Productivity Commission

Inquiry into the relationship between the Australian motor vehicle smash repair industry and the motor vehicle insurance industry

Submission by
Allianz Australia Insurance Ltd

Contents

Executive Summary

The motor vehicle repair industry is subject to ongoing rationalisation. This is not a result, as has been claimed, of features of the competitive market dynamic between insurers and repairers such as labour rates or preferred repairer networks. Rationalisation is being driven by more fundamental and longer-term trends that are causing significant reductions in the number of motor vehicle accidents and hence the demand for repair services, resulting in an over-supply of repairers. The factors driving this fall in demand include:

- the drought, because with less wet weather comes less car accidents, although hopefully the drought is a temporary factor;
- vehicle technology (eg ABS brakes, integrated steering and braking systems);
- lower urban speed limits (ie the advent of 50 and even 40 km/h urban speed limits);
- stronger enforcement of road rules (eg speed and red light cameras, double-demerit points in holiday times and random breath testing); and
- traffic calming devises (eg, roundabouts, speed humps).

These changes are not unique to Australia. With the exception of the current drought, these factors are causing similar decreases in motor vehicle accidents in many other, particularly developed, countries.

The repair industry itself is also subject to technological changes both in terms of equipment and process management that are increasing the potential for scale economies. This is contributing to the oversupply of repair capacity as well as increasing the gulf between the more efficient and less efficient repair shops.

Allianz is of the view that the regulation, either through an industry code or black letter law, of things like labour rates or choice of repairer, would be unnecessary and counterproductive and have no impact on the financial pressure being felt by less efficient repairers nor on the continuing rationalisation of the repair industry. The most appropriate government response, if any, to repair industry rationalisation would be the same as that for other industries facing rationalisation (eg, sugar and dairy). That is, some form of structural adjustment scheme that assists repairers to either become more efficient or exit the industry. Although assisting poor performing repairers to become more efficient rather than exit would likely only exacerbate the oversupply situation. On balance, rationalisation is probably best left to market forces.

Preferred repairer schemes are primarily used by insurers to provide higher levels of customer service to policyholders and/or to exert greater control over the repair process, in particular, the pricing of repair work. The latter reason flows from the ongoing difficulty insurers have in preventing or minimising the dishonest and fraudulent practices of some repairers. Access to repair networks is based on a combination of objective criteria, related to skills and equipment and the ability to

carry out a good quality repair, as well as a number of more subjective and insurer-specific criteria such as:

- a repairer's track record with an insurer;
- the existing level of trust and cooperation in the relationship between the parties; and
- the geographical location of potential network repairers, which is driven by the location of existing network repairers and the demand for repair work in particular areas.

Nationally agreed criteria for access to insurer networks would be unworkable. They could be objective only and would create an expectation among repairers that if they met the criteria they should be able to become a member of an insurer's network. This ignores the subjective and insurer-specific criteria insurers also need to use to select network repairers. This approach would also be inconsistent with the approach some insurers adopt to issues such as policyholder choice of repairer, for example, Allianz Australia's choice of repairer policy.

While Allianz does not guarantee our network repairers a minimum amount of work, there is a legitimate expectation that membership of a network will deliver an increased volume of work to repairers. Because Allianz offers full and unrestricted customer choice of repairer, the amount of work we can deliver to our network repairers is driven by the choices of our policyholders. Thus, Allianz needs to align the number and location of its network repairers with the preferences of our policyholders. At present, the amount of work Allianz policyholders choose to put into our network is satisfied by our existing network of 157 repairers nationally and, for example, 34 in Sydney.

However, there are probably more than 1000 repairers in Sydney that could meet Allianz' minimum objective criteria for network membership in terms of skills, equipment and quality of repair work. Indeed, in Allianz' experience, most repairers are able to carry out good quality repair work. However, our current network is capable of handling the amount of repair work our policyholders choose to deliver to it. The only way Allianz could support a larger network would be to deliver more volume to it, and this could only be done by somehow restricting our policyholders' choice of repairer. Allianz highly values our policy of repairer choice as a part of our overall product offering and would not be prepared do anything that undermines this.

Allianz Australia's policy of choice of repairer is also linked to the way we price repair work. Allianz has done away with competitive quoting in part because of its potential to conflict with our choice of repairer policy. For example, if an Allianz network repairer or another repairer provided a cheaper quote than our policyholder's preferred repairer, we would not be able to uphold our promise of repairer choice. Instead, we have developed the Allianz Managed Repair Process (MRP). Under the MRP, Allianz assessors and repairers work in a cooperative way to determine the best way to repair a damaged vehicle and the price of the repair in order to provide a fair level of remuneration for the repairer and a high quality, competitively-priced repair. The MRP also reduces conflict between Allianz and repairers as well as the incentive

for repairers take ‘short cuts’, which some have argued is a feature of other approaches to the pricing of repairs.

It has been argued that repairers face significant financial pressure and that the industry is unsustainable as a result of low hourly rates paid by insurers, which for general repair work are up to around $30 per hour. However, a focus on hourly rates in isolation is misleading and disingenuous. All industry participants are aware that, like many other countries, repair work is priced on the basis of the so-called ‘funny time, funny money’ system, under which low hourly rates are offset by overly-generous allowable times. Thus, for ‘repair’ work (ie traditional panel beating and related repair methodologies), insurers allow repairers times that are at least three times (and often much higher multiples) the ‘actual’ time taken to undertake particular repairs. This approach is used because of the great difficulty in determining in advance how long it will take to repair vehicle damage.

The alternative to ‘repairing’ a damaged part or panel is to replace it with a new or recycled one. However, in circumstances where a part is repairable, replacement is generally much more costly. The times allowed for replacing parts (also referred to as ‘remove and replace’ (R&R)) are much closer to, although still generally longer than, ‘actual’ times, and certainly much less generous than ‘repair’ times. However, the labour rates paid for both types of work are generally about the same. The resulting greater generosity in the times allowed for repair work compared to R&R work has a strong positive impact on repairers’ behavior, in particular, their incentive to repair rather than replace parts. Because repairing parts, when this is possible, is always less costly than replacing them (because if it wasn’t insurers would prefer replacement instead), the overall cost of rectifying vehicle damage is reduced and this flows through to consumers in the form of lower insurance premiums.

