant proportion of repairers understood that the life expectancy of the 'unusual business model' was likely to be limited. Whilst many of these repairers supported these campaigns, they have also responded to the changing role some insurers are playing. They have chosen to focus on their business, finding efficiencies and investing in technology to ensure they deliver quality repairs at a competitive cost. These repairers have also sought to develop stronger relationships with insurers.

2.4 The situation today – excess repairer capacity exposed

Today, only a relatively small number of insurers compete in each geographic market. They are all fiercely competitive and focussed on ensuring customer satisfaction to retain market share. In pursuit of improved quality and cost outcomes, insurers have endeavoured to play a more active role in the claims process. These efforts have proved to be highly effective for two interrelated reasons:

- notwithstanding claims by the repair sector, most customers do not have their own repairer and have limited interest in playing an active role in managing the repair process; and
- many customers welcome the involvement of the insurer in guiding the repair process and value the protections that insurer involvement has provided.

One of the consequences is that insurers offering choice have found, particularly those that sell direct and do not involve intermediaries, in most instances that customers will use the repairer they recommend.

The resulting redefinition of the customer-insurer-repairer relationship by many insurers has collided with the unusual business model developed by repairers based on capturing the car (see Section 2.2.1). The illegal and illicit practices have also been challenged (see Section 2.2.2). The ability of repairers to capture cars using inducements or via tow trucks is slowly evaporating. This fundamental change in the market dynamics is now exposing the chronic oversupply of repairers that has existed for many years. Until very recently, the oversupply was sustainable due to the lack of interest or willingness on the part of insurers, the major insurers in particular, to tackle inflated repair costs. As a result, a significant proportion of repairers now find themselves attempting to compete for a limited supply of repair work with a business

⁹ Lindgren, J in *AARA v NRMA* [2004] FCA 700

¹⁰ Spratt, W. (1967), *Competition, the answer to motor insurers' multi-million dollar question*, Australian Insurance and Banking Record, p.125.

model that is no longer relevant or effective. These repairers either failed to identify the changing dynamics or chose to persist with the unusual business model that required customers to insure with insurers that offered choice. The associated campaigns were aggressive, comprehensive and sustained. Notwithstanding these efforts, widespread support from consumers has not been forthcoming.

The fact that there is an oversupply is acknowledged by the repair sector and industry commentators alike (Attachment 1.7):

At the moment, we still have too many crash repairers.¹¹

Currently, insurers have too much choice when it comes to repairers simply because there are too many repairers.¹²

The level of smash repair oversupply is not clear. Currently, with approximately 1.2-1.5 million repair opportunities Australia wide, and of the order of 5000 smash repairers, there is an average of five to six repairs available per shop per week. While views vary as to the volume of repairs required to provide adequate returns, it is generally accepted that this is simply not enough. General estimates suggest the volume should be approaching ten vehicles per week. International comparisons provide another perspective on the oversupply (see Table 2.3).

Table 2.3: International Comparisons: Registered vehicles per repair shop – Australia, United Kingdom & United States of America

Country	No. of Repair shops	Total Passenger Vehicles (million)	Vehicles per repair shop
USA	53,000	130	2453
UK	5,300	25	4717
Australia	5,038	9.7	1925

Source: Paint and Panel (2003), *Australia suffers in car/shop ratio*, March/April, p. 24.

2.4.1 Factors exacerbating repairer oversupply

There is a series of other factors that have exacerbated the oversupply problem.

- The drought has meant fewer days when roads are wet. And typically there are more accidents, and the accidents involve more damage (ie more repair work per job), during wet periods.
- Tougher road rules and increased enforcement has curbed driving behaviours that contribute to accidents (eg speeding, drink driving)
- The growing number of relatively low cost, short life expectancy motor vehicles has increased the number of total losses, resulting in a greater proportion of cars being written-off rather than being repaired.
- New technology in cars has improved handling and braking allowing more accidents to be avoided. Accidents that do occur are often less severe. The improved technology has also meant that tasks that may once have been performed by repairers now have to be

11 Australian BodyShop News (2003), *What do you tell your repairers*, Interview with Purchase, Executive Director VACC, August, p. 30.

12 McCewing, F (2004), *Editorial –It's all about choice*, Paint and Panel, July/August, p. 5.

outsourced to specialists (eg plastic and aluminium repairs, reconfiguration of some electrical components).

- Major fleet operators (including the Government) have taken a far greater interest in repairs, introducing their own processes or outsourcing claims management, with a view to better manage repair costs and quality.
- Increased regulation ranging from taxation and OH&S through to environmental requirements and zoning laws, and stricter enforcement by all levels of Government, have imposed additional costs.
- Some manufacturers (eg BMW, Mercedes, Subaru) have or are establishing their own 'franchised' or 'preferred' repair shops. Also, access to relevant technical specifications, equipment and training provided by manufacturers is becoming increasingly difficult.
- The combination of new technology and the work of the National Motor Vehicle Theft Council (NMVTC) have reduced the incidence of motor vehicle theft. This has in part impacted on the availability of 'midnight spares' (stolen parts), which were used by some repairers. Some less scrupulous repairers also topped-up earnings through involvement in re-birthing rackets. The NMVTC has greatly curtailed this profit opportunity.
- Like many other trades, the availability of skilled tradespersons has emerged in recent years as a problem and the sector is struggling to attract new apprentices.¹³ Proprietors now find themselves with escalating wages in order to retain or attract the better tradespersons and also find themselves using these tradespersons for tasks that might previously have been performed by apprentices, at substantially lower costs.

In combination, these factors have reduced the amount of available work and increased the cost of running a repair shop.

Like the oversupply problem, these pressures are acknowledged by repair sector spokespersons and commentators:

The condition of our roads and weather conditions will play a part. Other rules and regulations in our society will play a part. For instance, driving laws – drink driving, speed cameras and speed limits – have had a dramatic effect on the number of crashes. Clearly, the number of accidents is reducing. Cars are safer. There are fewer drunks on the road crashing vehicles. The roads are better. ... The fact that we're in a drought has reduced the number of crashes, because they're not as wet.¹⁴

... due to the changing habits of motorists, brought about by more policing leading to stringent penalties in drink-driving and speeding, reducing the number of accidents and, therefore, demand.¹⁵

In an industry with shrinking profitability and increasing competition, excessive Government regulation and charges are the last straw for some body shop repairers.¹⁶

The Government is ripping the heart out of our small business with outrageous charges connected with superannuation, tax, Worksafe, fringe benefits, bank charges and a host of other charges. The cost of compliance with GST is horrific. We are bleeding. This business has been established for 27 years but won't be here much longer.¹⁷

13 Victorian Department of Employment & Workplace Relations (2003), Job Outlook.

14 Australian BodyShop News (2003), *What do you tell your repairers*, Interview with Purchase, D., VACC Executive Director, August, p. 30.

15 Ibis World (2003), Smash Repair Industry Report.

16 Paint & Panel (2003), Diagonal Reports, Automotive Research Firm, March/April.

17 Australian BodyShop News (2003), *Small repair shops bleed as big business prospers* - citing one repairers frustration., July, p. 29.

2.4.2 Structural change and rationalisation

The tragic but harsh reality is that the repair sector is facing fundamental structural change and rationalisation. The unusual business model that emerged in the repair sector is no longer effective. Moreover, the inefficiencies in scale and operating practices that previously survived are now under pressure.

The repair sector itself acknowledges these pressures, acknowledges that rationalisation is needed, acknowledges the implications of the changes in the insurance industry and that the more efficient repairers will survive and do well. The Executive Director of VACC summarised the position in August 2003:¹⁸

I think there are some repairers out there who would be well advised to shut their doors. There are a lot of very good crash repairers and they're doing well and they're going to continue to do well. There are also many crash repairers who are developing good businesses and who will ultimately do very well.

There are others who might be better trying to turn their hand to something else. If some of them don't do this, they will increasingly go into debt and lose absolutely everything they've got. ... It's very difficult to persuade these repairers to sell-up because many are getting on in years and would find the change too dramatic. ...

The repair shops that are doing well are probably making very good use of technology. They have good business practices. They would have their accounting practices and procedures well under control. They would know what each job is costing them. Many repairers simply do not know what a job is costing them. There are repairers who do know if they're making a profit or a loss out of each job they do....

There are those who are running professional businesses, including the presentation of that business. They're the ones who are also attracting insurance company business. And if you're doing a lot of insurance work, generally, you'll be one of the more profitable crash repairers. ...

The rationalisation of insurers is extremely significant and going forward, we clearly won't have the same number of insurers. ...

And those who remain are already hell bent on introducing even tougher preferred repairer networks. These preferred repairer networks will contain a reduced number of repairers because they only want to deal with as few repairers as possible ... and only very good ones. This will mean that more and more repairers are simply not going to get insurance work and that means the drop out rate will speed up significantly. The concentration is happening quickly and the trend will exacerbate the problem for body repair shops on the margin. It is already gathering pace and will continue during the next few years.

The recommended repairer system has been happening for many years but because there were many insurers and so many preferred repairer networks, a lot of repairers would get an opportunity to work with at least one of them.

What repairers have to do is make sure they get into the repairer networks. They must be seen to be using technology, have good work practices and procedures, and be seen to have good premises and be professional outfits. And only when they do those sorts of things will they have a chance.

One commentator went further and had the following advice for the industry:

Our industry is very similar on both sides of the Tasman...I think that repairers have to take ownership of their businesses. To(o) many repairers talk in terms of insurer multiples and concentrate too much on the insurers so called hourly rate instead of knowing their true costs and living and breathing there (sic) own labour recovery rates. It always seems to be everyone else's fault what ever happens in our industry.¹⁹

18 Australian BodyShop News (2003), *What do you tell your repairers*, Interview with Purchase, D. VACC Executive Director, August, p. 30.

19 Crowther, R. (2003), Chairman NZCRA, Australian BodyShop News (2003), September, p. 28

The Federal Minister for Small Business and Tourism has also acknowledged the structural change the repair sector is facing:²⁰

As you will be aware, there are a number of factors impacting small businesses in the smash repair sector resulting from structural change in the industry, changes in the market for insurance, improvements in technology and training, and improvements in efficiency and quality.

As with any structural change there will be 'winners and losers'. It is unfortunate that some repairers will not survive. However, the more competitive, efficient and dynamic repairers who are capable of delivering superior cost and quality will be part of the economically viable repair sector that is emerging. Consistent with the views of the repair sector there is evidence of repairers doing well and anticipating a positive future.

Confidential Attachment 3.1 provides details of a current comprehensive review of almost ten per cent of the repair sector. The key findings of the review are that, relative to 2001:

- smaller 'one-to-two man' shops have been most likely to exit the market;
- remaining 'typical' sites are more substantial, have more employees and increased throughput;
- average turnover has generally improved;
- investment in technology has increased;
- sources of income other than insurance related-repairs have become more important (eg work for car yards, warranty work for dealers correlated with the huge growth in new car sales, vehicle restoration and spray painting jobs such as polyurethane coatings for kitchens);
- general improvements in efficiency; and
- profits seem to have improved.

2.5 Concluding comments

This chapter has outlined the dynamics that have given rise to the structural change and rationalisation pressures confronted by the repair sector. At its essence, the chronic oversupply that survived for many years due to the inattention of insurers is now under pressure from a consolidated insurance market that is taking an active interest in the cost and quality of repairs. There is also less work around and the cost of doing business has increased.

Repairers reacted differently to the changing dynamics. Some set about ensuring their business delivered competitive cost, quality and timeliness outcomes. They also worked on their relationships with insurers in anticipation of the changing dynamics. Others either failed to identify the changing dynamics or chose to persist with the unusual business model that required customers to choose insurers that offered repairer choice. The associated campaigns were aggressive, comprehensive and sustained, even though these repairers have had the ability and right to work with those insurers that offer choice of repairer.

20 Federal Minister for Small Business and Tourism (2004), *AAMI Repairer Code of Conduct*, Written Correspondence, 22 April.

It is noteworthy that the repair sector acknowledges that:

- there is an oversupply of repairers;
- the oversupply is impacting repairer profitability;
- some repairers would be better closing their doors;
- it will be difficult for the inefficient shops to survive;
- the better shops will survive;
- insurers are striving to work with the better repairers; and
- if you are working with insurers you are more likely to be profitable.

Notwithstanding this, and as would be expected, at least some within the repair sector, and the peak bodies in particular, continue with the concerted campaign that has been underway for many years aimed at advancing what they believe to be the interests of their members (or at least some of their members). Together, these campaigns endeavoured to obtain public support and sympathy around a number of key claims:

- Choice: Consumers are being disadvantaged as insurers take greater interest in the repair process and direct repairs.
- Repair quality and safety: Insurers are forcing repairers to carry out sub-standard and unsafe repairs, in a bid to drive down repair costs.
- Profitability: The actions of insurers are unreasonably impacting on repairer profitability.
- Hourly rates: The hourly rate applied to time manuals has not kept pace with the cost of running a repair shop.
- Payment times: Insurers are imposing unnecessary pressure on repairers due to their tardiness in paying invoices.
- Preferred Repairer Schemes: These schemes are inequitable and discriminatory, denying some repairers the opportunity to source repair work.

Many of the claims and arguments are not new. And it is noteworthy that the repair sectors extensive campaigns to obtain consumer support around ‘choice’ and ‘quality’ over the past two decades have been ineffective. Along with the insuring public, the Industry Commission has also considered and dismissed many of the issues.

Chapter 3 AAMI's approach to motor insurance

This chapter outlines AAMI's approach to motor insurance. It overviews AAMI's processes for sales, claims, interactions with repairers and the dispute resolution mechanisms available to customers. The chapter also highlights the benefits of AAMI's approach for key stakeholders including customers, repairers and shareholders. Some of the direct or indirect criticisms of AAMI's approach are also covered.

3.1 The Sales Process

AAMI uses a variety of sales channels. The telephone remains the dominant sales channel followed by the Internet and branch outlets. AAMI does not use agents or brokers allowing it to ensure consistency in delivery and providing substantial savings in distribution costs.

AAMI takes the disclosure of all key features of its policies, motor and home, very seriously. AAMI telephone sales and branch operators disclose to all potential motor customers key features of the policy. Operationally, this process is executed via a Motor Sales Anatomy (see Attachment 2.1). This Anatomy is scripted on our computer system and is a mandatory screen. The operator is required to read the Anatomy script and complete a system indicator verifying the disclosure. Among other things, this script clearly states that AAMI arranges the quotes from quality repairers and chooses the repairer. The AAMI on-line sales process replicates this approach.

All customers who obtain a quote, cover note or purchase a policy are then provided with a Product Disclosure Statement (PDS) and Policy book (see Attachment 2.2) that fully describes all benefits, limits and conditions of insurance being offered. Customers, can also download a Product Disclosure Statement and Policy on line, request a copy be mailed or pick up a copy at a branch.

In relation to the repair process, the policy states (p. 37):

If your car has been damaged and can be repaired, our responsibility to you when we authorise repairs is to ensure that the repair work is properly carried out.

We ordinarily obtain two independent, competitive quotes, from repairers recommended by AAMI. If you want, you can choose a repairer to provide one of the quotes. Our assessor will review the quotes, including any quote from a repairer you choose, and what is necessary to properly repair your car. We will select the repairer who has submitted the more competitive and complete quote and that will be the repairer who repairs your car.

AAMI also discloses in its PDS and policy book what parts it will authorise in the repair of a customer's car (p. 38):

[Where]... your car is within its manufacturer's standard new car warranty period – New OEM (original equipment manufacture) parts will be used except for the replacement of windcreens and window glass for which Australian manufactured, Australia Design Rule compliant parts may be used.

[Where]... your car is outside its manufacturer's standard new car warranty period – New and/or reconditioned OEM parts will be used except for the replacement of windcreens and window glass for which Australian manufactured, Australian Design Rule compliant parts may be used.

Parts produced by OEM suppliers may be used in the repair of components such as radiators and air condensers.

Customers have access to an interpreter service to assist them if they are having difficulties in understanding the policy conditions and provisions. They also have a statutory cooling-off entitlement of 14 days. This gives customers the opportunity to review the policy details and cancel the policy if they are unhappy with any aspect of the cover offered. AAMI extends this by allowing cancellation at any time subject to a fixed cancellation fee of \$20.

Before operators are allowed to sell motor policies they are required to complete a seven week National Induction program. Once on the phones, there is also a remote monitoring process in place. This involves listening to phone calls on a sample basis to ensure that operators are, among other things, following the Anatomy.

3.2 The Claims Process

AAMI deals directly with its customers through the sales process and does the same when customers make a claim. Our aim at all times is to minimise the stress and inconvenience of making a claim for the customer.

In the first instance, the customer will ring AAMI to lodge a claim. At that time a Claims Assist operator will record all details relating to the claim and explain the repair process to the customer. The customer will be advised that two quotes for repairs to their car will be needed. Depending on the severity of the accident, and their individual requirements, one of the three following options will be offered.²¹

Non-driveable Repairs

If the car is non-driveable AAMI will arrange to have the vehicle towed to one of its Customer Service Centres where we will invite two repairers to quote for repairs. Should the customer have a preference for a particular repairer we will invite that repairer to submit a quote and will obtain a second quote from an AAMI repairer.

Valet Repairs

If the vehicle is driveable, the owner is given the option of our Valet Service. With the Valet Service the customer simply drives their car to one of our Customer Service Centres. A Client Manager will greet the customer, inspect the damage to the vehicle, and provide the customer with written confirmation of their claims details. Details of the valet process are included in the AAMI Customer Charter (see Box 3.1).

Driveable Repairs

In some cases the customer, when lodging their claim, expresses an interest in being more involved in the repair process, wanting to obtain quotes themselves and make arrangement directly with the repairer for their repairs. In such cases, the customer is asked to obtain two-quotes, at least one being from an AAMI repairer, and to bring these quotes into the Customer

21 The two-quote system is used for the majority of repairs. In remote and regional areas a one quote approach is often utilised. AAMI also trials other approaches to identify opportunities to improve cost, quality and timeliness outcomes.

Service Centre where their vehicle will be assessed and repairs authorised. The customer will then arrange to book their car in for repairs directly with the repairer.

In areas where AAMI does not have a Customer Service Centre repairs are arranged in consultation with the customer.

