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INSURANCE AUSTRALIA GROUP

RESPONSE TO THE PRODUCTIVITY COMMISSION'S DRAFT REPORT INTO SMASH REPAIR AND INSURANCE

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INTRODUCTION

Insurance Australia Group (IAG) welcomes the Productivity Commission's *Draft Report* into **Smash Repair and Insurance** released on 18 November 2004. IAG is particularly encouraged that the Commission noted:

"... as noted in chapter 1, the ACCC has found no evidence of market behaviour by insurers that warrants a regulatory response under the TPA." (page 118).

As IAG outlined in its initial submission, it would not appear rational for IAG to seek to lessen competition in the market for motor vehicle repair services. A competitive market in motor vehicle repair services is likely to result in lower repair costs. Given IAG is an acquirer of smash repairer services, it is in IAG's interest to ensure that the market for motor vehicle services is as competitive as possible (*IAG Submission, page 42*).

The fundamental premise that underpins competition policy is that all sectors of the economy should be subject to competition unless it can be shown that there is a net public benefit not to do so, as IAG highlighted in its initial submission (*IAG Submission, page 46*). IAG continues to oppose any legislative or regulatory reform that results in **legitimate competitive conduct** between insurance companies and smash repairers being constrained to protect some businesses from facing fair competition.

IAG is also encouraged that the Commission's *Draft Report* highlighted the **consumer benefits** associated with preferred supplier schemes. Indeed, the Commission noted:

"...The Victorian Government commissioned a report from Professor Joshua Gans, which concluded that 'preferred repairer schemes ultimately raise consumer value':

... because insurance companies are generally in a better position than consumers to evaluate smash repair services. Consumer warranties on repair services offered by insurance companies also correct a market failure that would otherwise exist. Moreover, the introduction of these schemes does not appear to have unduly restricted consumer choice. (sub. 26, p. 9)

The ACCC also concluded that:

... the establishment of the preferred repairer schemes has introduced a number of significant benefits for consumers. (ACCC 2003b, p. 9)"

Furthermore, the Victorian Government's submission to the Inquiry stated, "Professor Gans concluded that, from an economic perspective, there does not appear to be a case for government intervention to protect consumers with regard to preferred repairer practices" (*Victorian Government submission, p.9*)

GENERAL COMMENTS

IAG particularly notes and confirms its support for the Commission's preliminary findings in relation to the following issues:

1. Safety and Quality of Repairs

The Commission reached the conclusion that:

"There is no clear evidence of a systemic safety issue related to PSR arrangements. While quality is harder to assess, insurers and repairers face strong incentives to ensure that quality and safety appropriately meet the needs of their customers" (page 58).

As IAG highlighted in its initial submission, IAG's Preferred Smash Repairer (or PSR) scheme contains mechanisms and is complemented by various company-sponsored initiatives to improve the quality of repair services. Importantly, IAG's PSR scheme does not seek to achieve reductions in the price of repair services at the expense of quality (*IAG Submission, page 36*).

2. Quotation Timeframes and Minimum Payment Terms

The Commission concluded:

"There is little evidence to suggest that the current arrangements in relation to timeframes for quoting are creating problems in the commercial interactions between repairers and insurers" (page 85).

"There is no justification to impose regulated minimum terms of payment on insurers. These should continue to be matters for negotiation between insurers and repairers (as they are between firms and suppliers in most industries)." (page 88).

3. Consumer Choice and Repairers

The Commission reached the preliminary conclusion that:

“Consumers wanting choice of repairer can choose to insure with one of the several insurers offering that choice. On this basis, consumers have restricted, but reasonable, choice of repairer.

- *Consumer choice of repairer should not be mandated” (page 100).*

IAG welcomes the Commission’s finding that consumers do enjoy reasonable choice of smash repairer and that consumer choice should not be mandated.

To mandate that consumers should choose a repairer would be to transfer considerable economic risk to consumers. That is, relative to insurers, consumers are likely to have less information regarding the quality and appropriate cost of repair services and furthermore, may have no desire to take on such risk.