It has been argued by some that the ‘funny money, funny time’ approach should be replaced with a ‘real time, real money’ approach. For example, hourly rates could be doubled and allowed times halved with no net impact on the bottom line cost to insurers. If this were true, however, there would also be no net impact on the bottom line remuneration for repairers. Thus, if one accepts the view that current levels of remuneration are insufficient, moving to ‘real money, real time’ would do nothing to address that issue. This suggestion also ignores the fact that it is not possible to accurately determine in advance the real time it will take to repair a damaged part. Which means, while it might be possible to move to ‘real money’, there is unlikely to be a fully offsetting reduction in allowable hours to the corresponding ‘real time’. The result would therefore be higher average repair costs, which would flow through to higher insurance premiums.

A move to ‘real time, real money’ would also remove the current incentive to repair rather than replace parts because the relative greater generosity in times allowed for the former would be removed. With this incentive removed, repairers would be more likely to argue for parts to be replaced rather than repaired. However, part replacement is generally more expensive because of the additional cost of the parts themselves plus the fact that replacement generally requires more painting than for repairs.

Any increase in average repair costs would also push more vehicles over the threshold point where it becomes more commercial to write them off. In Australia, Allianz writes-off about 8 percent of vehicles. Our sister company in Germany, where 'real time, real money' operates, writes-off around 25 percent of vehicles. This is directly put down to the greater use of part replacement rather than repair as a result of the 'real time, real money' system. For an industry already in a state of capacity oversupply, a reduction of nearly 20 percent of repairable vehicles if such an outcome translated to Australia as a result of a move to 'real time, real money', would significantly accelerate industry rationalisation and exacerbate the financial pressure on less efficient repairers.

On the issue of late payments, Allianz rejects suggestions that there is a systematic problem with late payments to repairers. Internal audits by Allianz indicate that 84 percent of repair invoices are paid within 15 days and 94 percent within 30 days. Payments that exceed this period are the result of incorrect invoices provided by repairers and the delays subsequently incurred in correcting them.

Some have argued that an industry-wide code of conduct is required to address issues between insurers and repairers. This issue was considered by the Australian Competition and Consumer Commission (ACCC), which conducted a number of roundtable discussions between insurers and repairers culminating in the September 2003 report, *Discussion on the relationship between the Australian motor body/smash repair industry and the general insurance sector*. The ACCC report encouraged insurers to develop corporate codes with repairers or, where they already exist, to extend them to non-network repairers to ensure that comprehensive dispute resolution mechanisms are available to address repair industry issues. Allianz responded positively to the ACCC report and developed a code to govern our relationship with non-network repairers – the *Allianz Claims Promise – Customer Choice of Repairer*. The code covers a range of issues that were raised by repairers including choice of repairer, vehicle assessment, parts, repairer guarantees, payment terms and dispute resolution.

Allianz is of the view that corporate codes would be much more effective than an industry-wide code in addressing repairers' concerns. Insurers operate significantly different business models in relation to vehicle repairs, particularly in respect of key issues such as preferred networks, choice of repairer and the pricing/quoting of repair work. These different approaches give rise to different issues with repairers. Many of these issues are unique to the insurer involved and would not lend themselves to resolution through a one-size-fits-all, industry-wide code. To cope with the markedly different approaches by insurers to their dealings with repairers, an industry-wide code would need to be pitched at a high level of generality and principle. Such a code would be unable to respond to the specific concerns repairers might have with a particular insurer. A corporate code, on the other hand, can be tailored to address in detail the specific concerns that arise with an individual insurer's approach. Allianz recommends that the Commission support a comprehensive, self-regulatory corporate code regime as the best way to address any issues repairers may have with insurers.

1 Introduction - Allianz Australia Corporate Profile

Allianz Australia is a wholly owned subsidiary of the worldwide Allianz Group (Allianz AG), offering Australians the resources and expertise of the world's largest financial services company and the twelfth largest corporation.

1.1 The Allianz Group – the global perspective

Founded in Germany in 1890, the Allianz Group has extensive expertise in insurance and financial services. The Group is one of the world's leading financial services providers, offering insurance, banking and asset management products and services. The Group has around 700 subsidiaries, operates in over 70 countries and serves more than 60 million customers worldwide. Allianz AG's products and services are delivered by its more than 170,000 staff.

The Group's three core businesses are:

- Protection (property and casualty insurance);
- Provision (life and health insurance); and
- Performance (asset management and banking).

As one of the largest providers of international corporate insurance, Allianz insures almost half the Fortune 500 companies.

In 2003, global gross written premium for insurance was $147 billion, making the Allianz Group the largest insurer in the world based on premium income. By way of comparison, the whole Australian general insurance market was around $20 billion in 2003. With assets under management of $1.6 trillion, the Allianz Group is also among the largest investors in the world.

1.2 Allianz Australia – the local perspective

As one of the largest general insurers in Australia, Allianz Australia's 2,900 employees provide insurance to over 2 million customers. Operating in Australia and New Zealand, Allianz Australia achieved a gross written premium of $2.2 billion and had funds under management of more than $4 billion in 2003.

Allianz provides insurance for approximately 65 per cent of Australia's Top 50 companies. Backed by the additional capacity and capability of its global parent, Allianz Australia is able to write large and complex insurance risks.

Allianz Australia offers a comprehensive range of general insurance products tailored to suit the individual needs of a diverse range of customers. Our insurance products include:

- personal home and motor;
- commercial property and motor (including fleet and heavy vehicle);

- workers compensation;
- compulsory third party;
- business interruption, small business and farming;
- construction, engineering, machinery;
- public and product liability;
- professional indemnity; and
- marine.

To complement our substantial range of general insurance products, Allianz Australia also offers the services of a number of specialist businesses, providing expertise in pleasure-craft insurance, premium funding and, rehabilitation and return to work, through our subsidiaries Club Marine, Hunter Premium Funding and Recovre, respectively.

2 Rationalisation of the vehicle repair industry

Rationalisation of the repair industry, like that of many other industries, has been ongoing for many decades. However, market changes have accelerated this process in recent years. It has been argued for some time that Australia has an oversupply of repairers. Even if that is not true of the past, it is true now because a marked reduction in the number of accidents has led to a reduction in demand for repair work. This has caused a current over-supply of repairers. For example, at Allianz, the number of motor vehicle claims fell by 6000 in 2003 over the previous year and claims in the first six months of 2004 are down a further 2000 on 2003. Allianz has about 7 percent of the vehicle insurance market, so if our experience is representative of other insurers, this decline translates to a reduction of vehicle accidents of over 80,000 in 2003, with further declines in 2004. This represents a significant reduction in the amount of work available to repairers, which is having a significant impact on the profitability of some repairers.