Box 3.1: The AAMI Customer Charter

Introduced in 1996, the *AAMI Customer Charter* was Australia's first general insurance customer charter and the first retail customer charter. The 2004-2005 *AAMI Customer Charter* contains 19 promises to customers to ensure AAMI always provides customers with the highest possible standards of customer service. Failure to meet any of these promises results in a penalty payment of \$30 to the customer. The *AAMI Customer Charter* is supported by annual independent audits, an annual public report, a dedicated Charter office that monitors compliance on an ongoing basis, and a dispute resolution process. A copy of the current Customer Charter and the most recent Charter Annual report are contained at Attachment 2.3.

Promises 8 to 11 deal with motor claims service guarantees:

8. When we recommend our Valet Service for your car claim, for no extra cost we will:
 - Pay for your taxi to home or work after you deliver your car to our nearest Customer Service Centre
 - Make all the necessary repair arrangements for you
 - Nominate a person who will keep you fully informed of the progress of those repairs
 - Pay for your return taxi fare so that you may collect your repaired car
 - Contact you within five working days of you collecting your repaired car, to ensure you are satisfied with its repair
9. All AAMI Motor Vehicle Assessors will be qualified motor vehicle repair tradespeople.
10. The quality of workmanship and the materials authorised in the repair of your car will be guaranteed for the life of the car.
11. Within three working days of agreeing to settle your motor vehicle total loss, we will post a cheque for the agreed amount.

3.3 The Assessment and Repair

Irrespective of which of these three processes the customer chooses AAMI's assessment process follows similar lines.

AAMI will ordinarily obtain two-quotes on all repairs, with at least one of these quotes being obtained from an AAMI repairer. Should the owner request a quote from a repairer who is not an AAMI repairer, that repairer will be invited to submit a quote, and where this is the most complete and competitive quote, repairs will be authorised to that repairer.

Repairers are asked to submit their quotes in dollar terms, providing a description of the proposed repair method, taking into account AAMI's parts policy guidelines in preparing their quote. Only Original Equipment Manufacturers (OEM) parts are to be used in carrying out repairs, and only new parts will be used during the manufacturers' warranty period (see Attachment 2.4).

The assessors employed by AAMI are all qualified motor vehicle repair tradespeople. We also confirm this undertaking in our Customer Charter (see Box 3.1). In determining the successful quote, the assessor will take into account repair method and parts quoted. Repairs will be authorised to the most complete and competitive quote. Repairers are also expected to advise

the Assessing Supervisor if, for any reason, they may be concerned that the repair method authorised will not allow the accident damage to be properly repaired (see Section 3.4).

Once the assessment is completed, the owner will be advised of the name of the successful repairer and will be provided with full details of the repairs that will be carried out should they request them.

AAMI guarantees all repairs it authorises, whether the repairer is an AAMI repairer or not. AAMI's Lifetime Repair Guarantee remains in place even if the vehicle is sold and applies after the repairer's guarantee expires. Copies of all guarantees are given to every customer at the completion of repairs.

As previously mentioned, AAMI conducts a quality follow up call on most repairs to ensure the customer is completely satisfied. If a problem exists the vehicle is returned to the Customer Service Centre and rectification work is carried out if necessary under AAMI's supervision.

3.4 Repair Standards and Code

In the mid to late 1990s AAMI realised that the next stage in lifting customer service, repair quality and cost management required a more structured approach to repair management than had been applied up to that point. Repairers that had been working with AAMI had also been calling for this. It was also clear that the repair sector would soon be faced with rationalisation pressures (see Chapter 2). Relatedly, other insurers were embarking on the process of reigning in costs and lifting repair quality and were 'competing' for the better quality repairers. Consequently, AAMI considered it was important to secure the relationship value for its repairers. This was necessary if AAMI was to continue to advance its repair cost, quality and timeliness ambitions.

In 2001, AAMI introduced the Repair Standards and Code of Practice in order to create a structured, consistent, transparent and equitable framework for our dealings with our repairers nationally (see Attachment 2.5). The framework was developed in consultation with the ACCC and repairers. It was designed to bring transparency and natural justice to the relationship. It provided a dispute resolution process and was also fashioned specifically to ensure compliance with the then new provisions of the *Trade Practices Act* (unconscionable conduct). These documents reflect AAMI's corporate commitment to work closely with its repairers to deliver the highest levels of customer service.

The Standards document clearly sets out the business rules for AAMI and its repairers, detailing responsibilities and expectations for both parties. The Code of Practice provides repairers with a dispute resolution procedure, through the independent Code Executive Director. Underpinning these documents, AAMI also introduced a transparent performance management system for its repairers nationally.

In 2004 these documents were revised, taking into account the key recommendations of the 2003 ACCC Issues Paper.

The Standards document, clearly sets out:

- Details of the Quotation and Repair Process
- Procedures for speedy authorisation of Additional or Supplementary Payments
- Repair Guarantees and Responsibilities (for both AAMI and Repairers)
- Repairer Performance Targets – cost, quality and timeliness
- Performance Management Provisions – verbal and written warnings protocol
- Provisions on AAMI's Conduct
- 14 Day Payment Terms
- Provisions on Repairer's Conduct
- Repairer Goodwill Provisions
- Replacement Parts Policy Guidelines
- Reinspections and Rework Procedures

Since its revision in 2004, the Code of Practice document has been extended beyond AAMI Recommended Repairers and is now applicable to all repairers having dealings with AAMI. This document sets out:

- Standards of Conduct for AAMI and Repairers
- 14 Day Payment Terms
- Procedure for response to Repairer applications
- AAMI's disclosure commitment - claims and repair processes
- Repairer Consultation Provisions
- Dispute Resolution Procedure
- Public Reporting Provisions
- Contact Details for Code Executive Director

3.5 Rationale and Benefits

AAMI's approach to motor insurance and repairs described in Sections 3.1, 3.2 and 3.3 has evolved over many years (see Chapter 2). AAMI believes its approach reflects its obligations to key stakeholders:

- a competitive premium and a quality service for AAMI customers;
- AAMI staff;
- repairers;
- shareholders; and
- the community more generally.

The key benefits are described below.

3.5.1 A competitive premium

Repair costs are the single biggest cost component of motor insurance premiums, accounting for around 70 to 80 cents in every premium dollar.

The two-quote system plays a critical role in AAMI's management of repair costs:

- By obtaining more than one quote, AAMI establishes a competitive market estimate for the repair cost. The two-quotes obtained will reflect two repairers' views of the cost for which the repair can be undertaken in accordance with AAMI's requirements (e.g. OEM parts etc).
- The two-quote system also limits the ability to load the cost of inducements a repairer might have offered to secure the repair work such as loan cars, payment of excess on behalf the customer, the repair of non-claim-related work, spotters fees, drop fees and so on (see Chapter 2). This is simply because there is no certainty that he will get the job.

Like all businesses, big and small, repairers have different input costs (fixed and variable) and no two repairer's considerations are the same:

- Shop capacity – is the shop busy or does it have capacity to undertake more work?
- Fixed costs – what overheads must be covered (e.g. lease costs, equipment, insurances etc)?
- Running costs – what are the variable costs (e.g. labour, materials, electricity etc)?
- Technology and expertise – does the repairer have particular technology or expertise in relation to the car (or type of repair) in question?
- Parts - does the repairer have access to the parts required on more or less favourable terms?

Just as consumers can make savings by shopping around for the provision of goods or services, AAMI can also make savings. While AAMI accepts that the two-quote system does not necessarily secure the most efficient or competitive cost, it will generally deliver a more competitive cost than can be obtained with only one quote. Confidential Attachment 3.2 provides examples of quotes and the savings provided under the two-quote system.

One of the key beneficiaries of these savings is the customer, with AAMI being able to offer more competitive premiums. JP Morgan (2004) recently highlighted the benefits for consumers in an independent study of the motor insurance industry. This study involved a detailed review of pricing trends in the Australian Insurance Market examining 360 profiles and obtaining almost 1700 quotes (see Attachment 1.8).

JP Morgan found:²²

AAMI is the most price competitive insurer followed by IAG. Although on average AAMI was 4% cheaper than IAG.

Across the 360 profiles tested, the average price difference between the lowest quote and second lowest quote was 14%, and the average difference between the lowest quote and the highest was 43%. This reinforces the saying that "it pays to shop around".

With AAMI's average new business premium being in the order of \$600, the potential savings for consumers who are prepared to shop around would be around \$260. It must logically follow, however, that should a consumer choose to make such savings by insuring with AAMI then they must accept AAMI's claims process (which is clearly disclosed prior to sale and in the policy documents), as it is this process that has made these savings possible.

22 JP Morgan (2004) *Motor Insurance Industry – Patterns in Pricing: It pays to shop around*, July 15, p. 1.

JP Morgan went on to say (p. 5):

[AAMI] clearly has one of the best motor insurance businesses in the market. Our analysis shows that AAMI is the most price competitive insurer in the market on average, which in turn goes along way toward explaining the success of AAMI in growing its market share over recent years. It is also clear from the results ... that AAMI generates strong levels of profitability. Given that AAMI is one of the most aggressive on price this suggests that it makes up the difference through superior operating efficiency. ...

When an AAMI policyholder has an accident, their car is taken to an AAMI service centre where AAMI takes control of the end-to-end repairs. Given AAMI's volume and the fact that no profit margin needs to be built in for the service centre (as opposed to a third-party smash repairer), AAMI achieves economies of scale. The fact that AAMI can compete so effectively against IAG despite the fact that IAG's motor portfolio is nearly twice the size ... suggests that AAMI's unit costs are better than IAGs.

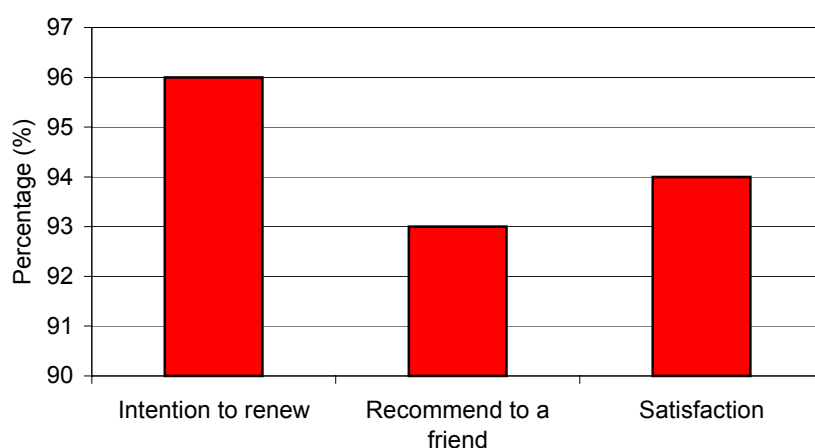
3.5.2 An exceptional claims and repair service

While one of the major benefits for consumers of AAMI's approach to repair management is a competitive premium, AAMI recognises that it must also compete on service. To this end, some of AAMI's cost savings are returned to customers in the form of service benefits. These benefits include not having to manage the repair process, the Valet Service, Lifetime Guarantee on repairs, and the use of only OEM parts (see Sections 3.3 and 3.4). AAMI is also the only insurer to back up key promises with an independently audited Customer Charter that includes financial penalties should AAMI not meet its customer service undertakings (see Box 3.1). Clearly, the claims process itself – taking control of the repair – is critical to these benefits.

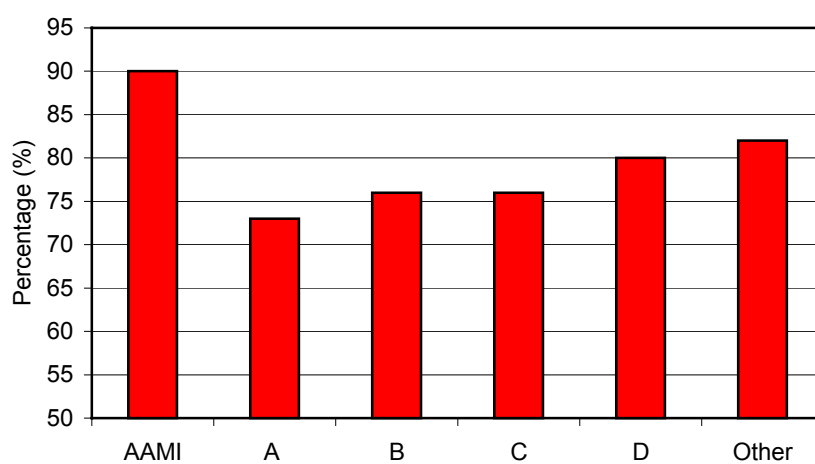
AAMI's customers clearly value the service provided. A sample of extracts from customer compliments is provided in Box 3.2. Further examples are provided in confidential Attachment 3.3. Customers are clearly delighted with the service they are receiving and the quality of repairs. The fact is, many customers value the fact they do not have to be involved in the repair process and deal with repairers. Indeed, this is a central component of AAMI's value proposition; AAMI takes away the stress and hassles associated with a car accident and repair process. The effectiveness of this proposition is constantly reflected qualitatively in research and customer feedback and quantitatively in AAMI's exceptional growth and profitability.

In 2004, the level of satisfaction with AAMI's approach is such that:

- 93 per cent of AAMI customers that have experienced the claims process are prepared to recommend AAMI to a friend (see Diagram 3.1);
- 96 per cent intend to renew after experiencing the claims service (see Diagram 3.1);
- 94 per cent of AAMI customers that have experienced the claims service are satisfied (see Diagram 3.1); and
- AAMI's claims service also ranks favourably against its competitors (see Diagram 3.2).

Diagram 3.1: Customer Ratings of AAMI Service Following a Claim

Source: Sweeney Research - Motor Claimant Satisfaction Report Q2, 2004

Diagram 3.2: Rating of Insurer Claims Service – Total Completely/Very Satisfied

Note: Insurers A to D are the major insurance companies NRMA, RACV, RACQ, Suncorp-GIO, however their identity is not revealed.

Source: Sweeney Research - Motor Market Monitors Q2, 2004

Box 3.2: Examples of customer compliments

After the accident I became extremely stressed. When was I going to get the time to get quotes for repairs? I was so pleased to hear that AAMI did all that for me.

Racquel, Qld

I am astounded at the efficient, excellent response I received from the staff. All I had to do was drop my car off and they did everything. I was so pleased with the fact that I did not have to run around and fix it all up. I am a good "ad" for AAMI!!

Suzanne, GC

Thank you for the exceptional service while handling every aspect of our claim. The professionalism of AAMI's staff makes you special but their friendliness distinguishes you from all other insurance companies. Not having to worry about where to get the car repaired and how to get home after dropping it off took all the stress out of the situation.

Chris, NSW

When I had an accident I was in a panic as I was on my way to an exam and didn't think I'd make it, but due to AAMI service I did. ... half the battle is getting to and from repairers. It has been a pleasure dealing with AAMI.

Glenn, NSW

I felt great relief knowing I could pass my car over to you and you did all the hard work for me. Congrats on a great service and thank you for making it so easy for me.

Cherie, Vic

I recommended AAMI to my friends because they have made making a claim so painless. The phone service was excellent, as was the valet service. I was most impressed all round with the professionalism and courtesy.

Jennifer, Vic

They took my car in for repairs and kept me informed and sent a car when it was ready. I was very pleased with the job well done and a very clean car as well. It took a great load off my shoulders.

Patricia, Vic

I was extremely happy with the service. I had to take my car in on my way to work and was concerned about time. Someone greeted me soon after I pulled up, they filled out their forms and in no time there was my cab ready to go.

Allison, SQ

I've never claimed anything before and was kind of scared with the misconception that it would be a hassle. I was so wrong. I was immediately impressed with the attention received from the customer service guy that took the claim over the phone. The Valet service as quick and our client manager was lovely. The car was fixed quickly and the work is of the highest quality.

Edda, ACT

Getting my car fixed was so easy, absolutely no hassles at all, the complementary taxis were much appreciated and overall I just never knew the whole process was going to be such a breeze.

Andrea, NSW

The service provided was absolutely impeccable and throughout the whole process I have not had to lift a finger! Congratulations on providing the wow! factor to a thoroughly satisfied customer. I have never had the pleasure of saying that about an insurance company before.

Hayley, Vic

I would like to mention how easy and stress free making a claim and getting my car repairs done were. I didn't have to worry about quotes myself and take time out of my business to do this.

Terry, Qld

The speed and ease of the whole operation amazed me. AAMI saved me countless hours of running around.

Brendan, SA

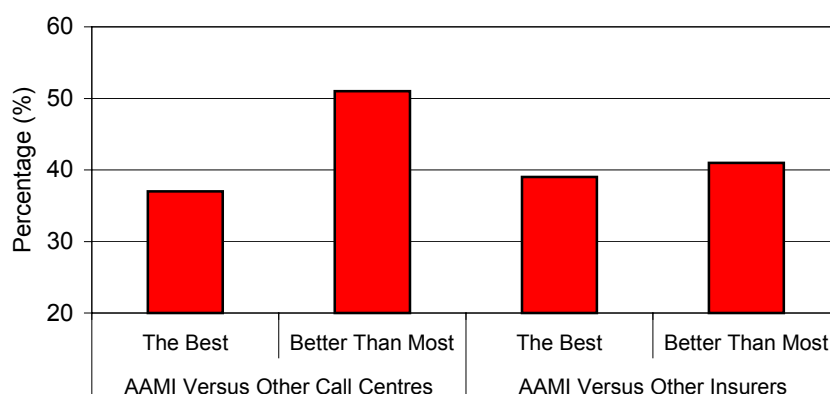
AAMI were wonderful. They took care of everything for us ... Our car was fixed with no hassle, everyone we dealt with was friendly and nothing was too much trouble.

Michael, SA

Additional examples are provided in Attachment 3.3.

The benefits of AAMI's approach to claims also extend to other aspects of AAMI's service such as the telephone service. Unlike most companies, AAMI has resisted the cost pressures to move to an Interactive Voice Recognition (IVR) environment and invests heavily in its telephone service. AAMI sees the telephone service as an important differentiator. Clearly, this investment is in part facilitated by the savings AAMI generates through the claims process, and sees AAMI delivering a superior telephone service (see Diagram 3.3.)

Diagram 3.3: Telephone Service Performance



Source: Sweeney Research – Telephone Service Monitor, 2004

3.5.3 Transparency & consistency for staff

AAMI recognises that its ability to satisfy the needs of its various stakeholders is critically dependent on the efforts and goodwill of its staff. To this end, AAMI believes the transparency and consistency of its various processes are essential. This ranges from transparency in the sales process and policy documentation, (e.g. choice of repairer and parts) through to the promises contained in the Customer Charter, the Lifetime guarantee on repairs and the Repair Code and Standards framework.

