

**Submission  
No 34**

## **MOTOR VEHICLE REPAIR INDUSTRY**

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**Date Received:** 14/02/2014

# **Inquiry into the NSW Motor Vehicle Repair Industry**

Submission by

## **Allianz Australia Insurance Limited**

### **The motor vehicle repair industry operating environment**

Like all sectors of the economy to varying degrees, the smash repair sector is a dynamic and constantly changing one. This is particularly the case for sectors impacted by technological change, as is the case for businesses involved with technology-based products such as motor vehicles. A range of factors have and will continue to impact on the operation and viability of smash repairers, including:

- changes in the frequency and severity of motor vehicle accidents (which has been falling);
- changes in the materials used in the manufacture of motor vehicles (eg high-strength steels, water-based paints);
- the incorporation of more advanced technologies into the manufacture of vehicles (eg computerisation, collision avoidance systems);
- the need for repairers to invest in more advanced equipment to diagnose faults and repair accident damage (eg computerised diagnostic and repair equipment, inverted welders);
- the need for repairers to upgrade and/or develop the skills needed to operate increasingly advanced repair equipment and to undertake new repair techniques;
- the impact of changes to the efficient scale economies of repair shops in light of technological and other changes;
- specialisation in the repair sector, such as repairers focused on specific market segments (eg SMART repair, paintless dent repair, manufacturer-owned repairers, heavy vehicle repairers); and
- the aging of the owners/principals of repair shops.

In such a market, the exit of repair businesses and the entry of new ones into the industry is inevitable and is a sign of an industry adapting to the constantly changing environment in which it operates. That in the process of an industry's ongoing adaptation to changes in its operating environment, at any particular time, some businesses fail, or are unprofitable, or the total number of businesses in the sector declines over time as the industry consolidates, is inevitable. Indeed, it would be abnormal if this did not occur. Long-term stability in the number, location, ownership, size, geographic distribution or profitability of businesses is not apparent in any other sector of the economy, so it would be surprising if the smash repair sector was any different.

It is apparent that as a result of the influences above that, in fact, the smash repair sector has been in a period of consolidation and decline for some time and this is expected to continue. For example, independent industry research firm IBISWorld has stated that:

*“The Motor Vehicle Body, Paint and Interior Repair industry is estimated to be in the decline stage of its life cycle. ... The industry is rationalising. The number of industry enterprises is forecast to decline by an annualised 1.5% over the 10 years through 2017-18. The main reason behind rationalisation has been overcapacity, that is, there are too many repairers for a relatively small fleet of vehicles. This is affecting profitability, and inefficient repairers are being driven out of the market.”<sup>1</sup>*

*The Motor Vehicle Body, Paint and Interior Repair industry will continue to decline due to improving vehicle technology and safer roads over the next five years. The number of fatal road accidents is forecast to keep falling, so too will the average age of the Australian vehicle fleet.”<sup>2</sup>*

Despite these changes impacting the repairer, when it comes to profitability, the sector has proved to be relatively resilient. For example, the profitability (ie operating profit margins) of the smash repair industry was estimated to be 9% in 2012-13.<sup>3</sup> An equivalent measure of profitability<sup>4</sup> for motor insurance in Australia for 2013 was also 9%<sup>5</sup>. In general, both insurers and repairers may prefer to be more profitable than they

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<sup>1</sup> 2013 IBISWorld Industry Report S9412, Motor Vehicle Body, Paint and Interior Repair in Australia, p.12.

<sup>2</sup> 2013 IBISWorld Industry Report S9412, Motor Vehicle Body, Paint and Interior Repair in Australia, p.9

<sup>3</sup> 2013 IBISWorld Industry Report S9412, Motor Vehicle Body, Paint and Interior Repair in Australia, p.7.

<sup>4</sup> The measure of profitability used is derived from the Net Underwriting Combined Ratio (COR). A COR of 100% indicates that an insurer's premium revenue exactly equals its costs. A COR of less than 100% indicates a profit, while a figure of greater than 100% indicates a loss. APRA began publishing CORs on a class of business basis in 2013. For the three quarters to Q3 2013, the COR for the Domestic Motor Vehicle class of insurance was 91%, which translates into an underwriting profit margin of 9%.

<sup>5</sup> APRA, Statistics, Quarterly General Insurance Performance Statistics, September 2013,

are, however, Allianz suggests that profitability of 9% fits within a range that most objective observers would regard as not uncomfortably low and not unreasonably high.

Overall, therefore, Allianz is of the view that there is nothing in the operating environment affecting repairers or in the way the sector is adapting to change that demonstrates any case for government regulatory intervention into the sector or into the relationship between repairers and those that procure their services, whether they be individuals or insurance companies.