A number of factors have contributed to this trend including:

- the drought, because with less wet weather comes less car accidents, although hopefully the drought is a temporary factor;
- vehicle technology (eg ABS brakes, integrated steering and braking systems);
- lower urban speed limits (ie the advent of 50 and even 40 km/h urban speed limits);
- stronger enforcement of road rules (eg speed and red light cameras, double-demerit points in holiday times and random breath testing); and
- traffic calming devises (eg, roundabouts, speed humps).

Thus, even if industry rationalisation has resulted in a decline in the number of repairers, any such decline would appear to have been outstripped by the reduction in the number of repairable vehicles. This growing demand-supply imbalance is exerting additional pressure on the less efficient elements of the repair industry. At the same time, the greater use of repair networks by insurers is channeling this falling number of repairs into a particular sub-set of the repair industry, that is, those that belong to one or more insurer networks. Assuming that repairers involved in insurer networks are more efficient on average than those that are not (which is reasonable because efficiency (measured by average repair costs) is generally highly regarded by insurers in selecting repairers for their networks), the advent of repair networks is placing even more pressure on less efficient repairers.

There is also a number of other factors driving repair industry rationalisation. One is technological changes that result in higher minimum levels of investment needed to run a repair business which, along with other changes, increases the potential for scale economies and hence reduces the number of repairers needed to supply an efficient level of repair capacity. Another change that is increasing the gulf between more

efficient and less efficient repairers is advances in repair shop management processes, which are being adopted by some repairers (eg, incentive-based remuneration for tradespersons and organisational processes that increase the vehicle throughput of repair shops). Process improvements by insurers (eg, reductions in the time to finalise quotes before repairs can commence) are also impacting on throughput and scale efficiencies and hence the number of repairers needed to service the available demand.

Unfortunately, there seems to be an inadequate acknowledgement by some repairers and their representatives of the real causes of rationalisation and a misguided focus on particular features of the current market environment (eg, hourly rates or preferred networks) as the reason some repairers are finding it difficult to compete. However, Allianz is of the view that industry rationalisation is being driven by more fundamental, long-term trends, in particular, the falling demand for repairs and the increasing scale and competitiveness of the more efficient repairers. As a result, rationalisation will not be reversed by regulatory measures (including codes) that aim to make changes to the competitive market dynamic that currently exists between insurers, repairers and consumers. Such regulatory measures would likely be:

- irrelevant from the perspective of achieving a sustainable repair industry (eg, a rise in hourly rates that would apply to all repairers but leave the relative efficiency and competitiveness of repairers unchanged); and/or

- unrelated to the real causes of industry rationalisation and therefore have little impact on it.

If governments take the view that some repairers need support, this should be provided directly through some form of structural adjustment package to assist repairers to improve their efficiency and hence profitability or exit the industry. This would be far preferable to unnecessary and potentially damaging regulation that would have little effect on the extent of industry rationalisation but which would in all likelihood result in higher repair costs and hence higher insurance premiums. Any changes that increased repair costs would also result in a higher proportion of vehicles being written-off, which would further reduce the amount of work available to the repair industry and further exacerbate the rationalisation that is currently being driven by market forces and technological changes.

3 Preferred repairer schemes

3.1 The use of repair networks by insurers

In considering the issues surrounding preferred repairer schemes, it is important to consider the reasons why they have emerged. Insurers have to deal with a repair industry that has long-standing and ongoing problems with fraudulent and dishonest practices. In part, some insurers have developed repairer networks as a way of exerting more control over the repair process with the objective of minimising the opportunity and incentive for repairers to engage in dishonest practices. Dishonest practices by repairers are endemic and include:

- replacing undamaged parts with damaged parts prior to vehicle assessment, with the result that the repairer can charge the insurer for new parts while 'repairing' the vehicle using its original undamaged parts;
- quoting for new parts but using cheaper recycled or non-genuine parts instead;
- quoting to replace parts but carrying out cheaper repairs instead; and
- inflicting additional damage on vehicles in order to create more repair work.

An example of motor vehicle insurance fraud is shown in Figure 3.1. In this case, the damage to the sedan on the bottom, which is insured by Allianz, was supposed to have been caused by the vehicle on the top (which is insured by another company) as a result of a rear-end collision. However, it is clear given the damage to the white vehicle, it is not possible that it could have inflicted that level of damage on the sedan. This attempted fraud was identified through cooperation between Allianz and the other insurer and is still under investigation. The development of 'third party recovery agents' and their collusion with some repairers with the aim of increasing repair costs is the latest development insurers have to contend with.

Allianz Australia supports the use by insurers of repair networks as a way of achieving competitive repair costs, maximising the quality of repair work and improving the level of service provided by repairers to policyholders. While Allianz operates a policy of customer choice of repairer, we have developed the Allianz Network of Repairers so that we can offer our policyholders assistance in finding a repairer. Through our Service Level Agreements with network repairers, Allianz is able to ensure that our policyholders receive a high quality of personal service and efficiency in their interactions with a repairer in addition to a quality repair of their vehicle.

Figure 3.1: Same collision, different amount of damage: true or fraud?

The Commission's Issues Paper sought views on the potential for nationally agreed criteria for preferred repairer schemes. Allianz is of the view that nationally agreed criteria would be unworkable and undesirable. Most repairers could meet the basic minimum requirements in terms of skills, equipment and quality of work. With these objective minimum requirements as a given, an insurer's decision to grant network membership then comes down to more subjective or insurer-specific criteria, such as trust, track record and geographical location. The need to balance the number of repairers in a network with the amount of work going into the network will impact on the overall numbers of network repairers as well as their location. It would be doing repairers a disservice to give them an expectation of network membership on the basis of their ability to meet a number of objective nationally agreed criteria. This is because far more repairers would meet such criteria than insurers require to handle the volume of repairs that can be delivered into insurer networks. This is particularly true of Allianz where, as a result of our policy of repairer choice, the amount of work available to network repairers is essentially driven by the choices our policyholders make.