Together, these processes minimise the extent to which staff are exposed to situations where ill-defined subjective judgements must be made (e.g. determining the cost of repair, asking a repairer to provide an open-ended guarantee), enabling them to be confident in their communications and decision-making with all stakeholders.

3.5.4 A professional relationship with repairers

AAMI believes that many repairers value the professional relationship that has been developed and is underpinned by the AAMI Standards and Code (see Attachment 2.5). In particular:

- AAMI values its relationship with its repairers, many of whom have worked with us for 10-15 years. In 2001, AAMI had 559 repairers nationally and today we have 556 repairers. Our panel comprises shops that range from small, family businesses to shops with a \$2-3 million turnover with AAMI. We do not have set criteria for entry to our scheme. Our repairers are expected to maintain general industry standards, and abide by all existing regulations, but we do not prescribe how they equip or set up their businesses (Standards p. 12). New repairers are only added to the repairer panel when necessitated by repair volumes.

- AAMI sets down clear performance targets for our repairers, and provides them with regular feedback on how they are performing against these targets (Standards p. 8). We do not tell our repairers how to run their business; we simply measure their outputs. Under this framework repairers have the opportunity to consider their own particular business circumstances and source work on the basis of their ability to run an efficient shop, consistently producing quality and timely repairs and submitting competitive quotes.
- The performance management system is clearly specified, simple and transparent – the same as that for our staff. Counselling, verbal and written warning protocols are followed before a repairer is removed from the panel (Standards p. 9). Since 2001, 24 repairers nationally have been removed from the panel, five of these appealed AAMI's decision to the Code Executive Director. AAMI's decision was upheld in each of these cases.
- AAMI does not use non-genuine parts and clearly sets out our parts policy in writing. We also take responsibility for informing customers of the repair method, and types of parts used in repairs. We expect our repairers to tell us if they are concerned that the repairs authorised will not allow the accident damage to be properly repaired (Standards p. 4).
- We understand supplementary or additional repair costs may be incurred during repairs and set out a clear process for the speedy authorisation of these amounts (Standards p. 5).
- We have 14-day payment terms for all repairer accounts.
- AAMI's Lifetime Guarantee is AAMI's guarantee, and is not imposed on our repairers. We expect repairers to warranty their work for the term of their individual guarantee, after that AAMI is responsible for all costs involved with reworks.
- AAMI's goodwill procedures are intended to assist our repairers in obtaining a goodwill payment on the sale of their business by providing the potential buyer with the prospect of access to AAMI work (Standards p. 13).
- All repairers also have access to AAMI's internal and external dispute resolution procedures. We are confident that most issues can be resolved with our local staff but encourage repairers who are not happy with our decision to raise the matter with the Code Executive Director without fear this will in any way impact on their relationship with the company. The Code of Practice outlines the dispute resolution process.

Notwithstanding the attempts AAMI has made to build a more professional relationship with repairers we accept areas of dispute are unavoidable. This is no different from all business relationships. Through the procedures we have established, it has been our experience that many of these issues can be raised and addressed within the existing frameworks.

3.5.5 Profitable growth for shareholders

AAMI has an obligation to ensure that investors in Promina are rewarded in terms of the creation of economic value. Indeed, AAMI has a wide variety of legal obligations, which variously distil down to a requirement to maintain the solvency of the company.

By any measure, AAMI's performance has been outstanding. Over the past ten years AAMI achieved:

- organic per annum growth in policies of 11 per cent in a market growing at less than 5 per cent.
- an average post-tax return on capital of almost 20 per cent whilst the market averaged less than 10 per cent.

These financial goals have been achieved without any additional shareholder funding. AAMI has also been able to deliver highly competitive premiums to customers (see 3.5.1) and outstanding service (3.5.2).

3.5.6 Community benefits

While its primary focus has been on the stakeholders noted above, AAMI also believes its success in delivering competitive premiums and superior customer service brings broader community benefits. Many of these benefits simply reflect the dynamics of a competitive market place. Non-AAMI customers benefit from the competitive pressure AAMI places on other insurers to manage their claims costs, deliver competitive premiums and provide good customer service. From a broader perspective, clearly these competitive pressures improve the affordability of insurance and provide an efficient market check on gouging and poor service performance.

More generally, frameworks such as AAMI's Standards and Code and the Customer Charter provide examples of processes that might be applied by other insurers or in other industries. Indeed, there is a number of examples in which AAMI's competitors have drawn on AAMI's frameworks in their businesses. These include the neutral ground of Assessment Centres for assessing and allocating repair work, the Lifetime rating/no-claim bonus offering, Suncorp's recent introduction of a Charter, telephone-based claims lodgement and Lifetime repair guarantees.

3.6 Dispute Resolution for Customers

Whilst AAMI makes every effort to deliver a superior service to customers, from time-to-time some customers are not satisfied with the service they receive. There are a variety of disputes resolution procedures available to customers. Indeed, there are legal requirements for AAMI to have disputes resolution procedures in place. In summary, AAMI must:

- satisfy the Essential Elements of Effective Complaints Handling in Section 2 of Australian Standards 4269-1995;²³
- document its IDR procedures;²⁴ and
- establish appropriate links between individual IDR procedures and the relevant external dispute resolution (EDR) scheme and have a system for informing complainants about the availability of the relevant EDR scheme (i.e. General Insurance Enquiries and Complaints Scheme - IEC).²⁵

3.6.1 IDR Process

AAMI has a fully documented IDR process that meets the requirements of the Australian Standard.

Customers who are not satisfied with any aspect of the claims process are encouraged by AAMI staff to raise these concerns initially with AAMI's Customer Ombudsman, who will respond within five working days of receiving a complaint. Customers who disagree with the

23 ASIC Policy Statement [PS 165.10(a)] & [PS 165.96]

24 ASIC Policy Statement [PS 165.10(b)] & [PS 165.30]

25 ASIC Policy Statement [PS 165.10(c)]

AAMI Customer Ombudsman's decision, are encouraged to take their concerns to the General Insurance Enquiries and Complaints Scheme (IEC).

All complaints are reviewed at no cost to the complainant. AAMI publicises the fact that its IDR process is free and that utilising the IDR and IEC's EDR service will not and does not affect the complainant's legal prerogative to seek remedies through a court or tribunal.

Contact details for both the AAMI Customer Ombudsman and the IEC are included in the policy document and in the "AAMI Consumer Appeals Service" brochure which is freely available at all AAMI Customer Service Centres and branches (see Attachment 2.6).

Uninsured third parties can also access AAMI's IDR process.

3.6.2 EDR Process

Customers are advised that they have the right to have the Customer Ombudsman's decision reviewed by the EDR scheme administered by the IEC (Insurance Enquiries and Complaints Ltd). This scheme is ASIC approved and provides a free, independent, swift and final determination of disputes for customers. Industry members pay a levy and a fee for each dispute referred to IEC. Customers pay nothing. Insurers are bound by the determination made by IEC. Customers are not.

AAMI publicly reports on the number of IDR and EDR matters it handles and the outcome of these. No other insurer currently does this.

Subject to certain limitations, uninsured third parties, can access the EDR scheme administered by IEC.

3.6.3 Other Dispute Resolution Mechanisms

Customers can choose to bypass the IDR/EDR process and go direct to a tribunal or court. Customers are also not bound by the EDR decision (although the insurer is) and can choose to take the matter further to a court or tribunal. Customers can also lodge a complaint with a range of different regulators, including Offices of Fair Trading.

3.7 Criticisms of AAMI's approach

AAMI's approach to motor insurance and repairs described in Sections 3.1 to 3.3 has evolved over many years (see Chapter 2). Notwithstanding the benefits noted, AAMI's competitive quoting and repair process has come under sustained attack, predominately from sectors of the repair industry who correctly view AAMI's business model as a direct challenge to their ability to operate their business in the same way as they did in the 1980s.

While many repairers have looked to business efficiencies, alliances with insurance companies, and investment in their business, to improve their productivity, some sectors of the industry have been unable, or unwilling to do so. In the main, it is these repairers (supported or indeed encouraged by Trade Associations) that have historically been vocal critics of AAMI's method of operation, and who wrongfully purport to represent the views of the entire repair industry.

The main issues as they relate to AAMI are considered below. They are also considered in the broader context of the insurance industry in Chapter 4.

3.7.1 Choice

AAMI accepts that its claims and repair process may not meet the needs and requirements of all customers. But AAMI is not targeting all customers. It is targeting those customers that accept that AAMI will obtain competitive quotes, manage their repairs and in the process provide them with various benefits. While we would contend most customers do not have their 'own' repairer, and cite our market growth and customer satisfaction levels in support of this contention, AAMI is not seeking to insure a customer who wants to select their repairer when they have an accident. Consequently, AAMI clearly discloses to customers that we retain the right to obtain competitive quotes and select the repairer of our customer's vehicle when they make a claim under their AAMI policy. We do this at the point of sale and in the associated documentation. A cooling-off period is provided should the customer not be happy with the policy they have purchased.

For those customers that value or require choice of repairer there are numerous options in the market place including insurance companies that provide the option of repairer choice. Some insurers see their offering of 'repairer choice' as a competitive advantage that is marketed (see Chapter 4).

For the financial year ended 30 June 2004, AAMI's Customer Ombudsman received six complaints from customers regarding choice of repairer. The Customer Ombudsman upheld AAMI's decision in all of these matters. One of these customers chose to refer the matter to IEC. IEC also upheld AAMI's decision. It is also noteworthy that AAMI's Customer Contact Managers have reported no policy cancellations following the more recent active campaign by the repair sector on the issue of choice (and quality).

The extremely low level of complaints (and absence of cancellations) would suggest the overwhelming majority of our customers are clear on the terms of the policy they have bought. Moreover, they are happy when making a claim to allow AAMI to manage the repair process for them as they are confident AAMI has the expertise to provide them with quality repairs in a timely fashion.

Nevertheless, on occasion an AAMI customer may express a wish to have a non-AAMI repairer quote on their repairs and we are happy to accommodate this. While maintaining the right to determine where the car is repaired, AAMI will invite repairers who are not part of our network to quote should a customer so request. Where that repairer provides the most complete and competitive quote, repairs will be authorised and all AAMI guarantees will apply. Around 25 per cent of AAMI's work is done by repairers outside our network, much of this following an owner request for a non-AAMI repairer to quote. In AAMI's experience, often a customer will nominate a repairer where an inducement has been offered.

3.7.2 Repair Quality

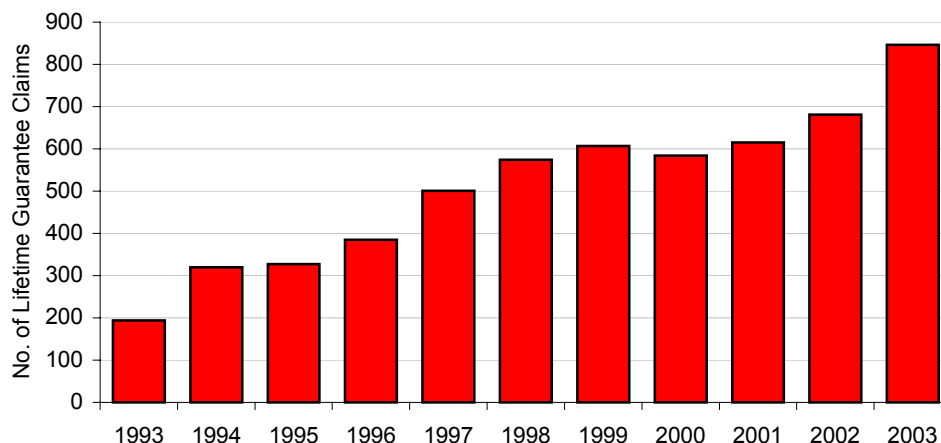
Since its introduction in the 1980s, (see Chapter 2) repairers have claimed the two-quote system, and subsequent insurance company efforts to reduce repair cost, will automatically lead to a lowering of repair standards. We do not accept these assertions; in fact, we would strongly argue the quality of repair work today is better than it has ever been, in part due to insurers taking an active interest in management of the repair process.

AAMI makes every effort to ensure the quality of repairs. All our assessors are qualified tradesmen; our repairer performance management system focuses strongly on repair quality and repairers not able to meet the standards required have been removed from the panel. AAMI offers a lifetime guarantee on repair work.

AAMI has never been approached by an authority with concerns about repair quality following an accident. We have not been approached by motor vehicle registration authorities. The ACCC, ASIC and State Fair Trading Departments have never approached AAMI with concerns about AAMI's processes and the implications for repair quality. Indeed, in discussions with regulators and customer representatives, they have been proponents of the palpable benefits for consumers brought about by AAMI's competitive quoting philosophy, provided disclosure is made at the time of sale.

AAMI's Consumer Ombudsman recorded six complaints relating to repair quality in the financial year ending June 2004. Diagram 3.4 highlights claims under AAMI's Lifetime Guarantee. During this period over one million repairs have been managed. The claim rate is negligible.

Diagram 3.4: Claims under AAMI's Lifetime Guarantee



While AAMI acknowledges that not every car is repaired perfectly, and problems do arise from time-to-time, it is AAMI's experience that the majority of repairers are producing high quality repairs, albeit in a highly competitive market. Furthermore, should a problem arise there are numerous protections built into all insurance company processes, as well as external dispute resolution bodies, to ensure the consumer is protected (see Section 3.6).

To continue to point to a small number of examples of unacceptable repair quality in support of claims of widespread consumer risk is no longer a sustainable position when considered against the one million-plus repairs carried out each year (see Chapter 4). It is AAMI's view that such

claims are not only inaccurate, but also do a disservice to the vast majority of repairers who take pride in the quality of work they produce.

3.7.3 Hourly rates

AAMI shares the repairers' view that the existing funny times/funny money system is a nonsense, however, we do not share their publicly expressed view that they are only being paid \$23 per hour for repair work under this arrangement (see Chapter 4).

AAMI does not have an hourly rate, instead we ask repairers to quote in dollar terms and allow them to arrive at their repair cost by whatever mechanism they wish, applying whatever rate is appropriate for their business. Repairs are then authorised to the repairer who submits the most complete and competitive quote.

It is AAMI's view that market forces are a more reliable determinant of a competitive repair cost than an artificial and inaccurate times and rate mechanism, which can never reflect that multiplicity of factors that will give rise to a cost of repair. In this context, it is worth noting that under AAMI's approach, repairers are responsible for determining their own profitability.

3.7.4 Payment Terms

AAMI again supports the repairers concerns with late payment of accounts. There is no doubt speedy payment terms are critical to cash flow, and this is particularly the case for small businesses. AAMI has committed to 14-day payment terms for all repairers, irrespective of whether they are part of AAMI's repairer scheme or not.

VACC's own survey of insurer payment terms has recognised AAMI as the fastest payer of repair invoices²⁶, not just in this survey but also in the two previous surveys.

AAMI is committed to paying all repairer invoices within 14 days. AAMI takes this commitment seriously and has appointed staff in each State to act as contact points should repairers experience problems with payments, and conducts regular internal audits to monitor payment performance. Confidential Attachment 3.5 provides an example of AAMI's most recent internal audit. By any standard the result is exemplary.

3.7.5 Access to repairs

The repair sector has complained that preferred repairer arrangements are inequitable as they restrict access to the limited supply of repair work. Ironically, many of the repairers who are today most critical of the fact that they cannot be included in the AAMI repairer panel are those repairers that through the 1980s and 1990s refused to do work for AAMI and aggressively campaigned against AAMI (see Chapter 2).

Repairers' inability to access preferred repairer arrangements is directly linked to the fundamental issue of oversupply of repairers. The simple fact, harsh as it may be, is that there are simply too many repairers for the available work. Not all repairers, therefore, can belong to AAMI's repairer scheme. AAMI was involved in the management of almost 200,000 cars in 2003. If this work was shared amongst the Australia's 5000 repairers (see Chapter 2), each

26 VACC (2004), *Insurers Payments to Repairers Audit*, February, p. 3.

would receive approximately 0.75 repairs per week. No one would benefit by such an arrangement. There would be no basis for a business relationship, the increased competition would drive costs down (at a time when some repairers claim they are not being paid enough), and the ability to maintain repair quality and timeliness would disappear.

AAMI also believes it has an obligation to remain loyal to its existing preferred repairer network, many of whom have worked with us for 10-15 years. Many of these small businesses have linked their financial viability to AAMI and would not survive without access to a reasonable and relatively consistent volume of our work. It is inappropriate that these repairers be asked to sacrifice their business to assist those other repairers that have not been able to keep pace with the changing dynamic of the market and/or pursued a business model based on inducements and tow trucks. Moreover, it is insulting to ask AAMI repairers, many who have been demonised by others in the repair sector, to now surrender their business opportunities to others. More fundamentally, and as discussed in Chapter 4, AAMI believes it is any company's right to choose the suppliers with which it deals, those it is confident can deliver the levels of service and competitive pricing its customers expect.

While our loyalty to our existing repairers, and the available volume of work, dictate that not all repairers can be part of AAMI's panel, we have undertaken to respond within 28 days to every application to join our panel.

3.7.6 The two-quote system

One aspect of AAMI's approach that has drawn the ire of some in the repair sector is the two-quote system (see Chapter 2). It would be naive for AAMI to suggest that all repairers who have subscribed to our Standards and Code are supportive of the two-quote system. Understandably, the ongoing requirement to maintain an efficient business and submit competitive quotes in order to secure work is not a pressure that all repairers favour. Some would rather a return to a one-quote environment.

However, other repairers have structured their business around the AAMI two-quote model. They back their ability to run an efficient business and secure work by submitting competitive quotes and consistently delivering on quality and timely repairs. These repairers do not have to be involved with tow trucks, pay spotters and drop fees or offer inducements. They are able to make savings by positioning their shop in lower profile sites (they do not need to attract "off the street" quoting opportunities) and they do not have to expend extensive resources in managing customers.

Some repairers have also claimed that the exercise of getting more than one quote – requiring repairers to compete – drives quality down and jeopardises safety. As noted above, there remains no evidence in support of this claim. Our market economy relies on competition to drive not only cost but also quality. Indeed, if the practice of obtaining more than one quote to obtain a cost gave rise to the quality problems the repair sector is claiming, the competitive processes that drive all aspects of our economy would have failed long ago – the economy would be a basket case!