As the Commission noted, “it is difficult to see how mandating choice would lead to ‘improved productivity’ in repair and the ‘lowest possible market prices’”(page 97).

IAG agrees with the Commission that while greater consumer choice “may well enhance the fortunes of a particular section of repairers, it could come at the expense of those repairers that operate efficiently and effectively under present arrangements” (page 97).

IAG also support the Commission’s view that insurers “should not be prevented from explaining the advantages and disadvantages of the various options available” (page 100).

As submitted in its initial response to the Commission, IAG provides clear choice of repairer to consumers via its Choice of Repairer policy option. This allows consumers to transparently choose their own smash repairer by purchasing this option when they purchase or renew a policy.

4. Dispute Resolution

In relation to existing dispute resolution systems, the Commission concluded:

“The existing internal consumer dispute resolution systems of the individual insurers appear to be working adequately. Further, while the Commission has not assessed the IEC’s administrative arrangements, there is no evidence that the IEC’s systems are not broadly appropriate, nor that the IEC is not sufficiently independent.” (page 105).

“There is no evidence of any significant deficiencies in the procedures for resolving disputes that arise directly between consumers and repairers.” (page 105).

As it submitted in its initial response to the Commission, IAG has developed and manages an IAG Personal Insurance Preferred Supplier Code of Practice that includes a dispute resolution process for its preferred smash repairers and other preferred Personal Insurance suppliers.

This Code’s dispute resolution process includes a three-stage escalation of an unresolved dispute lodged by a preferred supplier – including a preferred smash repairer – by the External Dispute Resolution Group. This Group currently comprises a former ACCC Small Business Commissioner and a former NSW Minister for Consumer Affairs.

The dispute resolution process of the Code is now being reviewed after operating for one year.

RESPONSE TO SPECIFIC ISSUES

Contract Issues

The Commission recommended that:

“Greater transparency from insurers in such aspects as PSR selection criteria and notification of opportunity to apply for PSR status would reduce uncertainty and improve relationships between the two industries” (page 50).

As IAG highlighted in its initial submission, membership of IAG’s PSR preferred smash repairer arrangements is open and transparent. Application to join the scheme is open to all repairers who meet the required criteria and IAG’s business needs. Membership of IAG’s PSR and ASR schemes remains contestable at all times.

IAG has been working for sometime with stakeholders associated with its preferred supplier arrangements, including smash repairers, to enhance the transparency with which it does business with its suppliers.

In response to this work with stakeholders and the Commission’s preliminary findings, IAG will investigate, as a means of enhancing transparency in relation to its PSR arrangements:

- publication on its website of the non-commercial-in-confidence criteria it applies to judge whether a smash repairer meets minimum benchmarks to be considered as a preferred supplier;
- maintenance of a register comprised of smash repair businesses not presently Associate Smash Repairers (ASRs) or PSRs that have expressed an interest in being IAG preferred smash repairers in the future should IAG have a business need to appoint new participants. IAG will also investigate maintenance of a register of ASRs that have expressed interest in being appointed an IAG PSR should IAG have a business need to appoint new participants. IAG will investigate calling for expressions of interest, which would be nationally advertised twice a year and communicated to major peak smash repair representative bodies. However, individual smash repairers would be able to register their interest with IAG at any time during the year. IAG will use these registers as part of its processes to appoint new ASRs and PSRs to its PSR network.

Guarantees and Warranties For Smash Repairs

The Commission notes:

“...a repairer should only be required to guarantee the work it actually performs and then only for an agreed reasonable time...” (page 84).

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

IAG is liable under the guarantee to the customer. Under the PSR and ASR Agreements the repairer is liable to IAG for defective repairs, and IAG will generally seek to recover the cost of honouring the guarantee from the repairer who undertook the repairs.

If the repairer ceases to trade or refuses to fulfil its contractual obligation to IAG for rectification of repairs, IAG manages rectification at its own cost to make sure the customer receives the fulfilment of the promise under IAG's guarantee.