3.2 Choice of repairer

The issue of preferred networks is in part linked to the issue of choice of repairer and also to the way repair work is quoted. For example, some insurers seek to have all repairs carried out by members of their preferred networks. It is not possible to offer full choice of repairer in these circumstances because it could result in policyholders seeking to have repairs carried out by non-network repairers. On the other hand, the use of competitive quoting can be inconsistent with offering choice of repairer. For example, what happens if another repairer provides a lower quote than the policyholder's preferred repairer?

Thus, the issues of preferred networks, repairer choice and quoting for work are intertwined. Insurers adopt a range of different models that suit their individual approaches in relation to these issues. It would not be possible, as some have argued, to require all insurers to offer choice of repairer because to do so may be incompatible with an insurer's approach to interrelated issues such as the use of preferred networks and the way work is priced.

Allianz offers its customers a complete and unrestricted choice of repairer. As a result, only about 40 percent of Allianz repair work is undertaken by our network repairers. Table 3.1 shows the overall proportion of repairs that are carried out by the Allianz Network is 34 percent. However, these figures are understated because it includes all areas, including those where Allianz does not have network repairers. Table 3.2 adjusts for this fact and shows the proportion of repairs carried out by Network Repairers in areas where Allianz Network Repairers exist, which is 41 percent. This only allows Allianz to operate a modest-sized network of 157 repairers nationally and, for example, 34 repairers in Sydney. Membership of the Allianz network is offered on the basis of an ability to provide a high level of service to our customers as well as a good quality repair. A track record of a cooperative and trusting relationship between Allianz and the repairer is also an important consideration. In light of the dishonest practices some repairers engage in, a repairer's track record plays a significant role in the decision to offer membership. However, this is very much a subjective

consideration based on insurers' individual experience with repairers. Recommending a network repairer results in a high degree of policyholder expectation on Allianz to perform in terms of service and quality repairs. Therefore, the relationship between the repairer and the insurer is of the utmost importance. This is why the track record of a repairer is crucial when we consider membership of the Allianz Network of Repairers.

Table 3.1: Proportion of vehicles repaired by Allianz Network Repairers - August 2004 (all areas)

State	*Number of New Assessments*	*Number of Vehicles to the Allianz Network of Repairers*	*Proportion of Vehicles to Network* *%*
WA	519	157	30
NSW	1515	255	17
VIC	1274	515	40
QLD	1380	683	50
SA	847	262	31
Total	**5535**	**1872**	**34%**

Table 3.2: Proportion of vehicles repaired by Allianz Network Repairers - August 2004 (areas with network repairers only)

State	*Number of New Assessments*	*Number of Vehicles to the Allianz Network of Repairers*	*Proportion of Vehicles to Network* *%*
WA	392	157	40
NSW	1275	255	20
VIC	1144	515	45
QLD	1084	683	63
SA	655	262	40
Total	**4550**	**1872**	**41%**

Geographical location is another key criterion in choosing network repairers because they need to be located in the areas where our policyholders want them. Most repairers would be capable of undertaking repair work to the minimum standards required by Allianz. For example, there would probably be more than 1000 repairers

in Sydney alone that would meet the minimum objective criteria relating to repair quality. Yet, the amount of work Allianz policyholders are currently choosing to go into the Allianz network can be satisfied by 34 repairers in Sydney.

While membership of the Allianz Network does not come with a guarantee of a certain amount of work, repairers have a legitimate expectation that on becoming a network repairer they are likely to receive a higher volume of work from Allianz. Allianz can only meet this expectation by balancing the size of our network against the number of Allianz policyholders that choose to use a network repairer. The only way Allianz could support a larger network of repairers would be to put in place measures that deliver a higher volume of work into the network. This could only be done by restricting our policyholders' choice of repairer so that more work was available to support a larger repairer network. Allianz is not prepared to undermine its customer choice of repairer policy in order to force a greater volume of repair work into a network that is larger than that needed based on policyholder preferences. This is a key reason why it is not possible to open up insurer networks to all repairers capable of meeting a set of minimum objective criteria. Even in the case of insurers that do not offer choice of repairer, the amount of work generated by an insurer's policyholders would still place a natural limit on the appropriate size of a network.

While Allianz offers choice of repairer, we do not believe that this should be mandated. Insurers adopt different business strategies in relation to issues such as policyholder choice and preferred network schemes and this is an entirely legitimate feature of a competitive insurance market. It is a myth that all policyholders want choice of repairer. Most people have an accident on average every 7 years or so. Most people also generally prefer a repairer conveniently located to their home or place of work. These facts, combined with general population and employment mobility, mean that very few people use the services of a repairer often enough to develop strong preferences about repairers. As long as insurers are transparent with policyholders about whether they offer choice of repairer, all policyholders have a choice of repairer by virtue of the fact that they can choose an insurer that offers choice if they value such sufficiently high enough.

3.3 Allianz Australia's Managed Repair Process

In terms of the interrelationship between preferred networks, repairer choice and the pricing of work, Allianz is able to offer unrestricted choice of repairer because it adopts an approach to quoting that does not conflict with our policy of choice. Indeed, the Allianz Managed Repair Process (MRP) is about more than establishing an agreed price for the repair, it allows for Allianz and repairers to work in partnership throughout the repair process to ensure a high quality, competitively priced repair that provides a fair level of remuneration to repairers.

Allianz does not use a competitive quoting system to price repairs. Indeed, the policyholder is not required to get a quote at all. Under the Allianz MRP, the policyholder simply needs to choose a repairer. Allianz will work with any repairer our policyholders choose. In order to price the job, both an Allianz assessor and the repairer work together to determine a fair price. Together, the assessor and repairer examine a vehicle that has had the damaged parts removed so that all the damage can

be seen. Allianz does not ask repairers to quote on damage they can't see, which can happen with multi-quote pricing systems and can be the cause of subsequent disputes between the insurer and repairer.

By examining the dismantled vehicle together, the assessor and repairer agree on how to return the vehicle to its pre-accident condition including the repair methodology, whether parts will be repaired or replaced, whether new or original recycled parts will be used and the hours that will be allocated to the various components of the repair process. This reduces the uncertainty that comes with trying to quote on unseen damage and the problems this can cause, such as creating incentives for repairers to act dishonestly to improve the profitability of jobs that require more work than initially anticipated. The MRP operates in the same way for all repairers, whether or not they are members of the Allianz Network of Repairers. The only exception is that, while Network Repairers are able to dismantle the vehicle before the assessor examines it, for non-network repairers this dismantling takes place with the assessor's authority and generally in the assessor's presence. This is to reduce the opportunity for fraudulent and dishonest practices to take place.