AAMI does not resile from its right to obtain more than one quote for the provision of a service. Indeed, it is noteworthy that competitive tendering is Federal and State government policy when outsourcing government works in order to ensure efficient and effective use of taxpayers' funds. AAMI believes it is good policy in the private sector too. It ensures the

efficient and effective use of not only shareholders' funds but also customers' contributions to the premium pool. More generally, AAMI believes that the two-quote system is an equitable way to determine the allocation of work. In simple terms, it rewards those repairers that are able to submit competitive quotes and consistently deliver on quality and timely repairs.

3.8 Conclusion

AAMI takes the principles of transparency, consistency and natural justice very seriously. In relation to the sales process:

- there is clear disclosure during the sales process and in the PDS and policy that AAMI retains the right to obtain competitive quotes and select the repairer;
- staff are thoroughly trained and monitored to ensure the appropriate disclosures are occurring;
- customers have a cooling-off period during which time they may cancel the policy should they find any aspect of the policy does not meet their needs; and
- customers are entitled to cancel their policy at any time and receive a refund less a \$20 administration fee.

Our claims process provides many protections for consumers, particularly those who do not wish to be involved in the repair process:

- only qualified assessors are used;
- repairers are required to use OEM parts;
- a Lifetime Guarantee is provided (which is honoured even if the vehicle is sold);
- the repairers AAMI works with obtain regular feedback on their quality and timeliness performance;
- the Customer Charter reinforces the robustness of the service guarantees;
- customers can nominate a repairer to submit a complete and competitive quote; and
- free IDR and EDR processes are available in the event a customer has concerns.

The AAMI Standards and Code framework provides a solid foundation for AAMI's relationship with repairers:

- clear performance targets around cost quality and timeliness;
- regular performance feedback;
- structured performance management system;
- the requirement to use genuine parts;
- 14-day payment terms;
- goodwill provisions; and
- IDR and EDR processes.

Relevant provisions have been extended to non-AAMI repairers.

In summary, AAMI has for many years taken the view that if the customer is to get the benefit of the guarantees offered by AAMI and a high quality service at a competitive premium, then AAMI simply has to be involved in the repair process. AAMI has made all reasonable efforts to ensure consistency and transparency for stakeholders. AAMI's market share growth of over the past decade is the ultimate proof that the company's approach to doing business has been

extremely successful, delivering significant benefits not only to AAMI's customers, but also to its repairers and shareholders. Sustaining these benefits would not have been possible if we were imposing on our customers a repair process they did not want; if we were treating repairers in anything less than a professional manner; and if we were repairing cars with scant concern for repair quality.

Chapter 4 Motor insurance and repairs – a broader perspective

Chapter 3 discussed AAMI's approach to motor insurance and considered some of the claims made by the repair sector as it relates to AAMI practices and stakeholder outcomes. This Chapter takes a broader perspective and considers the claims made by the repair sector in the broader context of the insurance industry. The commentary provided is general in nature and is not intended nor should it necessarily be interpreted as representing the views or positions of other insurers on these matters. The following issues are considered:

- consumer choice;
- repair quality and safety;
- repairer profitability including payment times; and
- hourly rates.

4.1 Consumer Choice

The issue of consumer choice is an emotive one. The Trade Associations and some repairers have promoted it aggressively on many occasions over the past two decades. Indeed, almost all opportunities and mechanisms have been explored in order to spark consumer interest in the issue (see Chapter 2).

It is claimed consumers are somehow suffering as a consequence of insurance company involvement in the smash repair process, particularly where insurers are involved in advising or directing the customer to a particular repairer. In reality, most customers do not share the repairer's passion for choice of repairer. And for those that do, there are numerous opportunities for them to exercise their choice as it relates to motor insurance and repairs within the current market environment.

4.1.1 The insurance choice

The first choice a car owner faces is whether to insure. Estimates vary, but it is believed somewhere between ten and 15 per cent of motorists are uninsured at any one time. This is due to a combination of factors: cost; value of the vehicle to the owner; use of the vehicle (some cars are used on properties and not public roads); and the individual's decision to self-insure. Many large corporations and governments choose to self-insure their fleets.

Of course, for many motorists insurance is not viewed as optional. However, they may elect to take only Third Party Property insurance. This covers damage caused to other vehicles and property while requiring the owner to cover their own damage and to take on the responsibility of managing the repair process for their own car.

Should the consumer make the choice to take out comprehensive motor insurance, there are a plethora of options available in what is a highly competitive insurance market. Louise Sylvan, ACCC Deputy Chairman, recently quoted a UK study²⁷ that showed car insurance to be one of the easiest products for people to shop for and change providers, either through easy access to direct insurers by phone and Internet or through broker services should expert advice and assistance be required.

27 Sylvan, L. (2004) Deputy Chair, ACCC, Speech to the National Consumer Congress, Melbourne, 15 March.

Not only is it simple for consumers to shop for insurance, but the recently introduced *Financial Services Reform Act* has further strengthened the disclosure requirements on insurers to ensure that customers know exactly what type of cover they are taking, as well as any relevant conditions of the policy. This disclosure is required under section 1013 Chapter 7, *Corporations Act* (Financial Services Reform Act), which is administered by ASIC.

Furthermore, consumers have rights to cancel their policy during the legislated cooling-off period after taking out insurance should they find when reading their policy that the cover they have purchased does not meet their needs.

While the repair sector continues to claim ‘choice of repairer’ is of key concern to the insurance-seeking consumer, the evidence does not support this contention:

- The research commissioned by one State MTA (see confidential Attachment 3.4) shows price is overwhelmingly the greatest factor when choosing an insurance company for motor vehicle insurance (43 per cent), followed by reputation of the insurer (30 per cent) and word of mouth/friends recommendation (19 per cent). Recommendation by a repairer is consideration for two per cent of people.
- AAMI has grown at an average annual unit growth rate of over 10 per cent over the past decade while disclosing its repair process. And during this period, AAMI was subject to public campaigns by the repair sector where consumers were advised not to insure with AAMI if they wanted choice and other insurers were recommended (see Chapters 2 and 3).
- Independent research conducted for AAMI (Sweeney, 2004) shows that price (73 per cent), policy features (17 per cent) and superior service (6 per cent) are the primary factors driving selection of an insurer.²⁸

This position was supported by the ACCC,²⁹ who confirmed that choice of repairer is not a key issue for consumers.:

Consumer groups claim that the issue of consumer choice is not a fundamental concern to the majority of consumers when their vehicle needs to be repaired under an insurance transaction.

Consumer groups advised the ACCC that:

... the predominant concern of most consumers is that the vehicle is repaired quickly, efficiently and to a high standard. Consumers are also concerned about the cost of motor vehicle insurance premiums.

While recognising that consumer choice is not a key issue for most consumers when taking out insurance, it is also important to note that the market place does provide numerous alternatives for those consumers who do seek such an option. Customers wishing to select their own repairer can insure with a company that provides this option such as Allianz, GIO, CGU, Suncorp and Budget Direct. In the case of Allianz, the company actively promotes repairer choice as a key feature of their policy offering.

While different insurers adopt different approaches, such as not offering customers a choice of repairer at all, Allianz regards customer choice of repairer as a key quality feature of our vehicle insurance offer.³⁰

Allianz has promoted the feature in its television advertisements (see Attachment 1.9).

²⁸ Sweeney (2004), AAMI Market Monitor, The Motor Insurance Market.

²⁹ ACCC (2003), *Issues Paper*, September, p 16.

³⁰ Body Shop News (2004), *The choice is yours says Allianz*, June, p. 14.

4.1.2 Exercising choice during the claims process

Having entered into a contract when taking out their insurance cover consumers have the option of making a claim or not when they have an accident. Because excess amounts tend to be around \$450 or \$500, for small repairs, owners have the choice to manage the process themselves rather than making a claim. Not-at-fault motorists also have a right at law to have repairs carried out where they like and pursue the costs from the at-fault party. Around one-third of all accidents involve a not-at-fault motorist.

Most consumers choose to involve their insurer. Moreover, it is understood that most customers who have the option to select a repairer under their policy opt instead to utilise the repairer nominated by the insurer.

This is not surprising when we consider that on average a motorist will have a claim involving a driveable vehicle once every seven to eight years and a claim involving a non-driveable vehicle every 20 years. Consequently, they are unlikely to have their ‘own’ repairer. In this respect, it is important to note that smash repairers offer ‘repair services’. They do not provide a retail service or product and as such are not the type of business that can rely on or should expect repeat business. They are akin to other repair services such as electrical repairs and building maintenance (e.g. glass replacement, roof repairs, drain cleaning).

Another factor that gives rise to the consumer decision to involve their insurer is that they are unlikely to have the requisite technical knowledge to select a repairer and successfully manage and oversee the repair process. This view was supported by the Industry Commission, which observed:³¹

Consumers often lack the technical competence and knowledge to make informed choices. Where they are poorly informed, the market may not impose the usual discipline on repairers to provide services of a standard or cost that would be demanded were consumers better informed.

In the extreme case where consumers have no information to enable them to differentiate between services provided by repair establishments, there would be no incentive for repairers to offer higher quality services since consumers would have no way of recognising and therefore valuing that higher standard.

The Industry Commission found that the information asymmetry problem facing customers was unlikely to be confronted by insurers because they deal with repairs on a regular basis.³²

This imbalance in information is likely to apply mainly to *individuals* [Commission’s emphasis] seeking mechanical and smash repair. As a rule, insurance companies (which act on behalf of individuals in arranging smash repairs) and fleet owners generate sufficiently high volumes of repair business to be relatively well informed about the capabilities of different repairers.

In light of these comments, it is not surprising that many customers elect to follow the advice and processes required or recommended by their insurer where a repair is required. Clearly, many insureds value the protections that come with insurer involvement.

31 Industry Commission (1995), *Vehicle & Recreational Marine Craft Repair and Insurance Industries*, Report No. 43, p. 80.

32 Industry Commission (1995), *Vehicle & Recreational Marine Craft Repair and Insurance Industries*, Report No. 43, pp. 80-81.

4.1.3 Exercising choice during the contract period or at renewal

Motorists also have the option to exercise choice during the contract period or at renewal. If a customer is unhappy about the service they receive or receive advice or information that gives them reason to be concerned about their insurance cover they have the option to cancel or renew with another company.

4.1.4 Freedom of Choice – The Real Issue

It is clear that the debate around freedom of choice is in fact a debate about something quite different. In reality, repairers' support for freedom of choice is a desire to return to the environment where repairers were all but guaranteed the right to repair any car they could get into their repair shop. As such, the debate relates to the issue of repairers' ability to secure repair work. Historically, this has been done by:

- 'competing' with other repairers by offering a variety of inducements (e.g. loan cars, undertaking non-claim related work); and/or
- 'competing' with other repairers at the accident scene through links or ownership of tow trucks.

However, as discussed in Chapter 2, insurers' increased interest in the cost and quality of repairs has meant that this unusual business model is no longer an effective approach for securing a reliable flow of repair work. Some repairers responded by ensuring they ran competitive shops that delivered quality repairs. Insurers have targeted these repairers under their preferred repairer type arrangements (see Section 6.1). Other repairers, encouraged and supported by the Trade Associations, persisted with the traditional model and banked on consumer support. Unfortunately, this has proven to be the wrong strategic and business decision for many of these repairers.

The legal position on the issue is quite clear. Policies that provide for the insurer to select the repairer when authorising repairs came under the consideration of the Federal Court in *Australian Automotive Repairers' Association-v-Insurance Australia Group Limited* in which Justice Lindgren stated:³³

Upon a proper analysis, there is never any question of the insureds acquiring goods or services from a (repairer)...

and later in the same judgement:

The insureds do not ... acquire repair services from the (repairer); they acquire them from (the insurer).

Interestingly, the question of 'freedom of choice' does not arise in a number of other transactions where businesses rely on other suppliers to deliver the ultimate service to the customer.

In the case of home insurance, suppliers such as builders, plumbers, electricians, renovators, electrical goods retailers and jewelers do not assert that the insured is their customer when supplying services and goods in the settlement of a home buildings and contents insurance

33 Lindgren, J in *AARA v NRMA [2004] FCA 700*

claim. They acknowledge that this work is sourced at the discretion and direction of the insurer. Similarly, home builders will outsource the supply of services such as concreting, plumbing, brick laying and roofing etc. These supporting suppliers do not claim that the home purchaser is their customer. They see the builder as their customer.

Despite all reasonable argument to the contrary, and the legal position, the repair sector continue to seek to enshrine in their proposed Code the right to argue that the vehicle owner should select the repairer irrespective of the insurance cover they have taken out (see Chapter 6).

4.1.5 Summary

The Industry Commission considered freedom of choice in the context of the two-quote system and found:³⁴

Two-quote systems are consistent with normal business practice. They do not infringe consumer rights since consumers have the choice of insuring with those companies that do not have a two-quote policy and allow policyholders the choice of repairer. However, policyholders need to be fully informed of company policy and its implications. [Commission's bolding]

The ACCC also considered the issue and concluded:³⁵

These issues of consumer choice should effectively be dealt with under the existing Insurance Enquiries and Complaints scheme.

There is no evidence or argument to suggest these positions are no longer relevant.

It is also noteworthy that those companies that take a greater interest in determining the repairer of the vehicle have the more competitive premiums (JP Morgan 2004) and there is no evidence that the service outcomes for customers are jeopardised (e.g. AAMI – see Chapter 3). Indeed, AAMI would contend its service outcomes are superior because it is involved in the repair process. Clearly, if customers wish to save on their premium, they must accept the terms and conditions of the policy they purchase. After all, it is these terms and conditions that underpin the savings.

Within the highly competitive insurance market consumers are free to choose whether to insure or not and if so whether they wish to take out a policy with a company that allows them to choose the repairer. The repair sector has gone to great lengths to inform consumers about the importance of selecting the 'right' insurer if they want to choose the repairer under an insurance claim. The ease of shopping and comparison, coupled with the disclosure requirements and the cooling-off and cancellation provisions allow consumers to make an informed decision as it relates to choice of repairer. As with any contractual arrangement, the time to determine what is required in an insurance policy is at the time of purchasing that policy – not at the time of making a claim. For those consumers that require or value choice of repairer, insurance products are available.

³⁴ Industry Commission (1995), p. 66.

³⁵ ACCC (2003), *Issues Paper*, September, p. 25.

4.2 Repair Quality and Safety

The repair sector has claimed insurance company involvement in the claims process, whether it is through preferred supplier type arrangements or other actions, has jeopardised repair quality and safety. These allegations have been made since the early 1980s when insurers began to take an interest in the management of repair cost and quality (see Chapter 2).

4.2.1 Consumer protections

There currently exist a wide variety of market-related and regulatory-based mechanisms, which serve to protect consumers from poor quality and unsafe repairs.

In today's highly competitive insurance market it is simply not in any insurance company's best interest to encourage, allow or support repairers to produce poor quality or unsafe repairs. As the Industry Commission noted in relation to poor repairs:³⁶

... this is not in the interests of insurance companies. Poor repairs undermine an insurer's business reputation and could lead to legal claims.

Recognising the importance of quality repair outcomes for reputation, growth and profitability, most insurance companies are actively involved in ensuring their customers receive quality repairs. Indeed, the ability to better monitor and maintain repair quality is in fact one of the key reasons for the establishment of preferred repairer schemes by many insurance companies (see Chapter 6).

The approaches used by insurers vary and come at a substantial cost to insurers. Assessors are employed performance monitoring and feedback systems are used, some only use OEM parts and many provide customers with a lifetime guarantee on repairs. And in view of the information asymmetry issues facing consumers noted in the previous section, insurance company involvement in the claims process is beneficial, not detrimental for consumers. Notwithstanding the efforts of insurers, should a customer have a concern, dispute resolution facilities, both within insurance companies, and through the independent IEC, are also freely available.

Like insurers, the vast majority of repairers go to great lengths to produce quality repairs and are not likely to jeopardise their reputation and the flow of insurance company work by knowingly engaging in practices that give rise to poor repairs.

There are also a number of other factors that serve to protect consumers. Most consumers have their car serviced on a regular basis and will from time-to-time have items such as brakes, steering, suspension and tyres attended to. If there were major issues with smash repairs it would be expected that these activities would serve to highlight problems. In addition, in many jurisdictions, registration procedures and road-side checks also provide assessments of road worthiness (see Appendix 1). Any major issues would be expected to be identified at this point. As noted in Chapter 3, AAMI has never been approached by a registration or regulatory authority in relation to a repair quality or safety issue.

36 Industry Commission (1995), p. 66

4.2.2 Consumer complaints and accident statistics

The available evidence suggests that the various market-related and regulatory protections noted in Section 4.2.1 are highly effective in providing consumers with high quality and safe repairs.

By any standard the level of quality issues in the industry is low. The insurance industry's independent dispute tribunal, the IEC, averages approximately one complaint per month in relation to repair quality issues. State Offices of Fair Trading & Consumer Affairs record few complaints regarding problems with smash repair work:

- N.S.W: The Motor Vehicle Repair Industry Authority (MVRIA) investigates complaints that are considered to be below usual trade standards and "In any one year there are less than 10 such investigations [by the MVRIA]."
- Victoria: "... the industry is mostly free from complaints."
- Tasmania: One complaint between 1 January 2003 and May 2004.
- ACT: Between Nov 2001 and June 2003, six repair complaints. None since.
- Queensland: Less than twenty complaints across 2003.
- S.A: No specific data on smash repairers, but a total of 97 for all motor repairs and servicing for the year 2002-03.

AAMI would contend most, if not all of these complaints, would relate to repairs where an insurer was not involved. Copies of this correspondence can be found in Attachment 1.10.

It is also noteworthy that the MTA-commissioned survey (see Attachment 3.4) found that satisfaction with insurers was running at 85 per cent. This result would be expected to reflect that the repair outcomes being received by customers are favourable.

State road transport authorities and the Commonwealth Government's Australian Transport Safety Bureau also assess the cause of fatal accidents (Appendix 2). The contribution of 'poor quality repairs' to fatal accidents is captured in the broader category of 'vehicle malfunction', which includes maintenance (eg tyres, brakes). In the States where vehicle malfunction is recorded, the contribution to fatal accidents is between 1-2 per cent (NSW 0.8 per cent, QLD 2 per cent and SA 1 per cent). The Australian Transport and Safety Bureau (ATSB) advise that critical malfunction was a major causal factor in about 3.5 per cent of fatal crashes.