## **Relations between repairers and insurers**

Insurers (particularly those operating in the motor insurance market) and smash repairers operate in highly competitive markets. In the context of the supplier-purchaser relationship that exists between repairers and insurers, there is a healthy level of competitive tension between the parties. Insurers seek to procure services for a fair, competitive price and obtain a good quality repair for their policyholder's vehicle. Insurers' desire to protect their brand and reputation, and retain their customers' business, along with the fact that they generally provide guarantees on the repairs they manage, means that seeking to ensure a high quality repair is an insurer's primary objective. It has been suggested by some that insurers somehow 'force' repairers to repair to 'price rather than a standard'. It makes no commercial sense for an insurer to do this and, given the potential implications of a poor quality repair for their customer's safety and that of others, such suggestions are morally and ethically offensive.

Repairers, on the other hand, have a commercial incentive to maximise the overall revenue earned by their business. This is normal business behaviour and in no way objectionable. It does mean, however, that insurers need to have systems and processes in place to ensure that in the procurement of repair services, they obtain a fair and competitive price. This can be achieved in a range of ways, such as through competitive quoting, entering long-term contracts with repairers (so-called Preferred Repairer Schemes), or having an insurance company assessor negotiate directly with the repairer in order to ensure a fair and competitive price is achieved.

In any commercial relationships involving millions of transactions (insurers procure around 2.5 million repairs annually across Australia), a small number of disputes will inevitably arise. Mechanisms to facilitate dispute resolution are contained in the Motor Vehicle Insurance and Repair Code of Conduct (the 'Code'). The Code sets out a range of principles, rights and obligations that govern the relationship between insurers and repairers and has worked well since its establishment in 2006. It has assisted in resolving the very small number of disputes that have arisen between Allianz and repairers since its inception. Allianz has had two disputes addressed under the External

Dispute Resolution (EDR) procedures of the Code during its more than seven years of operation.

The Code has recently been subject to external, independent review and recommendations for reform are currently under consideration by its governing body, the Code Administration Committee. One of the recommended reforms to the Code is the establishment of an arbitration process in relation to disputes. Allianz supports this recommendation. At present, most disputes under the Code are resolved under its Internal Dispute Resolution mechanism. A smaller number proceed to EDR, however, this is a conciliation-based process only. While the exchange of views and increased understanding of each party's perspective under EDR is often valuable, and the parties may ultimately 'agree to disagree' (because there is no alternative), this process can still at times leave one of the parties unsatisfied with the outcome. Allianz is of the view that, in such circumstances, the addition of an arbitration mechanism would enhance the Code's ability to resolve disputes.

Allianz notes that compliance with the Code is mandatory in NSW under the *Fair Trading Act 2007* (the 'Act'). NSW is the only jurisdiction where the national voluntary Code has been mandated. Specifically, Regulation 21(1) of the Fair Trading Regulation 2012 states:

*For the purpose of section 53 (1) of the Act, the code published in Gazette No 127 on 27 October 2006 at pages 9139-9168 (referred to in this Part as the "published code") is declared to be an applicable industry code of conduct.*

One of the advantages of voluntary codes over legislative instruments is their flexibility. The Code has been amended since its inception and, as indicated above, Allianz supports its further amendment to enhance its dispute resolution powers. However, no amendments to the Code flow through to the version mandated under the NSW regulation which, as indicated above, declares the version of the Code that existed on 27 October 2006.

Allianz also notes that any remedies available to insurers and repairers arising out of the declaration of the Code under the Act (ie penalties for breach of the Code under Part 6 of the Act) have, to our knowledge, never been used. At the time the Code was declared under the Act in NSW, Allianz was of the view that mandating the Code was unnecessary and likely to be of little, if any, value. That would appear to have been borne out by experience. Allianz suggests that in the interests of 'red tape' reduction (ie the removal of unnecessary and/or ineffective regulation) and removing the potential for unintended consequences to arise from the misalignment between the Code that has been declared under the Act and the current (and future) Code as it applies nationally, the NSW Government should repeal the declaration of the Code under the Act.

## The procurement of repair services by insurers

When a policyholder makes a claim under a motor insurance policy that requires damage to a vehicle to be repaired, the insurer has to decide which repair facility is best able to undertake the repair, from the perspective of both the customer (eg the quality and timeliness of the repair) and the insurer (eg the overall customer experience and obtaining a fair and reasonable prices). The policies offered by various insurers provide a range of ways in which the policyholder can input into this decision.<sup>6</sup> The market therefore provides a range of options to cater for different consumer preferences in relation to the level of input they wish to have into the insurer's decision as to who it will engage to undertake the repair. To Allianz's knowledge, there are no policies available in the market that provide the customer with an unfettered right to determine where the car is to be repaired. Having said that, any policyholder can obtain this right by seeking a cash settlement of their claim from the insurer and directly procuring the services of their preferred repairer themselves.