Under the MRP, assessors not only look at vehicles at the commencement of the repair. Particularly with Network Repairers, where a higher volume of Allianz work means that assessors are on-site most days, the assessor can continue to work with the repairer as the job progresses. Thus, if after commencement of the job, the repairer finds, for example, that a part needs to be replaced rather than repaired or there are additional damaged parts that were not initially identified, this can be discussed with the assessor and the quote amended. Under the MRP, the quote is left open until there is no more uncertainty about the repair so that it can be amended if necessary. This results in a fairer process for repairers and ensures that they get paid for all they have to do to repair the vehicle. This ongoing assessment of the needed repairs and interaction with the repairer, reduces the incentives for 'short-cutting' or other dishonest practices used by some repairers. Insurers and repairers have always had an adversarial relationship and the MRP has enabled us to create a higher level of cooperation and trust between Allianz and repairers.

3.4 Parts

One of the issues raised by repairers is the use of recycled (ie second-hand genuine) parts. Allianz does not use non-genuine parts in its repairs but supports the use of good quality recycled parts where appropriate. Recycled parts represent about 10 percent of all parts used by Allianz. Allianz has a policy of using only new mechanical and safety-related parts (eg steering, brakes) and of using new parts on new vehicles (ie less than one or two years old). However, once a vehicle is more than a few years old, similarly-aged recycled parts can be used and deliver a significant saving on repair costs, which is reflected in lower premiums. The desire of repairers to use new parts is generally prompted by the higher mark-up they receive compared to recycled parts. To address the incentive to use more expensive new parts when it is not necessary, Allianz includes in its price an allowance for the margin the repairer would have received if a new part were used, even when a recycled part is used. Under this arrangement, repairers are no worse off and Allianz retains the benefit of a competitively priced repair, resulting in is a win-win for both parties. This component

of the MRP removes any incentives repairers have to use expensive new parts when good quality recycled parts are available. It also reduces the incentive for repairers to quote for new parts but use recycled parts as a way of making a job more profitable. Thus, the 'short-cutting' on parts, which some repairers argue takes place, is not a feature of Allianz' experience.

There are a number of other advantages to using recycled parts:

- the ability to promote a competitive environment for car manufacturers' prices for new parts;

- environmental improvements through a reduction in the need to dispose of unwanted vehicle parts; and

- it helps support the approximately1500 small business recyclers around Australia whose viability relies on the existence of a market for used parts.

4 The financial relationship between insurers and repairers

4.1 Rates paid by insurance companies for smash repair work

The issue of hourly rates has been raised by some repairers and their representatives, in particular, that they are too low. However, it is not possible to assess the adequacy of current payments to repairers by looking at hourly rates in isolation. Relatively low hourly rates are offset by relatively generous times allowed to undertake repairs. This approach, known as 'funny time, funny money', is a long-standing industry practice that is well understood by all participants, not only in Australia but also in many other countries. The 'funny time, funny money' system has developed into an approach that:

- provides fair remuneration for repairers;
- reflects the uncertainties involved in accurately assessing in advance the amount of time repair (ie traditional panel beating) work might take;
- encourages the repair of damage whenever possible and economic in preference to the more expensive replacement of damaged parts;
- minimises repair costs, the benefits of which are passed on to consumers in the form of lower premiums; and
- maximises the amount of repair work available to the repair industry.

In returning a vehicle to its pre-accident condition, insurers and repairers are faced with the choice of:

- repairing any damaged parts that are repairable[1]; or
- replacing all damaged parts with non-damaged parts, be they new or recycled parts[2].

This choice does not apply to all parts. For example, Allianz adopts a policy of using new, genuine parts for all mechanical and safety-related (eg, steering, brakes, suspension) damage and on newer vehicles. However, in the case of bolt-on panels, structural panels and many cosmetic parts, the *repair* of damaged parts is generally an option.

Because any damaged part can be replaced with a new part, it is possible to return a vehicle to its pre-accident condition without carrying out any *repairs*. In other words, any damaged vehicle could be fixed entirely through the replacement of all damaged parts (including panels), without the need for the use of traditional panel beating repair methodologies. Whenever damage can be *repaired* more economically than the

[1] The use of traditional panel beating and related skills to fix damaged vehicle parts is referred in this submission as "repair". When the word is used in this context it is italicized to distinguish it from the more general use of the term.

[2] This type of work is referred in this submission as "remove and replace" (R&R) or simply "replace".

cost of replacing damaged parts, and the outcome is equivalent in terms of safety and performance, insurers generally seek to *repair* rather than replace damaged parts.

Thus, for damaged parts, insurers and repairers are faced with the choice of undertaking a *repair* or an R&R. An advantage of the 'funny time, funny money' approach is that it provides an incentive to *repair* rather than replace damaged parts. It does this by allowing a relatively longer period of time for *repair* work, which in turn provides a relatively higher level of effective remuneration to the repairer compared to R&R work. The dollar rates paid by insurers are generally similar for both *repair* and R&R work. Thus, for the same number of hours, a repairer will earn more 'profit' from a *repair* than they will from an R&R. The key reason for this divergence in the hours allowed arises out of the uncertainty of estimating in advance how long *repairs* will take.

There is a greater degree of certainty in how long it takes to remove and replace parts. Because R&R times can be more accurately determined, they are 'tighter' than *repair* times, although there remains some 'stretch' in R&R hours. In general, allowed R&R times are up to twice as long as the actual time to do an R&R. In allocating hours for R&R work, Allianz generally uses manuals prepared by the Motor Trades Association, which estimate R&R times for the different makes and models of vehicle available in Australia.

In the case of *repairs*, however, it is very difficult to estimate in advance how long a *repair* will take. The peculiarities of working with metal means that two similarly damaged parts can end up taking significantly different amounts of time to *repair*. This uncertainty, along with the knowledge that relatively longer times are used to offset relatively lower dollar rates, combines to provide a level of remuneration that results in a fair but competitive price for both repairer and insurer. *Repair* times are at least three times greater than actual times, and in many cases the multiple is five times or more.