Unfortunately, it is not possible to further disaggregate this data to identify the contribution of smash repairs to vehicle malfunctions. The Australian Transport Safety Bureau advised that:

... the majority of these critical vehicle malfunctions would be due to the vehicle not being properly maintained by the owner.³⁷

It also noteworthy that poor quality repairs is not identified as a separate category by these authorities simply because it has not been identified as an issue. Other authorities do not collect this information due to the low incidence rate.

When the customer complaints figures and the fatal crash data are considered in the context of the estimated 1.2-1.5 million motor vehicle repairs each year, the only conclusion that can be drawn is that consumers, and the community more generally, is well served by the current market and regulatory arrangements.

³⁷ Australian Transport Safety Bureau (2004), e-mail from Thomas Roberts. (See Attachment 1.13)

4.2.3 What Constitutes a Quality Repair?

By its very nature, repairing a collision-damaged vehicle is not a simple exercise. When repairing an accident damaged vehicle the aim is to ensure the vehicle is properly repaired. Clearly, this will require consideration of the age and condition of the vehicle (including normal wear and tear) as well as the manufacturer's original specifications. Within the repair sector, views as to the quality of repair vary and what is acceptable to some is not acceptable to others. In part, this arises because it is generally accepted that there are tolerances associated with repair. And it is worth noting that even new vehicles directly off the production line are not perfect, and will exhibit problems with paint finish, panel gaps and general fitment. Another complication is that smash repairers do not have the equipment nor the materials available to manufacturers who use robotics, production line techniques, electro-static painting and so on.

Leaving these issues aside, the quality of a repair is also impacted by the other factors. As the Commission noted:³⁸

Unsatisfactory workmanship can be the result of many factors including the competency, integrity or conscientiousness of tradespersons, as well as the standard of equipment.

Notwithstanding these considerations and the overwhelming evidence that repair quality and safety is not an endemic problem, some in the repair sector may provide the Commission with examples of what they claim to be poor quality repairs resulting from insurance industry practices. Indeed, a number of businesses have been established with the aim of 'exposing' poor quality repairs. These businesses will claim their inspection experience shows a high proportion of repairs are substandard, either in terms of quality or safety. It is axiomatic that the strike rate is high – the repairs inspected are for people who are concerned about quality. More generally, AAMI has already provided evidence to the Commission that highlights concerns about the validity and legitimacy of the claims being made by such businesses. AAMI can provide further evidence to the Commission if the evidence provided by such businesses forms part of the Commission's considerations.

4.2.4 Summary

Despite their protestations, the repair industry has never been able to produce evidence to support their allegations that insurance company practices are forcing repairers to perform substandard repairs. The reason is simple – there is no evidence of systemic repair quality or safety issues in the smash repair industry.

The Industry Commission's previous findings also hold today:³⁹

Overall, the standard of motor vehicle repairs appears to be satisfactory. Consumer dissatisfaction with repairs is not high when considered in the context of the number of repairs performed, or by comparison with similar service industries. [Commission's bolding]

It is likely that most vehicle defects which contribute to accidents are the result of poor maintenance and that only a small proportion are the result of substandard repairs. [Commission's bolding]

³⁸ Industry Commission (1995), p. 90

³⁹ Industry Commission (1995), p. 89 and p. 109.

The nature of smash repairs is such that not every repair will be perfect. However, insurers and repairers that are part of a preferred repairer arrangements have strong incentives to get repairs right. And recognising the importance of repair quality to their reputation and survival, most insurers invest heavily in systems and processes aimed at supporting the delivery of high quality repair outcomes for customers. Many insurers back their processes with lifetime guarantees and all customers have access to free dispute resolution procedures if they are not satisfied. Other important indirect checks on repair quality are provided through vehicle maintenance and registration procedures. Overall, the claims by the some in the repair sector that the practices of insurers are forcing repairers to do poor quality repairs is simply not supported by the evidence. Consequently, any policy reforms based on concerns about repair quality and safety based on the practices of the insurer would be misplaced. More generally, if the Government wishes to make further inroads into accident and injury rates, it would be far more effective to focus on the major contributing factors (e.g. youthful exuberance, speed, drunk-and drug-driving and fatigue).

4.3 Profitability

The repair sector claims that the practices of insurance companies are driving repairer profits to unsustainably low levels.

In large part, the profitability pressures faced by repairers is due to the chronic oversupply of repairers. This oversupply has been exposed as insurers have taken a greater interest in the cost and quality of repairs and are sought to develop more professional relationships with repairers. Reductions in the volume of repair work generally available and growing cost pressures have exacerbated this oversupply problem (see Chapter 2).

As with any market, a chronic oversupply would be expected to put pressure on returns as suppliers price at marginal cost or below with a view to maximise cash flow. Repair sector experts acknowledge this oversupply is impacting repairer profitability:

Currently, insurers have too much choice when it comes to repairers simply because there are too many repairers. It is not realistic to expect insurers to keep an oversupply of repairers profitable on moral grounds. Insurers are in a competitive market which demands they buy at the best price. While the insurer/repairer numbers remain as they are, so will the skinny profit margins being earned by most repairers.⁴⁰

Despite this oversupply, there are mixed views as to whether the smash repair sector is profitable. The most recent data from the ABS suggest the smash repair sector profit margins are favourable when compared to other automotive sector participants – a 5.4 per cent profit margin versus 1.9 per cent profit margin. Indeed, the return for smash repairers is only slightly below the service industry average of 6.1 per cent (see Table 4.1). Unfortunately, this data is not current and it would be expected that returns may have fallen as the structural change pressures have hit.

40 McCewing, F. (2004), *Editorial – It's all about choice*, Paint and Panel, July/August, p. 5.

Table 4.1: Service Sector – Profit Margins 2000/2001

Industry participant	Profit Margins 2000/01 (%)
Auto Electrical repairers	6.5
Auto Repairers	6.2
SERVICE INDUSTRY AVERAGE	6.1
Smash Repairers	5.4
Trailer & Caravan Dealers	4.3
Tyre Retailers	2.0
AVERAGE ACROSS SECTOR	1.9
Motor Cycle Dealers	1.8
Car Dealers	1.2
Fuel Retailers	0.5

Source: ABS, Cat. No. 8155.0., Australian Industry 2000/01. 5323 Smash Repairing

While some repairers are obviously doing better than others, it does seem to be widely accepted that those who are part of insurance company repairer schemes are more likely to enjoy better profitability levels than those outside these schemes. The repair sector itself acknowledges that repairers working with insurers are more likely to be profitable than those who are not:⁴¹

There are those who are running professional businesses, including the presentation of that business. They're the ones who are also attracting insurance company business. And if you're doing a lot of insurance work, generally, you'll be one of the more profitable crash repairers.

VACC correctly observed that less professionally run shops will be more likely to struggle in the current competitive environment while the better shops will do well, notwithstanding the oversupply in the market.⁴²

I think there are some repairers out there who would be well advised to shut their doors. There are a lot of very good crash repairers and they're doing well and they're going to continue to do well. There are also many crash repairers who are developing good businesses and who will ultimately do very well. ... There are others who might be better trying to turn their hand to something else. If some of them don't do this, they will increasingly go into debt and lose absolutely everything they've got. ... It's very difficult to persuade these repairers to sell-up because many are getting on in years and would find the change too dramatic. ... The repair shops that are doing well are probably making very good use of technology. They have good business practices. They would have their accounting practices and procedures well under control. They would know what each job is costing them...

In supporting the view that at least some sections of the smash repair industry are profitable, and in fact are looking to the future and investing in new staff and equipment, the September 2003 National Collision Survey reported:⁴³

... 65 per cent of repairers identified growth as their overall expectation for the coming year. The great majority of these thought such growth would be slow whereas 6 per cent identified rapid growth as their expectation for the next 12 months.

41 Australian BodyShop News (2003), *What do you tell your repairers*, Interview with Purchase, Executive Director VACC, August ,p. 30.

42 Australian BodyShop News (2003), *What do you tell your repairers*, Interview with Purchase, Executive Director VACC, August ,p. 30.

43 Australian BodyShop News (2003), *National Collision Repair Industry Survey*, Repairer NETworks, Sept, p. 14.

Encouragingly, a large proportion of respondents (40 per cent) foresaw minor increases over the next year in sales, capital expenditure, utilisation of capacity and profits. ... 15 per cent of repairers forecast a minor decrease in sales turnover and 20 per cent forecast a minor decrease in profits in the coming year.

The review information covering almost ten per cent of the repair sector provided in confidential Attachment 3.1 also shows improved profitability and increased investment.

Payment terms

Some repairers also claim that insurers' payment tardiness is impacting on repairer profitability. The available evidence indicates that paying repairers on time is the rule, not the exception. The annual VACC Insurer Payments to Repairers Audit 2004,⁴⁴ stated:

76 per cent of all invoices were paid within standard trade payment terms of 30 days...

The mean duration taken by insurance companies to settle Body Repair invoices was 24 days, with a median of 18 days.

The issue of payment terms was raised during the ACCC review.⁴⁵

The ACCC has not been provided with specific examples where payment has been unreasonably delayed by insurers.

That said, the VACC survey shows substantial variation between insurers in terms of their payment performance.

4.3.1 Summary

It is important to note the palpable contradiction in the repair sector's simultaneous contentions that on the one hand insurance work is desirable and profitable, but on the other that insurers' practices promote 'cutting corners', poor quality work and unsustainable rates of return.

There is a chronic oversupply of smash repair capacity. As with any market, this oversupply is putting pressure on profitability. That said, there are mixed views on repairer profitability. It would seem repairers who are part of a preferred repairer scheme, or who have developed a niche market for themselves, are more likely to be doing well. Indeed, the repair sector itself acknowledges that it can be profitable to work with insurance companies and that the better, more dynamic shops are doing well and will continue to do well. There is evidence to support this contention. Ultimately, while the chronic oversupply remains there will be some repairers whose returns will be under considerable pressure.

4.4 Hourly rates

It is claimed that the hourly rate applied to time manuals has not kept pace with the cost of running a repair shop. It is claimed the hourly rate remains at approximately \$23-\$30. This issue is linked to the issue of profitability. Some in the repair sector are calling for a new universal time and rate manual framework to apply to all repairs.

⁴⁴ Victorian Automotive Chamber of Commerce (2004), *Insurer Payments to Repairers Audit*, February, p. 13.

⁴⁵ ACCC (2003), *Issues Paper*, p. 13.

4.4.1 ‘Funny money, funny times’

The debate over hourly rates has been raging since the introduction of the times and rate manual approach in the 1960s. By its very nature, the time and rate manual approach forces both parties into opposing positions:

- insurers trying to control costs, or at the very least slow the increase in repair costs to minimise the impact on premiums; and
- repairers trying to drive pricing up to maximise their returns.

This has caused widespread manipulation and abuse of the times and rate approach by both insurers and repairers. Today, neither the hourly rate nor the time allowed for repairs in anyway reflects reality. The use of the times manual for deriving a cost of repair is known by all involved as “funny money, funny times”. This was recently acknowledged by the repair sector:⁴⁶

The ‘funny money, funny time’ method of quoting goes back to the late 1960s when it was hastily brought in to break a deadlock between repairers and insurers. Since then, the practice of unrealistically low hourly labour rates offset by unrealistically high repair hours has become entrenched in the industry. Many younger smash repairers have grown up with this false concept, and have become used to hours expressed as elastic units of time and dollars reduced to around a third of their true value....

Whether this repair is quoted in ‘funny’ terms as 200 hours at \$31 per hour or in real terms at 68.9 hours at \$90 a hour the bottom line is the same: \$6200. Which is better, fantasy or fact?

Most repairers will acknowledge the hourly rate is much higher than \$23-\$30. Box 4.1 indicates that a better estimate of the true hourly rate is somewhere between \$56 and \$96 dollars. Ultimately, the actual hourly rate will be determined by the efficiency of each repairer. What is clear is that few repairers in Australia are working at a rate of \$23 per hour.

46 Paint & Panel (2004), *Now it's time to get real*, May/June, p. 26.

Box 4.1: The true hourly rate

The true hourly rate can be estimated by reference to the three primary components that make up the average repair cost are considered. These are the:

- labour needed to repair;
- labour needed to paint (including paint material cost); and
- the cost of parts.

The average cost to repair a motor vehicle across Australia ranges from \$2400 to \$2800. On average, 47 per cent, or between \$1100 and \$1300 of that cost is parts. While in Australia, the cost of paint materials is not separately identified, it is known that the cost of paint material to repairers is between 6 per cent and 8 per cent of turnover. What is left over is the ‘labour’ which must cover all other costs.

Repair cost disaggregation	Range	
The average repair cost in Australia	\$2,400	\$2,800
<i>less</i> Parts – 47%	-\$1,128	-\$1,316
<i>less</i> Paint material cost – 7%	<u>-\$ 192</u>	<u>-\$ 224</u>
Labour – 45%-46%	\$1,080	\$1,260

With access to various sources the actual labour hours required, on average, to carry out both the paint and repair process can be estimated. These range from around 14 hours up to 21 hours.

Estimated true labour hours	
Actual average labour hour to repair in the US	21 hrs
Actual average labour hour to repair in the UK	15 hrs
RACV’s own repair centres (200 cars per week)	17 – 19 hrs
Glasurit Paints benchmarking say	13 - 16 hrs
IMRAS Repair Industry Study	14 hrs

Sources: Tony Passwater – President, AEII
 Richard Pawinski – Manager, UK Repair Network, RSA, UK
 RACV – Management advice
 Glasurit Paints, Darren Loble, Vision Plus Benchmarking
 IMRAS Consulting – Smash Repair Market Research Study, 2001

Drawing in this information, the “real rate” of labour is at best, between \$83 and \$96 per hour, or at worst, between \$56 and \$66 per hour.

Labour Available	\$1,080	\$1,260
Best Case @ 13 labour hours	\$83 per hr	\$96 per hr
Worst Case @ 19 labour hours	\$56 per hr	\$66 per hr

4.4.3 Can a universal time and rate manual be developed?

The notion of establishing a universal hourly rate can be established and successfully applied is fundamentally flawed. Every repair shop is unique with different overheads, equipment, staff and expertise levels. No two repairs are the same and it is, therefore, not possible to accurately

identify a definitive repair time, nor a definitive cost of the respective tasks to be undertaken. As the Commission noted:⁴⁷

Different repair businesses can have different costs. Indeed, the same business can face different cost levels at different times depending on levels of capacity utilisation.

The fact that hourly rates were developed in the sixties when the insurance cartel controlled prices through the Tariff is reason enough to call the entire notion into serious question. At a broader level, the notion of a universal hourly rate and time manual to apply to all repairs is tantamount to price fixing for the cost of repairs. It would entrench arrangements that preclude competitive outcomes. Repairers and insurers would still ‘negotiate’ over the application of the times and there would be disputes over how the rate should change through time. In order to satisfy the needs of all repairers, the rate would have to be set to cover the most costly and inefficient repairers. When it is realised that claims comprise 70 per cent to 80 per cent of the unit cost of a motor insurance policy, it is difficult to see how this is in any way desirable. It would be analogous to resetting Tariffs in the insurance sector and would be significantly detrimental to competition, good business practice and the consumer interest. In fact, AAMI’s ability to out-compete not-for-profit mutuals and GBE’s who did use rates and times manuals demonstrates the consumer detriment of such an approach.

Not all insurers use hourly rates. As discussed in Chapter 3, AAMI uses a two-quote system and a Code and Standards framework. Under this framework, repairers have the opportunity to consider their own particular business circumstances and source work on the basis of their ability to run an efficient shop, consistently producing quality and timely repairs and submitting competitive quotes.

4.4.4 Summary

The Industry Commission reviewed issues associated with the time and rate manual in its previous review:

The current time and hourly rate schedules used for repair quotations should be abandoned. If time and hourly rate schedules are considered to be useful in preparing quotations, they should reflect true times and costs.⁴⁸

Time and hourly rate schedules which are based on unrealistic times and rates of remuneration, are not conducive to sound business practices. They encourage dishonest practices and undermine relationships between the insurance and repair industries.⁴⁹

This view also holds today.

The time and rate manual approach is known to all in the industry as ‘funny money, funny times’. The times and rates reported in no way reflect reality. Most repairers will acknowledge, and the available evidence suggests, the true hourly rate is somewhere in the range of \$56 to \$96 dollars per hour – much more than the \$23-\$30 per hour mischievously claimed by some. A number of insurers such as AAMI do not use a time and rate manual approach, allowing repairers to submit a quote on the basis they see as appropriate. More generally, the proposal that a real time and rate approach can be

⁴⁷ Industry Commission, *Vehicle & Recreational Marine Craft Repair & Insurance Industries*. Final Report, 1995 p. 87

⁴⁸ Industry Commission, *Vehicle & Recreational Marine Craft Repair & Insurance Industries*. Report No. 43, March 1995 p. 69.

⁴⁹ Industry Commission, *Vehicle & Recreational Marine Craft Repair & Insurance Industries*. Draft Report, Nov 1994 p. 4.

developed is fundamentally flawed. Moreover, the universal application of any such approach would be tantamount to price fixing for repairs and would be detrimental not only to consumers, but also efficient repairers. If times and rates are to be used by some insurers they should broadly reflect reality.

Chapter 5 Structural change and consumer choice

This chapter considers key policy considerations relating to:

- structural change; and
- consumer choice.

In considering these issues, AAMI has taken into account the Commission's broad policy guidelines as defined in legislation, particularly the requirements to:

- improve the productivity and economic performance of the economy;
- reduce unnecessary regulation;
- encourage the development of efficient and internationally competitive Australian industries;
- facilitate adjustment to structural change; and
- recognise the interests of the community generally and all those likely to be affected by its proposals.

5.1 Structural change

There is a chronic oversupply of smash repair capacity (see Chapter 2). The oversupply has existed for many years due to the inattention of most insurers to repair costs and quality. Strong unit returns for repair work were available and substantial capital flowed into the sector. The capital flows were further facilitated by low set-up costs and limited government regulation. The oversupply has been exposed as the insurance market has consolidated and mainstream players have taken an active interest in the cost and quality of repairs. A reduction in the volume of work (i.e. number of accidents) coupled with increases in the costs of doing business has exacerbated the oversupply problem.