Allianz policies currently allow policyholders a relatively large degree of input into the decision as to where the car is to be repaired. Allianz's policy wording states:

### *Choice of repairer*

*Allianz can assist you in selecting a suitable repairer to repair the damage to your vehicle; however you also have the right to choose your own repairer. In both instances we will work closely with the repairer to strive to achieve the best repair outcome for you however we may require a second quotation from a repairer chosen by us. We will then choose (subject to any relevant policy limits) to:*

- 1. authorise the repairs at your repairer of choice;*
- 2. pay you the reasonable cost of repairing your vehicle; or*
- 3. move your vehicle to a repairer we both agree will repair your vehicle. In the instance that we both agree to move your vehicle we will provide you with a rental car for up to 3 days in addition to any other benefit provided under your policy.*

In common parlance, Allianz policies are said to offer 'choice of repairer', although as the wording above indicates, this does not provide the policyholder with an unfettered ability to direct Allianz to have the vehicle repaired wherever they wish. For example, if the policyholder's nominated repairer quotes a price that Allianz suspects is not a

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<sup>6</sup> Note, that the contractual relationship underpinning the repair of a vehicle under an insurance policy is between the insurer and the repairer. The owner of the vehicle is not a party to the contract to procure repair services. Insurance policyholders have no innate or inherent 'right' in law or otherwise to direct the insurer as to which repairer it should engage to repair the car. However, to varying degrees, insurance policies generally grant policyholders some input into this decision.

competitive one, we can “require a second quotation from a repairer chosen by us” to assist us in determining the “reasonable cost” of repairing the vehicle. As noted previously, the policyholder can still ultimately decide to use their preferred repairer and Allianz can facilitate this by exercising option 2 above, that is, providing what is commonly referred to as a ‘cash settlement’. The vast majority of repairs procured by Allianz are done under option 1 above. It is only rarely that Allianz decides to cash settle (option 2) or move a vehicle to an alternative repairer (option 3), and, when option 3 is used, it can be for a range of reasons, for example, the policyholder’s preferred repairer did not have the equipment and/or skill level to undertake the repair (eg on a prestige vehicle).

### **Methodologies for determining a fair and reasonable price for repairs**

The nature of an insurer’s policy wording in respect of ‘choice of repairer’ has implications for the repair procurement process the insurer may or can use. For example, the method known as ‘competitive quoting’ is inconsistent with Allianz’s current policy of offering ‘choice of repairer’. Competitive quoting is an approach by which, to identify a fair and competitive price for a repair, the insurer seeks multiple quotes (generally two, but maybe more) for the repair in order to determine (based on price, scope of works, repair quality and other factors (eg customer service)) which repairer it will engage to undertake the repair. One of these quotes may be from a repairer nominated by the policyholder if they happen to have a preference for a particular repairer to undertake the work.

Under this model, however, there is no certainty that a repairer nominated by the policyholder will provide the most competitive quote. Thus, it is not possible to provide a policy that offers a high degree of customer choice of repairer, as Allianz currently does, and adopt the competitive quoting model. As a result, Allianz currently adopts a ‘single quote’ model. Because Allianz currently offers a high degree of repairer choice, Allianz is potentially required to work with, literally, any repairer in NSW (and the whole of Australia) and generally does. Under Allianz’s single quote model, an assessor generally physically examines each vehicle and, in conjunction with the repairer’s quote, negotiates directly with the repairer on a car-by-car basis to reach a mutually agreed outcome in terms of the work to be done, the parts to be used (eg Original Equipment Manufacturer (OEM), recycled etc) and the price for the job.