4.2 The 'Allianz door'

Allianz conducted an in-house experiment to demonstrate the uncertainty of estimating *repair* times and to highlight the 'true' level of remuneration paid to repairers. The experiment involved a damaged door. A group of Allianz assessors were asked to nominate how long they would give a repairer to *repair* the door. The assessors' answers ranged from four to ten hours with six hours being the average. They were then asked how long they would allow for the *repair* under a 'real time, real money' approach. The answers ranged from two to four, with an average of three hours. The door was subsequently taken to a repairer and the *repair* timed. The door took 43 minutes to repair. For simplicity, assume that the actual time taken was one hour. At a $30 'funny money' rate, the repairer would have been paid $180, which represents the 'effective' hourly rate for the *repair*.

Table 4.1 provides a financial comparison between *repairing* the door and replacing it. In order to illustrate the incentive that current arrangements provide for repairers to *repair* rather than replace parts, the table uses the concept of 'repairer excess'. This is the additional amount the repairer receives because of the generous allowable times

under the 'funny time, funny money' approach. Repairer excess is the difference between the total amount paid to the repairer for the work in question and the cost of labour as determined by the hourly rate paid multiplied by the actual time taken. As noted, R&R and paint times are closer to 'actual' times and for the purposes of the exercise, it is assumed that they are twice 'actual' times. The *repair* time is that judged by assessors as part of the door experiment, which was six times 'actual' time.

Table 4.1: The 'Allianz door' – 'funny time, funny money' and the incentive to repair

	Repair	**R&R**
Parts		**$400**
	1:20 hours allowed time	2:40 hours allowed time
	40 minutes actual time	1:20 hours actual time
Hours for parts	1:20 hours	2:40 hours
Labour rate for parts	$30 ph	$30 ph
Cost of Fitting Parts	**$40**	**$80**
Repairer Excess	*$20*	*$40*
Paint	2:40 hours allowed time	3:20 allowed time
	1:20 hours actual time	1:40 hours actual time
Hours for Paint	2:40 hours	3:20 hours
Labour rate for Paint	$54 ph	$54 ph
Oven Allowance[a]	-	$80
Cost of Paint	**$144**	**$260**
Repairer Excess[b]	*$40*	*$90*
Repair	6:00 hours allowed time	-
	1:00 hour actual time	
Labour rate for *Repair*	$30 ph	-
Cost of *Repair*	**$180**	**-**
Repairer Excess	*$150*	-
Total Cost of Job	**$364**	**$740**
Actual hours worked	3 hours	3 hours
Total Repairer Excess	***$210***	***$130***

a Oven allowances are generally not paid for small paint jobs.

b For painting, only the hourly labour rate (ie $30) is used in calculating repairer excess, allowances for consumables (eg paint and oven allowance) are not included.

Table 4.1 shows that, at $364, *repairing* the door is less than half the $740 cost of replacing it. The table also shows that, despite the same number of actual hours worked in both cases, at $210, the 'repairer excess' in the case of a *repair*, is significantly higher than the $130 that would be achieved by the repairer if an R&R

were undertaken instead[3]. The table demonstrates how the 'funny money, funny time' approach provides an incentive to repair rather than replace parts, and that this:

- minimises the cost of fixing the vehicle for insurers. These lower costs flow through to lower premiums for consumers; and

- provides a fair level of remuneration to repairers. In this example, after taking away the amount paid for paint consumables, which is $64, the effective remuneration received by the repairer is $300 for 3 hours of actual work or $100 per hour.

Over the last decade and longer, advancements in the technology of *repair* equipment have had the effect of reducing the "actual" time to *repair*. However, the times given by assessors to perform a *repair* have not decreased accordingly. This has resulted in increases in the actual 'hourly rate' earned by repairers and explains how effective remuneration has increased over time even though the dollar rates paid by insurers have increased more slowly than inflation.

In light of the 'funny time, funny money' approach, it has been suggested that the perceived concerns with low hourly rates could be simply addressed by, say, tripling the existing hourly rate and reducing the time allowed to one-third. In other words, replace the current system with a so-called 'real time, real money' approach. Proponents of 'real time, real money' argue that insurers' bottom line would remain the same. However, at the same time, those arguing for higher hourly rates do so in an expectation that this would result in higher remuneration for repairers. Clearly, these outcomes are mutually exclusive. All things being equal, if the insurer's bottom line remained the same, so would the remuneration of repairers. Hence, for those that argue that a change to 'real time, real money' could be achieved at no extra cost, if lack of remuneration is seen as an issue, replacing 'funny time, funny money' with 'real time, real money' would not address the issue.

A more likely result of moving to 'real time, real money' is that repair costs and hence insurance premiums would rise. The reason is that such a proposal ignores the fact that it is not possible to accurately determine the real time for *repairs* in advance. While it would be simple in principle to increase hourly rates to what some might regard as 'real money', the difficulty of estimating in advance the length of time a *repair* would take means that an offsetting move to 'real time' is unlikely to fully occur. For example, in the 'door' experiment, regardless of what the hourly rate was, it would have been impossible for an insurance company assessor to obtain a repairer's agreement to allocate one hour for the door repair.

The experiment also showed that, at three hours, our assessors' average estimated 'real' time was still three times the actual time, demonstrating the difficulty in estimating real *repair* times in advance. This confirms the likelihood that a rise in hourly rates to reflect 'real money' is unlikely to be fully offset by time reductions.

[3] In general terms, the amount of R&R repairer excess in this example is probably an overstatement because repairers would likely argue that many R&R times are closer to 'actual' time than to two times 'actual' time.

This is the basis of Allianz' view that the most likely outcome of a move to 'real time, real money' would be higher average repair costs, which would naturally flow through to higher premiums.

The 'real time, real money' proposal also ignores the flow-on effects of removing the current incentive to *repair* rather than replace parts. By definition, the ability to *repair* damage results in a less costly outcome than the replacement of damaged parts. This is because if it was less costly to replace the damaged parts that is what the insurer would require. A move to 'real time, real money' would upset the 'balance' in the current system. Aligning *repair* times with R&R times, would remove the incentive to undertake less costly *repairs* in preference to more expensive R&Rs because repairers would be indifferent between the two alternatives. This is because the higher level of effective remuneration associated with *repairs* that is implicit in the current arrangement would be removed. However, while repairers would be indifferent and even prefer R&R work to *repair* work, the cost to insurers would increase because of the additional costs associated with R&Rs. These additional costs include the cost of the parts themselves and the additional painting that is generally required when parts are replaced[4] (see Table 4.1). This would have the effect of increasing average repair costs, with a flow on effect to premiums.