Repairers have reacted differently to the changing dynamics (see Chapter 2). Some set about ensuring their business delivered competitive cost, quality and timeliness outcomes. They have also worked on their relationships with insurers in anticipation of the changing market structures. Others either failed to identify the changing dynamics or chose to persist (in concert with the Trade Associations) with the unusual business model that required customers to insure with insurers that offered choice. With the majority of insurers continuing to provide for choice, these repairers still have the opportunity to advance their preferred business model.

There is some evidence of rationalisation in the sector. Repair shop numbers have decreased from around 6700 in 1992 to around 5000 today. Average shop throughput, turnover, productivity and profitability look to be on the rise, at least for some shops. There is also evidence of investment, reflecting actual or anticipated profit. And some repairers are looking or have found other sources of income (e.g. restoration, warranty related repairs, spray painting such as polyurethane kitchens).

Notwithstanding this, the fact there is an oversupply of repairers cannot be ignored. Today, there is of the order of five to six repairs available per shop per week. Although views vary, it seems generally accepted that weekly volumes approaching ten per week are required to ensure viability and justify ongoing investment.

Some in the repair sector and the Trade Associations have raised concerns about the interconnected issues of choice, repair quality, hourly rates, payment times, and preferred supplier arrangements. Drawing on these issues, the sector has called for Government intervention.

5.1.1 Policy considerations

At the outset, it is important that the Commission note that the repair sector acknowledges:

- there is an oversupply of repairers;
- the oversupply is impacting repairer profitability;
- the true hourly rate is substantially more than \$23-\$30;
- some repairers would be better closing their doors;
- it will be difficult for the inefficient shops to survive;
- the better shops will survive and do well;
- insurers are striving to work with the better repairers; and
- if you are working with insurers you are more likely to be profitable.

The contradiction in the repair sector's simultaneous contentions that on the one hand insurance work is desirable and profitable, but on the other that insurers' practices promote 'cutting corners', poor quality work and 'unfair' rates of return is a critical consideration for the Commission. The available evidence supports the former contention not the latter one. AAMI would contend that the calls for Government intervention reflect 'rent seeking' behaviour and a desire to obtain Government assistance to insulate the inefficient players from the structural change pressures.

Notwithstanding this, the structural change pressures faced by the repair sector are real and serious. The pressures are clearly relevant to the Commission's considerations. The repairers that emerge through the structural change will be part of a more efficient, dynamic and profitable sector. Consumers will benefit from ongoing quality repairs and through competitive premiums (the result of competitively priced repairs delivered by an efficient repair sector). At a broader community level, bringing the level of investment in repair capacity more closely into line with the level of real demand will also bring benefits in terms of efficient resource use. These outcomes, which are largely market-driven, are consistent with the Commission's broader policy objectives.

From an economic policy perspective, it is clear that any reforms that stymie or distort this structural reform process will come at a cost to consumers, efficient repairers and the community more generally. Great care must be taken to ensure that the pressures of structural reform are not confused with the claims surrounding choice, repair quality, repairer profitability and preferred supply arrangements. For economic policy action to be considered, either market or regulatory failure must be clearly established. But even if such failure is identified, any proposed reforms should not give rise to more serious regulatory failure, including destroying the competitive dynamism that currently exists in the motor insurance and repair market.

From a social policy perspective, the Government may wish to consider some form of structural adjustment assistance for the repair sector given the structural adjustment pressures that are evident. This is one of the Commission's broader policy considerations. The Commission is well versed in issues associated with the different forms of adjustment

assistance to industry. It is well established, that indirect measures that seek to prop up or insulate businesses from the drivers of structural change, create distortions to market signals, give rise to resource misallocation and come at a significant cost to the community. As the structural change is rarely avoided, such measures typically serve to amplify the pain of the structural change. The Commission has established that direct and transparent forms of assistance are preferable. In the case of the smash repair sector, financial assistance to either facilitate exit and/or to improve business acumen (something that key players in the repair sector acknowledge is a problem for some repairers) appear worthy of consideration by government.

5.2 Consumer choice

The issue of choice is raised in 1c. of the Commission's terms of reference. The issue of choice was considered in Chapters 3 and 4. These chapters found that consumers have a wide variety of opportunities to exercise their choice in relation to choice of repairer. They can:

- choose to self-insure their own vehicle, including taking third party insurance, allowing them to manage the repair of their own car as they see fit;
- choose an insurer that provides for choice of repairer – many mainstream insurers provide for choice of repairer;
- choose to cancel their policy during the cooling-off period if, after reviewing the policy or considering the offer, they decide they would prefer a different cover, including the ability to select the repairer under a claim;
- choose to cancel their policy and receive a refund, less any administration fee, if for any reason they decide they require a policy that provides repairer choice and they have purchased a policy that does not provide that option;
- in the event of an accident choose to manage the repair themselves. This may happen if they are at-fault and the value of the claim is below the excess. Alternatively, it may happen if they are not-at-fault, where they have a right at law to recover the cost of repairs from the at-fault party; and
- choose upon renewal to change company if they decide they would like a policy that provides for repairer choice and their current policy/insurer does not provide that option.

Insured's also have the option to utilise the free IDR and EDR processes should they be unhappy with their interactions in relation to any of the choices noted above.

A key policy issue is whether this information is disclosed to consumers or if they face an information asymmetry problem. The available evidence suggests that consumers should be well informed about these matters:

- the transaction costs associated with shopping and obtaining the relevant information (and advice if necessary) are very low;
- the cost of switching insurers is low;
- mainstream insurers advertise 'choice of repairer' as a policy feature;
- for over two decades the repair sector and Trade Associations have been actively informing consumers (through advertising, brochures, help lines, bumper stickers, advertisements and so on) to select the 'right' insurer if they value or require choice;
- for those consumers who have their 'own' repairers, they can obtain advice from that repairer on which insurers to select; and

- there are also legal obligations on insurers to disclose key policy features as well as cooling-off, cancellation provisions and IDR and EDR procedures.

These matters aside, the evidence is that choice of repairer is not an issue for the majority of consumers. Research shows the primary factor driving the insurance choice is price. This was confirmed by the ACCC and by consumer groups who advised the ACCC that the primary issues for consumers are motor vehicle insurance premiums as well as the quality and timeliness of repairs. Finally, and significantly, the legal position is that the repair contract is between the insurer and the repairer, and the insurer and the customer, but not the customer and the repairer.

5.2.1 Excluding or limiting insurer involvement in repairs

Despite all reasonable evidence to the contrary, and the legal position, some in the repair sector continue to seek measures, be it through a Code (e.g. the VACC Code – see Chapter 6) or regulation (e.g. anti-steering legislation) or other means, to:

- limit insurer involvement in the repair process, including guiding repairer choice; or
- to preclude the right of the insurer to select the repairer altogether.

As this policy direction has been proposed, and it is central to many of the proposals made by the repair sector, it is important that the likely ramifications are explored.

The immediate impact is that such measures would create paramount value in ‘capturing’ the car (and the customer) (see Chapter 2). This is because the ‘capture’ of the car would dramatically increase the prospect, or even guarantee the entitlement (depending on the precise approach), to repair. History, clearly suggests poor economic consequences for consumers. Some of the likely consequences are:

- Many repairers would quickly activate inducements and involvement with tow trucks as the primary and most effective mechanism for securing accident repair work. Much of the focus would move away from shop efficiency (cost and quality), a positive dynamic under the current structural change, towards capturing repair work and securing the highest possible price for that work.
- Those repairers that had committed to delivering competitive costs and a quality service, built a relationship with insurer through preferred supplier type arrangements, and generally invested in their business, would find their business model was no longer relevant – a sovereign risk problem.
- Repairers would seek to recover the cost of inducements and tow trucks through the cost of repairs. Repairers would be expected to be successful as insurers’ ability to introduce any competitive pressures will have been largely, if not completely, removed – be it directly through two-quote type processes or indirectly through competitive benchmarking type processes. The improved unit returns might be expected to hold (or even attract) resources into an already oversupplied repair sector. Clearly, the increased costs would be passed on in the form of higher premiums.
- The increased prospect of securing repair work would directly undermine State Government policies designed to overcome the unruly and inappropriate behaviour that has been associated with tow trucks at accident scenes. To place this in context, it is worth considering the insights driving recent towing reforms in New South Wales. These reforms involved comprehensive revision of existing legislation to improve regulation of

tow truck activities at an accident scene, tighten the fit and proper requirements and provide for a stronger regulatory authority. Preventing tow truck drivers from intimidating the public at accident scene, was a key driver in implementing change. The Government when introducing the new bill commented that:⁵⁰

...the most significant incentive that has given rise to unscrupulous and dangerous practices is that a high proportion of tow truck operators are paid “drop fees” by smash repairers.

And that:

All of these trucks compete against each other for the job and in the process they often harass and intimidate drivers of damaged vehicles to get the business. There are also regular complaints of tow trucks placing other motorists and the public at risk while racing to an accident in an attempt to be first at the scene. Some tow truck drivers have even gone so far as to follow injured motorists into ambulances to get their signatures to do the tow.

- There would be an increase in recovery scam type activities. The increased cost of repairs would be reflected in premiums. This would involve a diversion of resource. Indeed, the limits on insurer involvement would provide scope for illegal and illegitimate practices to flourish.
- Having limited control over where cars are repaired and limited ability to execute preferred supplier type arrangements, insurers would have limited control over quality. They would dismantle or detune their frameworks designed to lift or maintain quality. Lifetime guarantees would be removed. And insurers would be likely to move to cash settlement. This would leave the repair process entirely in the hands of the customer. However, as noted in Chapter 4, the average consumer has no expertise in smash repairs. And as noted in the Industry Commission’s previous report:⁵¹

Even with “perfect knowledge” there is no guarantee that the decisions taken by individual consumers will be consistent with the interests of the broader community. Where an insurance claim is not involved [which will be the case where insurers cash settle], individuals making decisions about smash repairs will often make trade-offs between lowering the cost of repairs and decreasing safety levels. ... While an individual may judge that it is better to save on maintenance or repair costs by not having all safety defects rectified, the increased risk to which other motorists (or subsequent owners of the vehicle) are exposed could make that decision contrary to the interests of the community.

- With insurers losing interest in quality issues, the Government would find itself responsible. Indeed, insurers would be expected to refer quality issues to the Government on the grounds that the Government had limited or precluded insurers’ ability to manage the repair process. Ironically, the Government would find itself having to introduce frameworks to protect consumers.
- Ultimately, the insurance business would again become very simple: take the premiums, invest them and pay the repair cost. Nevertheless, insurers would strive to earn a return on shareholders’ funds. If premiums were to gallop, affordability and non-insurance would become an issue and there would be pressure on the Government to regulate premiums and/or introduce assistance arrangements to assist lower income groups. Various forms of cross-subsidy would be introduced and depending on the impact of the regulation on profitability, some insurers may exit the market.

50 The Hon. Ron Dyer, Tow Truck Industry Bill, *Second Reading*, NSW Legislative Council Hansard, 27.10.1998
 51 Industry Commission (1995), p. 106.

It would be easy to scoff at this scenario or consider it melodramatic. However, Australia's own experience suggests these are very real prospects were such reforms introduced. Box 5.1 provides some relevant sobering considerations drawing on the US experience.

Box 5.1: Some lessons from the US Anti-Steering Legislation Experience

With no federal charter for insurance, American states are left to their own statutes in relation to the regulation on the insurance industry. Due to the very disparate nature of the regulatory environment, it is very difficult to draw any conclusions about the efficiency or otherwise of the motor insurance industry, the smash repair sector and the impact of the many regulations. Nevertheless, it is the case that anti-steering laws have been enacted across numerous US states. These laws restrict the ability of insurers to direct and manage smash repairs for their own customer. As a result of this disconnection, all consumers in those states must manage the own repair process. There is evidence that anti-steering brings with it a number of disturbing consequences.

- **Premiums rise:** In 2001, the US states with the highest average motor premiums had anti-steering laws, while four of the lowest five states by premium do not.⁵²
- **State Governments become the arbiter of repair quality:** States with anti-steering laws find themselves in the pivot between smash repairers and customers. For instance, in California, the Bureau of Auto Repair (BAR), which is a government agency, is charged with policing the auto repair industry. It conducts a range of activities in relation to smash repairs including repairer licensing, random inspections of repair quality, customer initiated inspections of repair quality, field operations to ensure compliance with relevant requirements, consumer education programs and prosecutions for inappropriate practices. Each disciplinary action costs US\$9000 and \$2023 to investigate each consumer case. The program cost taxpayers US\$95 million in 2003/04 for their vehicle inspection and repair fund.⁵³
- **Insurance fraud:** Unscrupulous practices were proven by BAR in their Pilot inspection program in September 2003. Forty-two per cent of inspected cars had parts or labour billed that were not provided. The average inflated bill per customer was US\$811.93.⁵⁴
- **Claims management companies emerge:** These companies field claims calls, make claims assignments to shops in their own preferred programs and offer insurers direct billing. These companies are in effect a 'middle-man' and the associated costs are passed through to premiums.⁵⁵

Whilst numerous American States have anti-steering type legislation other States do not. In addition, some States have come under legal challenge. For instance, this year, New York's anti-steering laws have been ruled unconstitutional in their Supreme Court and the Federal Court in Texas supported insurer Allstate's First Amendment right to freedom on speech in directing repairs for customers citing that the law "inhibits the dissemination of information that may benefit consumers".

Whilst the US regulatory environment is disparate and disjointed, the peak forum for State insurance agencies stated in 2004 that:

The National Association of Insurance Commissioners, now recognises that the marketplace is generally the best regulator of insurance-related activity.⁵⁶

In light of these outcomes, it would be very difficult to identify net benefits to stakeholders, and the community more generally, by limiting or precluding insurer involvement in the repair process. Such measures would appear to be in direct conflict with all of the Commission's

52 NAIC and Insurance Information Institute Private passenger auto insurance (2001), State average data.

53 Report to the Joint Legislative Sunset Review Committee (2003), Bureau of Auto Repair.

54 California Auto Body Repair Inspection Pilot Program (2003), Report to the Legislature, September

55 insurancejournal.com, Feb 2004.

56 NAIC (2004), Insurance Regulatory Modernization Action Plan, Sept. collision-insight.com, (2003) The Changing Face of DRP, October.

broad policy guidelines. It is also an infringement of an ancient and common law right to ‘stand in the shoes’ of the indemnified. To disallow the indemnifier from protecting its legitimate interests (and in this case not just shareholders funds but, critically, the premium pool, which is the sum of the contributions of all customers and management of which is the determinant of premiums) would be contrary to public policy.

Freedom of choice – the real issue

Ultimately, the debate around choice should be seen for what it is. It reflects the desire of some repairers to return to the environment where they were all but guaranteed the right to repair any car they could get into their repair shop. The issue is advanced by some repairers, encouraged and supported by the Trade Associations, that persist with the traditional and unusual business model that relies on inducements and tow trucks. As such, the elevation of choice as an issue is motivated by a desire to secure repair work – it is not about consumer interests at all!

5.2.2 Policy considerations

There is no evidence of an endemic or even partial market or regulatory failure in relation to choice. There are perhaps issues around information asymmetry if insurers are not complying with relevant disclosure-oriented legislation. To the extent that this is a concern, the Government should direct ASIC to undertake a review to confirm insurer’s disclosure practices in relation to the following matters:

- choice of repairer;
- cooling-off periods and cancellation provisions; and
- availability of IDR and EDR.

It is AAMI’s view that consumers are well served by the current disclosure of policy features, benefits and entitlements, irrespective of whether they are driven by market dynamics or regulatory requirements. An area where disclosure may not be as effective or forthcoming, concerns intended and actual parts requirements of insurers.

There are three categories of parts that can be used to repair a vehicle – genuine/original equipment manufactured (OEM) parts; non-genuine (or parallel or non-badged) parts; and recycled or second-hand parts. The quality of the non-OEM parts, most of which are produced overseas, is not clear:

[No one] can guarantee that a part, which has not come through the manufacturer’s distribution network, is equal to or better than the OEM equivalent part without the appropriate batch testing.⁵⁷

While there are varying views on the quality of non-OEM parts, the use of recycled parts is agreed to be a legitimate practice where appropriate given the age and condition of the vehicle:

The quality, value and usefulness of recycled parts should not be underestimated, particularly when costs may not warrant new parts.⁵⁸

Insurers have different policies regarding the type of parts they will authorise for repairs. Some, such as AAMI, will only authorise OEM parts, and only new OEM parts whilst the vehicle is

⁵⁷ Gibbons, J (2001), *Insurers are cashing in on parts confusion*, Paint & Panel, July/August, p. 6

⁵⁸ Paint & Panel (2004), *Recyclers new division*, May/June, p. 20

under the manufacturer's new car warranty. Some insurers direct repairers to use non-OEM parts.

Given the variances in insurance company practices regarding parts supply and usage, the need for insurers to fully disclose to consumers the parts being used to carry out repairs is vital. This was also the position taken by the Industry Commission in their 1995 Report in which they commented:⁵⁹

The integrity of the industry would be enhanced if repairers and/or insurers were to provide to consumers as a matter of course details of all parts used.

ASIC should confirm that the disclosure practices of insurers in relation to parts use are adequate.

As a final comment on the issue of consumer choice, it is worth reiterating the ACCC's conclusions and recommendations:⁶⁰

The majority of the issues ... relate to the relationship between small businesses and big businesses. The ACCC notes some concerns which have been raised which might affect the rights of consumers, 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. The ACCC considers that any future developments focus on the issues arising between smash repairers and insurers.

59 Industry Commission (1995), p. 133

60 ACCC (2003), p. 25.

Chapter 6 Relationships between repairers and insurers

This chapter considers key policy considerations relating to:

- preferred supplier arrangements; and
- the role of codes in improving relationships between insurers and repairers.

Similar to the previous chapter, AAMI has taken into account the Commission's broad policy guidelines as defined in legislation in considering these issues. AAMI is not in a position nor is it appropriate for AAMI to comment on the approaches of other insurers in terms of their specific relationships with repairers. Hence, AAMI's comments are general in nature other than as they relate to AAMI's own arrangements.

6.1 Preferred supplier arrangements

The Commission has been asked to consider a range of issues in relation to preferred supplier arrangements. Questions pertaining to these arrangements form a major part of the Commission's term of reference – in particular 1a.