IAG manages a robust quality assurance program as part of the performance plan arrangements it agrees with its PSRs and ASRs to monitor and audit safety and quality of work.

IAG assessors, conduct random audits of completed repairs with different weighting given to different aspects of the repair job, including parts, repair, remove and replace work and paint.

This program, as well as the industry development initiatives it funds to improve the skills base and strengthen management capacity among the enterprises participating in its PSR network, means the requirement for rectification work needed to honour IAG's lifetime guarantee on parts and workmanship is negligible.

Cancellation of Policies

The Commission has noted that:

“... if the consumer insists on using such a repairer, the insurer may well pay the ‘fair and reasonable’ amount directly to the consumer and then cancel the policy” (page 93).

Please note that this may suggest, incorrectly, that IAG does not give its insureds an opportunity to repair their vehicle before their policy is cancelled.

Termination of PSR status on Sale or Transfer of Business

In relation to the issue of tenure on the resale of a PSR business the Commission noted:

"Provided probity and prudential requirements are met, PSR status should not be automatically terminated on sale or transfer of a repair business. Allowing a short trial period with the new owner would enhance repairer certainty without undue risk to the insurer" (page 50).

IAG appreciates the competing considerations that were taken into account by the Commission when it made this recommendation. IAG also recognises the desire of businesses for enterprise goodwill to be factored into negotiations around a sale or transfer of ownership.

IAG, however, also has a responsibility to ensure that following a motor vehicle accident, its customers receive high quality, responsive and efficient services from agents/ suppliers – in this case PSRs – engaged by IAG to assist it fulfil its promise to its policyholders.

To balance these needs, IAG will investigate developing trial bridging arrangements for smash repairer businesses that, at the time of their sale or transfer of ownership, are contracted as IAG PSRs or ASRs and have an agreed performance plan in place with IAG.

As part of any trial arrangements to be put in place, IAG would make it clear that PSR status is not guaranteed in any circumstance and that criteria, including enterprise performance and IAG's business needs apply to all PSRs at all times.

For any trial period to be practicable, there would also need to be a **mutual obligation** on the vendor to make it clear to prospective purchasers that:

- any decisions by IAG to grant trial bridging status does not in any way guarantee or ensure future PSR or ASR status. This is important because all parties need to understand that IAG's agreement to a trial period carries no guarantee of ongoing IAG PSR or ASR status; and
- the vendor would also need to make it clear to prospective purchasers that the likelihood of ongoing status depends on the same conditions that apply to all IAG's preferred smash repair suppliers, including IAG's business needs.

A condition of IAG offering a trial assessment of ongoing PSR or ASR status following sale or transfer of a business also include that the new owners of the enterprise meet IAG's probity criteria. The new owners would also need to agree to continue to operate under the performance plan agreed by the previous owner or owners.

IAG's agreement to a trial period with new management would also be contingent on IAG receiving reasonable notice of the sale or transfer, and of the date the new ownership becomes effective. In many cases at present, IAG is only informed about a change of ownership after the sale or transfer has been completed.

Rates Paid for Smash Repair Work

The Commission noted:

"The 'funny time, funny money' system of quotation has severe drawbacks compared with an efficient and transparent system of pricing and costing and should be abandoned.

If times and hourly rates are used in any of the cost elements specified in quotes, they should reflect realistic times and rates applicable to the particular job and particular repairer.

If a PSR agreement specifies an hourly rate, that too should be an agreed shop rate applicable to the repairer involved, rather than a fictitious industry standard rate.

Materials should be separately costed and not included in hourly rates" (page 76).

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

IAG's PSR agreements outline hourly rates that it believes are realistic, taking into account a range of factors. Furthermore, this rate is only one part of a complex estimate process that repairers use to justify their "bottom line" costing of a job. As mentioned in IAG's initial submission, other factors in how a repair job is costed in a repair shop include (amongst others), fixed expenses, buying power and discounts and leasing versus purchase of equipment. Indeed, the Commission itself acknowledged that hourly rates were only part of the process when it concluded they "need to be examined in conjunction with the broader basis of quotation and payment of which they represent only part" (page 72).