Table 4.2 demonstrates how the incentive to repair is removed if hourly rates and times are based on a 'real time, real money' approach. In this example, 'real time' hourly rates are set at $90 per hour ($114 for paint[5]). In the table, the concept of 'repairer excess' is not used because it is incompatible with the actual times under the 'real time, real money' system. The concept of 'remuneration for allowable hours' is used instead. 'Remuneration for allowable hours is simply the number of hours allowed for work multiplied by the relevant hourly labour rate (excluding consumables). Table 4.2 is based on the same ratios as Table 4.1, that is, R&R and paint times are assumed to be twice actual times and repair time to be six times actual time.

Like the concept of 'repairer excess' used in Table 4.1, the concept of 'total remuneration for allowable hours' used in Table 4.2 demonstrates the greater incentive to repair provided by the 'funny time, funny money' approach. Table 4.2 also demonstrates how this incentive is removed by a move to 'real time, real money'. In this case, the repairer would receive the same amount of $270 regardless of which methodology they choose to return the vehicle to its pre-accident condition. However, while repairers would be indifferent to the repair methodology, the insurer would still pay significantly more if an R&R were undertaken. Allianz contends that the removal of the incentive to *repair* that is implicit in the current 'funny time, funny money' approach would have a significant impact on the current system.

[4] This is because parts such as bolt-on panels generally come in a neutral colour (eg, black or white) and have to be painted to match the vehicle in question. Replacing a large panel (eg, a door) will often require the painting of some or all of adjacent panels in order to match the colour of the new part with the rest of the vehicle. With a repair, only the section of the panel that has been repaired often needs to be painted.

[5] The $114 figure is made up of the new $90 ph labour rate, plus the existing $24 ph additional component of the paint rate that is paid to cover consumables such as paint.

Table 4.2: 'Real time, real money': impact on the incentive to repair

	Funny Time, Funny Money		*Real Time, Real Money*	
	Repair	R&R	*Repair*	R&R
Parts	**-**	**$400**	**-**	**$400**
Hours for parts	1:20 hour	2:40 hours	40 minutes	1:20 hours
Labour rate for parts	$30 ph	$30 ph	$90 ph	$90 ph
Cost of Fitting Parts	**$40**	**$80**	**$60**	**$120**
Remuneration for allowable hours	*$40*	*$80*	*$60*	*$120*
Paint				
Hours for Paint	2:40 hours	3:20 hours	1:20 hour	1:40 hours
Labour rate for Paint	$54 ph	$54 ph	$114	$114
Oven Allowance	-	$80	-	$80
Cost of Paint	**$144**	**$260**	**$152**	**$270**
Remuneration for allowable hours[a]	*$80*	*$100*	*$120*	*$150*
Repair				
Hours for *Repair*	6 hours	-	1	-
Labour rate for *Repair*	$30 ph	-	$90 ph	-
Cost of *Repair*	**$180**	**-**	**$90**	**-**
Remuneration for allowable hours	*$180*		*$90*	
Total Cost of Job	**$364**	**$740**	**$302**	**$790**
Actual hours worked	3	3	3	3
Total Remuneration for allowable hours	***$300***	***$180***	***$270***	***$270***

a The calculation of 'remuneration for allowable hours' is based on the payment of labour only, allowances for consumables are excluded

A rise in the average cost of repairs would also impact on the proportion of vehicles classed as total write-offs. The decision to write-off a vehicle flows directly from the interaction between the price of repairing the vehicle and its scrap value, which is generally about 25 to 30 percent of its market value. In these circumstances, market value means the amount the vehicle is insured for or the amount that policyholder will receive if the vehicle is written-off. As soon as the difference between the vehicle's market value and the cost of its repair falls below its scrap value, it is more profitable for the insurer to write the vehicle off. For Allianz Australia, the proportion of vehicles written-off is around 8 percent. Allianz Australia's German counterpart, where 'real time, real money' operates, writes-off around 25 percent of vehicles. This is seen as a direct result of the excessive use of replacement parts that the 'real time, real money' system encourages. If such an outcome were translated to Australia, an increase in the proportion of written-off vehicles would result in a reduction in the

number of repairable vehicles. For an industry facing rationalisation through an existing demand/supply imbalance, a further reduction in repair work would only exacerbate and accelerate the rationalisation process.

Allianz acknowledges that the existing approach appears far from rationale to those not involved in the industry. In a perfect world, it would be possible to estimate in advance how long a *repair* might take, which would at least make a 'real time, real money' approach possible. However, that is not the case. It is also Allianz' experience, that average repair costs are considerably higher in countries that have adopted a 'real time, real money' approach. In the absence of a workable alternative, Allianz would caution governments against making changes to the current arrangements unless it can be guaranteed that any change would not place upward pressure on repair costs and hence premiums.

4.2 The time taken by insurers pay smash repairers

Allianz rejects claims by some repairers and their representatives that there is a systemic problem of late payment by insurers. There is simply no evidence to support this claim. For both network and non-network repairers, Allianz commits to paying all correct invoices within 30 days. In fact, 84% of repair invoices are paid within 15 days and 94% within 30 days. Accounts over 30 days old are usually waiting for the repairer to provide information to Allianz to enable adjustments and corrections to be made to the invoice. In Allianz' experience, other insurers also report the payment of the vast majority of repair invoices within 30 days.

In Allianz' case, the relatively small proportion of payments that are not completed within 30 days are delayed because they contain repairer errors and the time taken to check and consult on these errors causes delay. Indeed, the problem of repairers putting in incorrect invoices is significant. In virtually all cases, these 'errors' favour the repairer. To address this, Allianz has found it necessary to employ a team of eleven parts specialists to check for errors in repair invoices. This measure resulted in savings of around $2 million in 2003. Like preferred repairer schemes, this is another initiative used by insurers to try and counter the persistent dishonest practices insurers are subject to by some repairers.