Numerous insurance companies have arrangements with a group of 'preferred' repairers to whom they direct repair work. Many of the claims raised by repairers in relation to these arrangements have already been considered:

- they eliminate an insured's freedom of choice (see Chapters 3, 4.1, 5.2);
- they are solely cost driven and impact adversely on repair quality and safety (see Chapters 3, 4.2);
- they are unreasonably impacting on repairer profitability (see Chapters 3, 4.3);

The outstanding issues concern the claim that preferred supplier arrangements are inequitable and discriminatory because they are denying some repairers access to the limited supply of available smash repair work.

6.1.1 Rationale for preferred repairer arrangements

Insurers have had preferred supplier arrangements with repairers for many years. However, it is only in more recent years there has been a genuine focus on utilising these arrangements to improve cost, quality and timeliness outcomes. This focus reflects the pressures to improve financial and service performance that accompanied the structural changes that have occurred in the insurance industry over the past decade (see Chapter 2). The Industry Commission noted in 1995 that:⁶¹

There is vigorous competition in major insurance markets ... The intensity of competition has increased following privatisation of some government insurance businesses and the breaking down of some traditional market boundaries. This has increased the pressures on insurance companies to function effectively and be responsive to users' needs. [Commission's bolding]

Whilst not all insurers have preferred supplier arrangements, many do. Through these arrangements insurers are endeavouring to build closer relationships with repairers for the benefit of consumers, insurers and repairers (eg greater supply certainty, streamlined operating

61 Industry Commission (1995), p. 54

practices). Cost savings and improved repair quality outcomes can be obtained by directing significant volumes of work into a supplier network. The repairers involved benefit from the increased certainty of supply, the ability to exploit scale opportunities and the increased structure around the business relationship. For many repairers, this greater supply certainty is preferential to relying on 'capturing' opportunities through inducements or relying on tow trucks.

Having preferred supplier arrangements with a supplier or group of suppliers is normal commercial practice throughout all industries and the arrangements insurance companies enter into with their repairer networks are no different. Governments themselves use preferred suppliers not only for smash repair work but also for all aspects of their activities (eg stationery, computer equipment, furniture, defence equipment). Typically, the associated processes involve tendering processes and a variety of performance standards.

6.1.2 Directing repairs to the network

By their very design, all preferred supplier type arrangements limit access to the available work. It is no different when it comes to preferred supplier arrangements for smash repair work under insurance claims. In order to be effective, the preferred repairers must have access to a reasonable volume of work opportunities. This provides value in the relationship and a basis for a constructive business interactions including feedback to the supplier on performance.

In the case of smash repairers, directing the limited supply of repairs to members of the network has exposed the chronic oversupply of repairers. This has placed pressure on many of those repairers that relied on 'capturing' repair work, and in some instances, a range of illegal practices (see Chapter 2).

It is not surprising that these repairers are now arguing to have the insurers' preferred repairer arrangements opened to all repairers. However, it would be astonishing if most repairers involved in preferred networks would favour this; certainly the AAMI repairers would not.

The unfortunate reality is that the mismatch between repair capacity and available repair work is so severe that it is not possible for all repairers to be part of a preferred repairer arrangement if those arrangements are to deliver the desired outcomes for all relevant stakeholders. Spreading the available work equally across all repairers would see each repairer receive around five to six repairs per week from a variety of different insurers. It is unlikely that any stakeholder would truly benefit from such an outcome.

Similarly not all repairers can belong to AAMI's network. AAMI was involved in the management of almost 200,000 repairs in 2003. If this work was shared amongst Australia's 5,000 repairers (see Chapter 2), each would receive approximately 0.75 repairs per week. No one would benefit by such an arrangement. There would be no basis for a business relationship, the increased competition would drive costs down (at a time when some repairers claim they are not being paid enough), and the ability to maintain repair quality and timeliness would disappear.

6.1.3 Obtaining or losing preferred repairers status

At a general level, insurers would be expected to target better performing repairers for preferred supplier status. While it would be expected to vary from company to company, considerations are likely to be:

- the ability of the repairer to consistently deliver high quality and timely repairs at a competitive cost;
- the appearance of the repair shop; and
- the professionalism and behaviours of the proprietor and staff.

The location of repairers relative to the insurers' customers (claims) base would also be a factor.

Targeting the better suppliers is reasonable strategy for any business. That insurers have targeted the better repairers for preferred supplier status is something that the repair sector acknowledges:⁶²

There are those who are running professional businesses, including the presentation of that business. They're the ones who are also attracting insurance company business...

What repairers have to do is make sure they get into the repairer networks. They must be seen to be using technology, have good work practices and procedures, and be seen to have good premises and be professional outfits.

In terms of conferring preferred status on additional repairers it would be expected that most insurers would consider the implications for the existing preferred repairers. In particular, they would take into account the capacity of existing repairers to meet the current and forecast workloads. If the workload was growing, or repairers were failing to meet the requirements, it might be expected that additional repairers would be offered preferred supplier status. As the ACCC noted:⁶³

Accreditation is not simply a reflection on the quality of a particular repairer; rather it is a reflection of the needs of the insurer, and can include quality standards and a necessary commercial relationship.

In broad terms, it would be expected that the loss of preferred repairer status may reflect a reduction in work volumes, failure on the part of the repairer to meet the performance criteria or a fundamental breach (eg fraud).

AAMI's Approach

AAMI's Code and Standards framework was discussed in detail in Chapter 3. The framework, which was developed in consultation with the ACCC and repairers, was introduced in 2001. Invitations were extended to repairers that had been working with AAMI, many of whom had been loyal to AAMI over the previous ten to fifteen years. Over the course of the past three to four years AAMI has focussed on maintaining the value of the relationship with these repairers by providing access to a reasonable volume of repair work.

62 Australian BodyShop News (2003), *What do you tell your repairers*, August, p. 30

63 ACCC (2003), p. 8

There are no set criteria for entry. Repairers are expected to maintain general industry standards, and abide by all existing regulations, but we do not prescribe how they equip or set up their businesses (Standards p. 12). New repairers are only added to the repairer panel when necessitated by repair volumes. Typically, these offers are extended to repairers that have previously approached AAMI. In 2001 AAMI had 559 repairers nationally and today we have 556 repairers.

AAMI sets down clear performance targets for repairers, and provides regular feedback on performance against these targets (Standards p. 8). Repairers are not told how to run their business; AAMI simply measures their outputs – their performance results. Under this framework repairers have the opportunity to consider their own particular business circumstances and source work on the basis of their ability to run an efficient shop, consistently producing quality and timely repairs and submitting competitive quotes. Within this framework, repairers have primary control over their profitability and their right to retain status as an AAMI repairer.

The performance management system is clearly specified, simple and transparent – the same as that for AAMI staff. Counselling, verbal and written warning protocols are followed before a repairer is removed (Standards p. 9). Repairers can appeal to the Code Executive Director. The Code Executive Director also reports on the application of the Standards and Code. This report is publicly available.

While AAMI has a commitment to existing repairers, and the available volume of work dictates that not all repairers can be part of AAMI's panel, we have undertaken to respond within 28 days to every application to join our panel.

6.1.4 Policy considerations

It is generally accepted preferred supplier arrangements are normal business practice, offering benefits to both consumers and the suppliers who are part of them. Like all businesses, insurance companies are equally entitled to choose the suppliers, or group of suppliers, with whom they do business. In the last inquiry, the Industry Commission considered the criticisms of preferred supplier type arrangements and found that:⁶⁴

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, consumers will also benefit (in the form of lower premiums).

The ACCC believes that:⁶⁵

... the establishment of preferred repairer schemes has introduced a number of significant benefits for consumers.

The repair sector acknowledges insurers are targeting the better, more profitable repairers for these schemes. Coupled with the chronic oversupply of repairers, this means not all repairers

⁶⁴ Industry Commission, *Vehicle & Recreational Marine Craft Repair & Insurance Industries*. Report No. 43. March 1995 p. 72.

⁶⁵ ACCC (2003), *Issues Paper*, p. 9.

can have preferred repairer status. And it is unlikely that those who are part of existing schemes would like them opened to all comers. In this respect the ACCC commented:⁶⁶

The ACCC recognises that insurers have a commercial right to limit membership of these schemes depending upon each insurers' needs and requirements.

Drawing on the preceding analysis, preferred repairers schemes are valid business practice:

- they improve the productivity and economic performance of the repair sector and insurance industries;
- they reduce or limit the need for Government regulation in areas such as repair quality;
- they encourage the development of efficient and competitive repairers and insurers;
- at a time when there is a chronic oversupply of repair capacity and structural change is underway, they provide for those repairers that are members and can meet the requirements, some certainty about their business prospects going forward; and
- they do not impinge or jeopardise the broader community's rights or interests in relation to choice or repair quality.

The ACCC recommended that:⁶⁷

- the dispute resolution mechanisms be extended and access to such mechanisms be provided to those repairers and suppliers, who have commercial dealings with the insurance company; and
- insurance companies provide to repairers clear guidelines and reasons for decisions made, particularly when a repairer is unsuccessful in being granted preferred repairer status.

AAMI has made appropriate changes to its Code and Standards framework to incorporate these recommendations (see Chapter 3).

National Criteria for preferred repairer status

The Terms of Reference require the Commission to consider the scope for a nationally agreed criteria for preferred repairer status. Insurers' approaches to repair management are very different. Their approaches reflect different business models and strategies, different policy offerings and features, and different operating models and procedures. For instance:

- some insurers only use OEM parts, some don't;
- some use times and rates manuals some don't;
- some use digital imaging and internet based quoting, some don't;
- some require the repairer to provide a lifetime guarantee, some don't;
- some allocate work using rankings (eg Gold, Silver, Bronze), some don't; and
- some have code type frameworks (eg AAMI, IAG, Allianz), some don't (Suncorp, GIO).

It is difficult to envisage how national criteria could be established. And it is more difficult to see what the benefits would be. Homogenisation of the criteria for preferred repairer status would neutralise a wide array of practices that underpin and drive competitive cost and service outcomes for insurance related smash repairs. This homogenisation would flow on to the motor insurance product (eg features and benefits) and, by definition, it would dramatically reduce the

66 ACCC (2003), *Issues Paper*, p. 9.

67 ACCC (2003), *Issues Paper*, pp. 25-26.

scope for price competition. Hence, a set of nationally agreed criteria for preferred smash repairers would have a deleterious impact on competition and would not benefit stakeholders.

Overall, there appears to be no substantive policy issues in terms of the merits and rights of insurers:

- to have preferred repairer type arrangements;
- to limit membership of these schemes according to each insurer's needs; and
- to structure their preferred repairer arrangements around their particular business strategies and operational practices.

6.2 The role of codes

The ACCC concluded that the issues between insurers and repairers relate to the relationship between small and big business. It also recommended that any future developments focus on the issues arising between insurers and repairers rather than other issues (eg consumer choice)⁶⁸. AAMI agrees with this statement.

A number of reviews have suggested that some form of code may be helpful in resolving some of the tensions between insurers and repairers. In its 1995 Inquiry the Commission recommended that a code could represent a way forward. The ACCC also examined codes and made recommendations regarding their possible role. The Small Business Council has indicated its support for the Victorian Government to review and assess the parameters under which a voluntary national code may be established.

Box 6.1: Overview of code types

Mandatory codes: Sections 51AD and 51AE of the TPA provide a legislative framework for the prescription of industry codes of conduct. Mandatory codes are binding on all industry participants and the ACCC can take action for breaches of prescribed codes. Generally the Government will only consider prescribing a code where.⁶⁹

- the code would remedy an identifiable market failure or promote a social policy objective;
- the code would be the most effective means of remedying the problem;
- the benefits associated with the code would outweigh any costs;
- there are significant and irremediable deficiencies in an existing self regulatory regime; and
- other self regulatory or quasi-regulatory options have been demonstrated to be ineffective.

Voluntary codes: These are normally developed through consultation between the relevant market players. Voluntary codes prescribed under the TPA are only binding on those parties that are signatories. Voluntary codes are enforceable on a contractual basis against signatories to the code, or by virtue of representations by signatories that they will observe the provisions of the code.

Industry codes: These are also known as business-to-business codes. They will normally deal with the relationship between the relevant players and would be expected to provide a basis for dealing with performance and general conduct issues, critical aspects of the business relationship (eg payment terms, treatment of goodwill) and disputes resolution mechanisms.

⁶⁸ ACCC (2003), *Issues Paper*, p. 25.

⁶⁹ The Treasury (1999), *Prescribed codes of conduct – Policy Guidelines on making industry codes of conduct enforceable under the Trade Practices Act 1974*, May 1999.

6.2.1 General considerations

The ACCC identified three broad code types (see Box 6.1 for further details):

- corporate codes;
- voluntary codes; and
- mandatory codes.

While a variety of codes exist (mandatory, voluntary and corporate), very little work has been done to identify how these codes should be constructed in order to ensure they do not jeopardise the broader interests of the businesses involved, consumers and the community more generally. Notwithstanding this, the following comments by the ACCC relation to the role of codes provides some insights:⁷⁰

Industry codes often address many areas of misunderstanding, uncertainty and lack of clarity in a productive manner.

Industry codes or other similar industry self-regulation mechanisms help to establish a framework for good corporate relations and promote competition and innovation in industry.

The ACCC supports any industry that attempts to develop mechanisms for industry self regulation providing these do not result in any anti-competitive conduct or detriment to consumers.

..., industry codes of conduct have potential to promote positive outcomes in terms of clarifying commercial relationships, facilitating open discourse and appropriate disclosure and/or promoting efficient dispute resolution.

The Commonwealth Office of Small Business also made some relevant comments in the context of the Franchising Code of Conduct:⁷¹

In developing the Code, a key issue for the Government was the need to balance improved business conduct with the need to maintain market certainty and competitive forces. There is an inherent risk in starting any businesses ... Why a business succeeds or fails will largely reflect its management's ability to cope with market forces, in particular their responses to competition and their ability to innovate and improve products and services.

The Code is not designed to replace normal market forces, but to assist and enhance understanding of the risks involved ... Hence, the Code focuses on providing sufficient disclosure for those entering into, changing or renewing franchise agreements to make informed decisions.

... the Code will not alter the risks, but by guaranteeing that adequate information is provided the Code ensures that the investor is better placed to identify and evaluate the risks.

Drawing on these comments, and the Commission's broader policy guidelines, the following criteria appear critical considerations regarding the efficacy of codes:

- They should not seek to promote, allow or facilitate anti-competitive conduct.
- They should not seek to replace, modify or usurp existing regulatory frameworks or stated Government policy.
- They should not seek to alter normal business risks or replace market forces.

⁷⁰ ACCC (2003), *Issues Paper*, p.18, p.19, p.19, and p.19.

⁷¹ Office of Small Business (1999), *Review of Franchising Code of Conduct*, Discussion Paper, December, p.11, p.12 and p.12.

- They should enhance an understanding of the risks involved by clarifying commercial relationships and facilitate open and/or appropriate disclosure.
- They should provide and promote efficient disputes resolution.

In broad terms, it is evident that codes should focus on improving business relationships and information flow but not seek to influence the way business is conducted to meet the needs or desires of any particular player or insulate them from competitive forces.

6.2.2 Existing corporate codes

A number of insurers have introduced corporate codes (eg AAMI, Allianz, IAG). AAMI's was motivated by a range of factors (see Chapter 3) including a desire to:

- bring greater certainty and transparency to the relationship;
- improve access to quality repairers;
- provide clear guidance on performance expectations and the processes for dealing with ongoing poor performance; and
- continue to deliver competitive and quality repairs for the benefits of customers and shareholders.

In broad terms, an advantage with corporate codes (and related frameworks) is that they can be constructed to reflect companies' operating and business practices. The other two code forms must be constructed for broad application across many businesses and suppliers.

The repair sector has claimed that insurers' corporate codes are lacking in that they⁷²:

... do not specify standards for repairers, have an inadequate dispute resolution mechanism and fail to provide guidance on customer service.

At least in the case of AAMI's framework (Standards and Code see Chapters 3 and 6.1.3), these claims are demonstrably incorrect. In relation to AAMI's approach, the Federal Minister for Small Business and Tourism (see Attachment 1.11) commented⁷³:

... it is pleasing to see that AAMI has been an industry leader in seeking to improve its relationship with its smash repairer network and has committed itself to maintaining high values and standards in its dealings with repairers. The provision of an easily accessible dispute resolution and independent appeal process through the Office of the Code Executive Director is an important step in helping address the mistrust that exists between insurers and repairers generally.

AAMI would also note that during its discussions with State based MTA's and repairers these issues have not been raised. The peak body, the MTAA, has not yet taken up AAMI's offer to discuss our Code and Standards framework. Additionally, AAMI would note that the Victorian Small Business Commissioner has advised that he has received no complaints in relation to AAMI's Standards and Code framework nor has AAMI received any complaints from State Fair Trading or Small Business Departments. In these circumstances, it is significant to note the AAMI Standards and Code meet the efficacy criteria set out in 6.2.1.

⁷² ACCC (2003), Issues Paper, p. 21.

⁷³ Federal Minister for Small Business and Tourism (2004), *AAMI Repairer Code of Conduct*, Written Correspondence, 22 April.

6.2.3 Proposed voluntary or mandatory codes

The VACC, on behalf of the repair sector, has promoted its own Code of Conduct, known as the Automotive Body Repair Industry Code. The Code seeks to guide dealings between insurers and repairers (see Appendix 1.12). It has been proposed that the Code form the basis of a voluntary or indeed a mandatory code under the TPA. In support of a mandatory code under the TPA, the repair sector has (and will) argue that the insurance industry, in direct contradiction to findings from numerous reviews, has refused to engage in discussions to find ways to resolve tensions between insurers and some repairers. This statement is simply not true.

Before considering the case for a mandatory code, and merits of the repair sector's proposed Code, it is critical to set the record straight regarding the insurance industry's engagements with the repair sector in relation to the Code.

The Automotive Body Repair Industry Code was first advanced three to four years ago. The insurance industry (via the ICA) made a submission to the Victorian Government in February 2001 in response to the proposed Code (see Attachment 1.14). Numerous concerns were raised, in particular those aspects of the Code that sought to distort or preclude genuine competition by:

- frustrating insurer's efforts to be involved in the repair process; and
- entrenching the 'right' of a repairer to repair a car regardless of the terms of the policyholder's insurance contract.