IAG would support a move to a system that more transparently identified the components of the total cost of a repair. However, this would only be truly effective - especially in terms of greater clarity for consumers - if it were the case for all smash repairs and smash repairers.

We suggest that the Insurance Council of Australia and the Motor Trades Association of Australia investigate jointly options for arrangements that would more transparently identify components of a total repair cost that could be applied to all smash repairs and all smash repairers.

Codes of Conduct

The Commission noted:

- *“the advantages of an industry-wide code are likely to outweigh the disadvantages provided that it were to:*
 - *focus on specifying ‘minimum standards’ in matters of process, transparency and dispute resolution;*
 - *not interfere in insurer-consumer or consumer-repairer relationships;*
 - *not cover matters that normally are commercially negotiated between individual insurers and repairers; and*
 - *not prevent individual insurers developing their own codes consistent with, or building on, the industry-wide code” (page 115).*
- *“dispute resolution procedures under an industry-wide code should avoid undue interference in the commercial relationship between insurers and repairers and, in particular, avoid provisions that could have anticompetitive consequences” (page 116).*

While IAG believes individual insurers through their own relationships and processes and the existing legislative and regulatory environment are addressing issues raised by smash repairers, if a Code of Conduct was to be introduced, IAG believes it should be **voluntary** in nature and include a national accreditation scheme for smash repairers including minimum standards for probity, on-site occupational health and safety and safety of repairs.

IAG agrees with the Commission that the case for an industry-wide Code of Conduct needs to be considered in a “broad benefit-cost framework, taking account not only of the particular needs of insurers and repairers but also the interests of consumers and of the community more generally” (page 111).

Codes of Conduct – Advantages and Disadvantages

There are a variety of advantages and disadvantages associated with mandatory codes of conduct as opposed to voluntary codes. In particular, IAG would like to draw the following issues to the attention of the Inquiry:

- Voluntary codes of conduct can operate just as effectively as mandatory codes where they have the support and commitment of its members and the industry's leaders. For example, we draw the Commission's attention to the General Insurance Enquiries and Complaints (IEC) scheme, which the ACCC stated was effective in resolving disputes that arise between consumers and insurers¹;
- Mandatory industry codes of conduct can create compliance burdens and additional costs for industry participants without any realisable benefit resulting in industry wide competitive disadvantage²;
- Voluntary codes of conduct avoid the overly prescriptive nature of mandatory codes; and
- Voluntary codes of conduct provide an industry with the flexibility to provide greater choice in the market and respond to the dynamics of the environment³;

IAG supports the Commission's view that any Code of Conduct should:

"avoid provisions which would unduly intrude into the normal commercial relationships between insurers and repairers — in particular, of course, any anticompetitive provisions would need to be avoided. For these reasons, an industry-wide code should not attempt to specify, on an industry-wide basis, matters such as:

- times to consider PSR contract offers;
- minimum hourly rates or prices;
- 'standard' hours for repair jobs;
- types of parts to be used;
- weightings for PSR selection criteria;
- requirements to spread work among repairers;
- terms of payment; and
- particular conditions of guarantees" (page 114).

¹ ACCC Issues Paper (September 2003) at p.20.

² ACCC, *Guidelines for developing and endorsing voluntary industry codes*, (2003, ACCC, Canberra) p.4

³ Hon Warren Truss MP (Minister for Customs and Consumer Affairs), *Codes of Conduct Policy Framework* (1998, Department of Industry, Science and Tourism), Canberra) p.15

Subject to the Commission's final report and the Federal Government's response to it, IAG would be willing to discuss the principles, scope, content and the implementation issues associated with developing a national voluntary Code of Conduct. Some important implementation issues include:

- Responsibility for developing the Code of Conduct;
- The Code's administration;
- Procedures for dispute resolution; and
- Funding issues.