5 Dispute resolution systems

The Australian Competition and Consumer Commission (ACCC) recently examined relations between insurers and repairers culminating in the release of the report, *Discussion on the relationship between the Australian motor body/smash repair industry and the general insurance sector,* in September 2003. In that report, the ACCC highlighted the benefits of corporate codes as a way of addressing concerns between insurers and repairers. Allianz responded positively to the ACCC report and developed the *Allianz Claims Promise – Customer Choice of Repairer* (also referred to as the Allianz Choice of Repairer charter), which is a corporate code governing relations between Allianz and repairers that are not members of the Allianz Network of Repairers (see Box 5.1). The Allianz Choice of Repairer charter responds to a range of issues identified by the ACCC by setting out:

- the right of Allianz customers to choose their own repairer;
- the requirement that repairers only use parts that comply with Australian Design Rules;
- a commitment by Allianz to pay all correct invoices within 30 days; and
- the introduction of clear limits on the life of repairers' guarantees of their work.

The charter also contains internal and external dispute resolution mechanisms. For external dispute resolution, Allianz uses the Australian Commercial Disputes Centre (ACDC). The ACDC is an independent, not-for-profit organisation established in 1986 to introduce and develop non-adversarial dispute resolution processes in Australia.

Allianz also uses the ACDC as the external dispute resolution mechanism for its Network Repairers, provision for which is set out in the Service Level Agreements Allianz has with those repairers. The extension of formal dispute resolution mechanisms to non-network repairers through the Choice of Repairer charter means that Allianz now has comprehensive coverage of the repair industry.

Box 5.1: The Allianz Choice of Repairer code for non-network repairers

Allianz Claims Promise - Customer Choice of Repairer

The Customer's Right to Choose

Allianz respects our customer's right to choose a Repairer to carry out repairs to their vehicle. We will work with that Repairer to achieve the best possible outcome for our customer.

When our customer lodged a claim for accident repairs, it was mutually agreed for you to carry out the repairs to their vehicle.

Set out below is an understanding for how we would like to conduct business with you, to ensure efficient and quality repairs.

Vehicle Assessment

Our Assessor will inspect the vehicle on the day nominated by you. Ideally, the inspection date will be the agreed commencement date for repairs. We would be grateful for you arranging delivery of the vehicle to your premises by 8am on the day nominated.

Prior to the assessment, please prepare a quotation addressing visible damage only. We do not expect you to complete the quote for areas of the vehicle where you are unable to see all the damage.

When the Assessor arrives at your premises he/she will authorise you to remove damaged parts, if required, to ensure all damage is visible prior to deciding the repair method and cost.

Vehicle Parts

All parts fitted by you must comply with relevant Australian Design Rules (ADR).

Where new parts are authorised, all invoices must show the Manufacturers' recommended list prices plus GST and the part numbers for each new part fitted. If alternative parts are required, our Assessor will agree upon the cost with you.

Should you use recycled parts to repair the vehicle, please ensure you have the appropriate documentation to support authenticity.

Guarantee

The quality of work performed must be in accordance with acceptable industry standards. Once the vehicle's repairs are completed, we ask that you provide the standard Guarantee for the work you have completed.

This Guarantee applies while the customer owns or leases the vehicle. Should the customer sell or transfer the vehicle, the Guarantee will terminate. The Guarantee is not transferable.

Payment

We will pay your repair invoice within 30 days of its receipt by us, provided the invoice corresponds with what our Assessor has agreed to.

Dispute Resolution

Allianz strives to do things the right way and keep all our customers happy, however sometimes disputes occur. When this happens, our objective is to resolve disputes using open and honest communication and a common sense approach.

We have established an internal dispute resolution process through which an independent decision-making authority will review the matter for you in a timely fashion.

In the event that we are unable to resolve a dispute using our internal process and we both agree, a dispute may be submitted for arbitration by the Australian Commercial Disputes Centre (ACDC). This does not create any legal obligation.

Any meetings organised by ACDC will be held in Sydney or another place agreed between us. The costs of conciliation are to be paid an equal share basis. The costs of arbitration by ACDC are to be paid as directed by them.

We look forward to working with you to provide a high level of service to our customer.

6 Conclusions

Allianz would like to see all insurers put in place dispute resolution mechanism that cover both their network and non-network repairers and this could be best achieved through the development of corporate codes between individual insurers and repairers. Other insurers have also responded positively to the September 2003 ACCC report, or are in the process of doing so. Allianz is aware that one major insurer recently extended the code covering its network repairers to also include non-network repairers and that at least one other insurer is considering the development of a corporate code with repairers.

While some have argued in favour of an industry-wide code, Allianz is of the view that this would not be effective in addressing the concerns expressed by some repairers and their representatives. Insurers adopt a wide range of approaches to issues such as preferred networks, choice of repairer and the pricing of work. These different approaches give rise to different issues with repairers. Many of these issues are unique to the insurer involved and would not lend themselves to resolution through a one-size-fits-all, industry-wide code.

To cope with the markedly different approaches by insurers to their dealings with repairers, an industry-wide code would need to be pitched at a high level of generality and principle. Such a code would be unable to respond to the specific concerns repairers might have with a particular insurer. A corporate code, on the other hand, can be tailored to address in detail the specific concerns that arise with an individual insurer's approach. In this regard, Allianz is of the view that the ACCC correctly identified corporate codes as the best way forward because of their ability to strike the appropriate balance between generality and specificity and their flexibility to address the concerns of repairers. If repairers still have concerns about their relationship with an insurer despite the existence of a corporate code, Allianz would argue that this is evidence of inadequacies in the code itself rather than evidence that the concept of corporate codes is not suitable as a mechanism to address repairers' concerns.

Allianz acknowledges that, as in any commercial relationship, disputes between insurers and repairers will sometimes arise. It is important therefore that insurers have in place mechanisms to minimise the chance of disputes occurring and, failing that, mechanisms to resolve them. The diverse nature of the insurance industry means that the best mechanism to minimise the chance of disputes happening in the first place is a corporate code that identifies the specific areas where disputes may occur and clarifies the rights and responsibilities of the parties in a way that minimises the chances of disputes occurring. This can only be achieved by insurers consulting directly with repairers in order to understand which aspects or features of their relationship have the potential to generate disputes and what mechanisms should be included in a code to minimise them.

Allianz recommends that the Commission support a comprehensive, self-regulatory corporate code regime as the most effective way to address issues surrounding the relationship between insurers and repairers. This would allow insurers to continue to move in the direction suggested by the ACCC.