To AAMI's knowledge there was no response from either the Victorian Government or the VACC in relation to the concerns raised.

Although the industry has raised these issues from the outset, each of the three versions of the Code that have been circulated contain provisions that provide for these outcomes. It has in fact been the repair sectors refusal to modify their position on these matters that has made discussions with the repair sector on insurer-repairer relationships problematic. These are similar to the issues AAMI confronted in the mid 1990s when it endeavoured to establish a code with the Body Repair Division of the VACC. Undoubtedly the greatest impediment in the process has been the repair sector's disingenuous refusal to concede the true motivation underpinning these anti-competitive demands.

The case for a mandated code

Reference to the Government's criteria indicates there is no case for a mandatory code:

- *Market failure:* There is no demonstrable market failure as it relates to the issues raised by the repair sector. There is no evidence of systemic or endemic market failure in relation to customer choice, repair quality, repairer returns and preferred repairer schemes.
- *Social policy:* There is no stated social policy objective in relation to smash repairers.
- *Regulatory failure:* There is no evidence of significant irremediable deficiencies in an existing self-regulatory or quasi-regulatory regime. The evidence demonstrates that consumers are well served by the current market and regulatory regimes, whether it is in relation to information disclosure concerning choice, ability of consumers to exercise choice, repair quality outcomes or access to disputes resolution. The evidence also indicates that many repairers are achieving satisfactory returns in an oversupplied market.

And AAMI has received no feedback that its framework for guiding the relationship with repairers is failing.

6.2.4 The Automotive Body Repair Industry code

In February 2001, the ICA provided a detailed response to the Code. Amongst other things the ICA advised the Victorian Government that:⁷⁴

ICA does not believe any attempt should be made to regulate or limit market forces that will rationalise the motor repair industry.

ICA believes the draft Code is designed to protect the automotive body repair industry with little consideration of customers' interests. Many provisions are less than precisely defined. This would result in differing interpretations and lead to disputes. Overall, the draft Code is a severely flawed document.

ICA believes many of the provisions of the draft Code are anti-competitive and interfere directly in normal commercial arrangements. Arrangements between individual insurers and their service providers, including the automotive body repair industry, are commercial dealings which are already subject to Trade Practices Act, the Insurance Contracts Act and ACCC oversight.

AAMI also has multiple concerns about the proposed Code. While it is beyond the scope of this submission to detail these concerns it is worth making a number of comments.

The Code goes well beyond trying to bring clarity and structure to the relationship between the insurer and the repairer. The underlying purpose of the Code is spelt out in the preamble:⁷⁵

This Code of Conduct has been created to promote competition through the provision of policyholder choice of repairer in the performance of repairs to motor vehicles. In order to encourage true competition in the motor vehicle repair industry, the State Government and insurers must acknowledge that the right to choose must be available to policyholders seeking the service of providers in the motor repair industry.

The choice and competition referred to here is based on securing repair work through inducements, tow trucks and exploiting the moral hazard risk faced by consumers. It is difficult to see how this form of competition has been of benefit to the insuring public or the community more generally. Consistent with this stated intent, the proposed Code contains various processes and provisions claiming to advance choice and competition but in reality designed to frustrate the insurer's execution of contractual policy provisions (eg 5.5(m), 8(b), 8(c), Annexure 2). As discussed, consumers of motor insurance have ample opportunities to exercise choice should they value or require choice of repairer.

The Code also seeks to dictate to insurers what they must include in their policies, communicate to their customers and the way in which they engage with a customer in relation to a repair (eg 5.5(n), 8(a)-(d) and Annexure 1 and 2). Insurers must obey relevant laws and regulations and are regulated by APRA, ASIC, ACCC, FSRA and the Privacy Commissioner as well as a variety of State based legislation. Provided they are operating within these regulations individual insurers are entitled, and should be encouraged, to develop their own competitive strategies. The way in which they interact with a customer should not be dictated by a repairer-insurer code.

74 ICA (2001), *Submission to The Office of Regulation Reform, Department of State and Regional Development in response to the Draft Provision s of the VACC Automotive Body Repair Industry (Fair Dealing) Code of Conduct*, February, p. 1.

75 VACC (2002), *Automotive Body Repair Industry (Fair Dealing) Code of Conduct*, July, Version 3.0, p. 3.

The Code proposes a Dispute Resolution Process (Clauses 11, 12 & 13). The proposed approach would inevitably lead to long delays in the commencement of repairs and great inconvenience to a motorist caught up in the middle of a dispute over ‘ownership’ of the repair.

Overall, the VACC’s Code and related provisions, seek a return to an environment where repairers compete against each other to ‘capture’ the damaged vehicle and, once in possession of that car, having an almost guaranteed right to repair it. It goes well beyond attempting to improve business relationships and seeks to change the way insurers conduct their business for the benefit of certain repairers. It ignores the ACCC’s suggestion that future developments should focus on the relationship between insurer and repairer issues and not consumer issues. It clearly breaches the criteria noted on Section 6.2.1 and, consequently, provides no basis for either a mandatory or a voluntary Code.

6.2.5 Policy considerations

That there is tension between insurers and repairers is unquestionable. Of course there is tension in all business relationships. However, the repair sector is also facing serious structural change pressures. In this environment, it is clearly incumbent upon insurers to ensure dealings with repairers are transparent, consistent and conscionable. Whilst AAMI has gone to great lengths to ensure that its behaviours are appropriate, it cannot comment on the behaviours of others. If there is evidence of inappropriate practices by an insurer(s), it is not appropriate to respond with policy reforms that punish all insurers and, worse, distort the market.

The case for a mandatory Code has not been established. There is no demonstrable market or regulatory failure. The existing mechanisms are delivering benefits to consumers and efficient repairers. That said, neither a mandatory Code nor a voluntary code can solve the structural change pressures faced by the industry; unless there is a preparedness to insulate the sector from these pressures. Such a course of action would come at a cost to consumers, efficient repairers and the community more generally. And history has shown that it would be an invitation to a myriad of undesirable practices.

The prospect for reducing the tensions with the repair sector, be it through a voluntary code or corporate codes, is limited if the sector continues to argue for undertakings from insurers that repairers should be entitled to open access to repair work and repair any car they are able to ‘capture’. Most insurers will not provide such undertakings and will certainly argue strongly against any reforms facilitating such outcomes. These outcomes would be to the detriment of consumers, efficient repairers and the community more generally.

Insurers’ approaches to these matters vary substantially. Consequently, any attempt to incorporate such provisions in a voluntary code would be fraught with problems. By necessity, a single voluntary code would need to be high level and deal with generalities. It could not drill down to the detail required to allow repairers to deal with their specific issues with specific insurers. Indeed, AAMI would contend that many repairers would acknowledge that their concerns in relation to these matters are only associated with particular insurers. This would suggest these matters are best dealt with in corporate codes (and related frameworks). To this end, the recent reforms to the TPA regarding collective bargaining for small business provide an avenue for repairers to elevate these issues.

Were the repair sector prepared to accept an insurer’s right to play a role in the repair process and direct repairs, it may be possible to make some progress. Indeed, AAMI believes its Code and Standards have shown the way. That said, it is difficult to conceive how the balance of the

issues raised by the repair sector can be dealt with in a voluntary code. These matters include things such as parts requirements (eg OEM or other), payment terms, goodwill provisions, arrangements for dealings with non preferred suppliers, disputes resolution approaches, repairer versus insurer liability under lifetime guarantees and so on.

Appendix A1: Motor Vehicle Registration and Road Safety Provisions

This appendix summarises motor vehicle registration procedures by jurisdiction in order to show existing mechanisms to assess vehicle roadworthiness.

New South Wales

In NSW motor vehicle registration must be renewed annually. Unless the vehicle is exempt it must pass inspection for roadworthiness at an authorised inspection facility prior to licence renewal.

If the car is unregistered the owner needs an Inspection Report (blue slip) from an Authorised Unregistered Vehicle Inspection Station, or an Inspection Report (pink slip) from an Authorised Inspection Station (AIS) in order register a vehicle. If the vehicle has previously been written-off evidence of repairs undertaken is required.

To renew an existing registration on a light vehicle (unless exempt) will require an inspection. The RTA advises that passenger vehicles under 2 tonne and less than 4 years old are exempt. All other cars are required to get their vehicles inspected and receive a pink slip to prove compliance with roadworthiness standards. If cars fail to receive a pink slip they receive a white slip (rejection slip) that shows the repairs a vehicle requires. After repairs are carried out a pink slip will be issued.

Pink Slip safety check points:

- Brakes
- Lights
- Suspension and steering
- Tyres
- Engine
- Oil
- Rust

NSW registration regulation provides an annual vehicle safety and roadworthiness check.

Victoria

In Victoria annual renewal of registration is not linked with a vehicle inspection. In Victoria a Certificate of Roadworthiness is generally required when a vehicle is sold or if a used vehicle is to be re-registered. In some cases a Certificate of Roadworthiness is also required to clear a Vehicle Defect Notice or a Notice of Unroadworthiness. The Roadworthiness scheme “operates to minimise the number of unsafe vehicles on the road” and the role of the licensed tester is to “make sure that the vehicle meets the standards specified to ensure that the vehicle is safe”⁷⁶

Safety-related components inspected during the roadworthiness inspection:

- Wheels and tyres
- Steering, suspension and braking systems

76 VicRoads web site – Roadworthiness Requirements

- Seats and seatbelts
- Lamps and reflectors
- Windscreen, and windows including front windscreen wipers and washers
- The structure of the vehicle itself
- Other safety-related items on the body, chassis or engine

VicRoads report that it is the responsibility of the car owner to ensure safety of the car is maintained. Additionally, the Victoria police are able to issue defect notices if they believe cars are unroadworthy.

Queensland

In Queensland, drivers only need to have a roadworthy test on their cars when they intend to sell them. A Safety Certificate must be obtained from an approved inspection station and displayed on a registered vehicle in order to sell it. A Safety Certificate covers basic safety functions such as, tyres, brakes, steering, suspension, body rust or damage, windscreen and lights.

The Queensland Department of Transport Website provides the following rationale for Safety Certificates, “It is designed to offer buyers better protection - buyers can be sure the vehicle is safe to drive having undergone a basic safety inspection before being offered for sale. This means there will be fewer unsafe vehicles on Queensland roads which will reduce the likelihood of crashes from defective vehicles”.

If a vehicle is declared a repairable write-off, you must obtain a Written-off Vehicle Inspection Certificate to clear it for registration. Once the vehicle has been cleared of written-off status, you can register the vehicle as normal.

South Australia

Transport SA is the Department responsible for registration of motor vehicles in South Australia. Certification of road worthiness is not required in South Australia. Vehicle inspections are only required for used vehicles not previously registered, used vehicles registered in another state, all new vehicles, all wrecked or written-off vehicles, all imported vehicles, vehicles with structural modifications or defective vehicles.

South Australian police can fine a driver if a vehicle is considered unroadworthy. Generally, the responsibility for vehicle safety sits with the car owner.

Western Australia

The West Australian Department for Planning and Infrastructure manages Motor Vehicle registration in Western Australia. As in South Australia there are no road safety inspection requirements for renewal of vehicles unless they have received a notice from the Police.

Tasmania

In Tasmania motor vehicles only require inspection when:

- the registration has expired for more than 3 months;
- new vehicles that are not registered through the dealer registration scheme or do not have a type approval number;
- vehicles previously registered interstate/overseas; and
- vehicles have received a defect notice from Police.

Responsibility for maintaining a motor vehicle in a roadworthy manner is up to the vehicle owner.

Northern Territory

In the Northern Territory owners of vehicles under 4.5 tonne and 10 years of age are required to have their cars inspected every two years. Annual inspections apply to light vehicles more than 10 years old. Exemptions apply to vehicles less than 3 years old.

In the Northern Territory, a motor vehicle owner is shown a current inspection report issued and signed by an Authorised Inspector, Motor Vehicle Registry Transport Inspector or Police Officer prior to registrations renewal. Registration renewal is required every 6 or 12 months.

The Department of Infrastructure, Planning and Environment is responsible for the administration of the Motor Vehicle Registry.

Australian Capital Territory

In the Australian Capital Territory a roadworthy certificate is required with an application for transfer of motor vehicle registration for a vehicle more than 6 years of age. The certificate can be supplied by the seller or organised by the purchaser, however, it must be valid when the application for transfer of ownership is lodged with the motor vehicle registry.

Only public vehicles (taxis, hire cars and buses) and vehicles weighing more than 4.5 tonnes are required to be inspected at the time of registration renewal.

The Department of Urban Services manages motor vehicle registration in Canberra.

Appendix A2: Factors Involved in Fatal Accidents

This appendix contains findings from a review of Commonwealth, State and Territory crash fatality records to better understand the impact, if any, of poorly repaired vehicles on road accidents.

The following departments were approached:

- Australian Transport Safety Bureau (Department of Transport and Regional Services)
- VicRoads
- RTA (New South Wales)
- Department Planning and Infrastructure (Western Australia)
- Department of Transport (Queensland)
- Transport South Australia
- Urban Services (Australian Capital Territory)
- Dept Infrastructure, Planning and Environment (Northern Territory)
- Dept of Infrastructure, Energy and Resources (Tasmania)

Repair quality is not identified as a separate category in the fatality records maintained by these departments and is captured within the broader category of ‘vehicle malfunction’ or ‘equipment failure’.

National

The Australian Transport Safety Bureau provides road fatality information through the *Fatal Road Crash Database*, and the *ATSB Road Fatalities Australia Monthly Bulletin* found on its Website www.atsb.gov.au. The ATSB database can only be sorted via age, gender, speed limit, crash type (multi or single vehicle), bus, truck, road user, year, date and hour of day. These search fields indicate the principle contributing factors to road fatalities.

Approaches to the ATSB indicate that until 1999 they recorded data showing vehicle malfunction as a cause of fatal accidents. The overall result was that "Critical vehicle malfunction or other vehicle factor" was a major causal factor in about 3.5 per cent of fatal crashes.

Continued collection of vehicle malfunction data by ATSB is under review given cost of collection and the relatively low fatal crash rates caused by vehicle defects.

New South Wales

The NSW RTA reports on-line the number of fatal accidents in NSW in the monthly bulletin “Preliminary Traffic Accident Data”. Overall trend data is broken down according to road-user class, sex of fatality, age of fatality, and region. Further analysis is undertaken according to “factors involved in fatal accidents”, which shows speeding, fatigue and alcohol involvement as principle factors. Fatalities are also analysed according to usage of safety devices.

Inquiries with the RTA showed there is a very small number of fatalities that are attributed to ‘equipment failure’. For the calendar year 2003, unofficial data indicates; 1 fatality due to brake failure; 4 attributed to tyre failure; 1 towing and 2 for unsecure load. Applying the

preceding incidences to August 2004 the total number of fatal accidents reveals that 0.8 per cent of accidents could be attributed to vehicle malfunction.

Victoria

Enquiries made with VicRoads and the Victoria Police indicate that car equipment failure is not recorded along with other information on car crashes. The VicRoads CrashStats database uses search criteria such as road conditions, traffic control, light conditions, object hit, atmospheric conditions, speed limit, type of vehicle, age and sex of road user, date and time, location and the use of restraints.

Queensland

Queensland Transport's department of road safety compiles road traffic data for public release. The most current information is reported in the "2002 Annual Road Traffic Crash Report", Chapter 5 of the report, 'Factors Contributing to Crashes' indicates that 'Vehicle Defects' contributed to 2 per cent of all fatal crashes and 3 per cent of all reported crashes. The top factor reported for fatal accidents was disobeying traffic rules (34 per cent), alcohol/drugs (29 per cent), inattention (25 per cent), speed (19 per cent) then fatigue (15 per cent).

Interestingly, looking at annual trends in contributing circumstances in fatal accidents from 1993 to 2002, shows that the vehicle defects has reduced from 21 deaths in 1993 to 5 in 2003.

Western Australia

The West Australian Office of Road Safety produces annual crash data, the most recent report, "Reported Road Crashes in Western Australia 2001" doesn't recognise vehicle malfunction in the key causal factors for road crashes. Staff advise that vehicle malfunction has a "negligible" impact on crashes and estimate contribution to be approximately 2 per cent.

The Insurance Commission of West Australia (reporting to the Department of Government Enterprises) states on-line that the principle causes for fatal crashes are speeding (36 per cent), alcohol (33 per cent) and fatigue (13 per cent).

South Australia

Transport SA manages reports on crash statistics for South Australia, the most current annual statistics are found in the report "road crashes 2002 in South Australia". This report lists key factors involved in accidents as, alcohol involvement, apparent error, speed, age and sex as leading causes. Under the category 'apparent error' the report indicates, "97 per cent of SA road crashes were the result of road user behaviour, 1 per cent were the result of vehicle faults and 0.5 per cent were the result of sickness or drivers falling asleep"⁷⁷

The report shows that driving under the influence (29 per cent) is the principle cause of fatal accidents followed by speed (22 per cent) and then inattention (19 per cent). Further inattention is the principle cause for casualty crashes (44 per cent).

77 Road crashes 2002 in South Australia, Transport SA, p8.

Northern Territory

The Department of Infrastructure, Planning and Environment manage information on road fatalities in the Northern Territory. The Road Safety Office advise that they do not record vehicle malfunction when compiling data on cause of fatal accidents.

Australian Capital Territory

The Department of Urban Services compiles annual crash statistics for the ACT. The department report that data showing crashes caused by vehicle fault or malfunction is not recorded.

Tasmania

In Tasmania the Department of Infrastructure, Energy and Resources manage road safety matters. Crash statistics are reported quarterly in 'INDICATOR' is a quarterly newsletter. For the first quarter of 2004, at least 64.7 per cent of fatalities and 43.5 per cent of injuries were associated with high-speed non-residential zones. Limited information is available on the causal factors for crash incidents.

Summary of Findings

A review of all Australian State and Territory governments shows that fatal crashes caused by 'vehicle malfunction' or 'equipment failure' are minimal. Further, it is not possible to conclude that vehicle malfunction is the result of faulty repairs.

In the States where vehicle malfunction is recorded percentages shown are between 1-2 per cent [NSW (0.8 per cent), QLD (2 per cent) and SA (1 per cent)]. The Australian Transport and Safety Bureau (ATSB) indicate that critical malfunction was a major causal factor in about 3.5 per cent of fatal crashes.