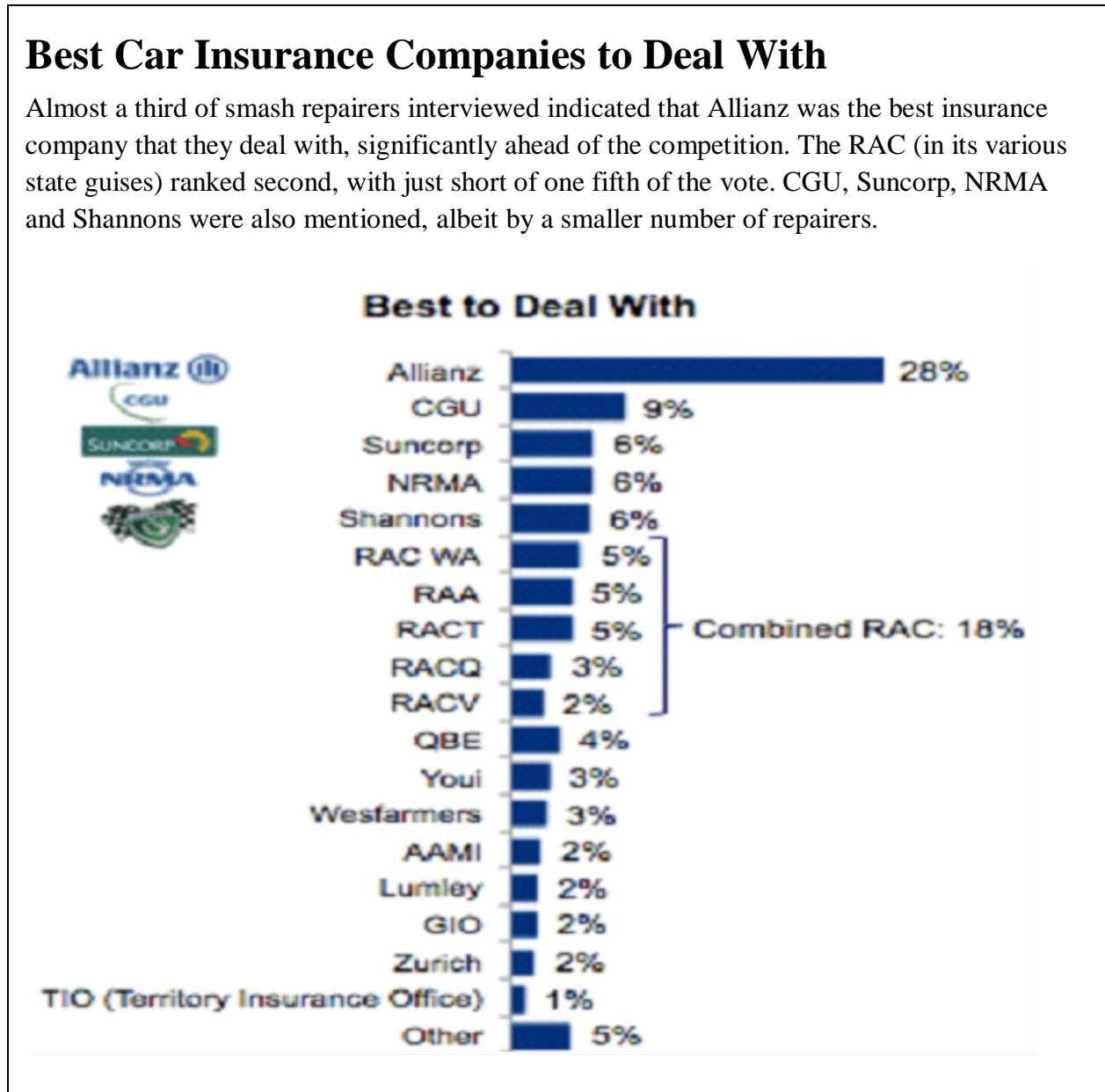
The single quote model, compared for example to the competitive quoting model, effectively gives the repairer a degree of ‘monopoly’ power when negotiating with Allianz assessors. This requires that Allianz’s assessors are highly skilled and constantly trained in order to keep abreast of the latest repair methods, techniques and equipment, as well as experienced in assessing quotes using the repair industry’s ‘traditional’



quoting methodology, which Allianz currently uses. On balance, however, Allianz's single quote model achieves a mutually agreed, fair and competitive price for repairs. As a result, Allianz has generally had and continues to have a good relationship with the overwhelming majority of repairers. This is something we have always known anecdotally and through feedback from repairers themselves and, pleasingly, was confirmed recently through independent quantitative research – see extract from a recent ACA Research report<sup>7</sup>.

## Best Car Insurance Companies to Deal With

Almost a third of smash repairers interviewed indicated that Allianz was the best insurance company that they deal with, significantly ahead of the competition. The RAC (in its various state guises) ranked second, with just short of one fifth of the vote. CGU, Suncorp, NRMA and Shannons were also mentioned, albeit by a smaller number of repairers.



<sup>7</sup> <http://www.acaresearch.com.au/>



In terms of the quoting methodology itself, as noted, Allianz currently uses the 'traditional' method (see Box below). This methodology has been in use for several decades and is widely understood and adopted across the repair industry. Allianz is in the process of assessing alternative quoting methodologies (eg eMTA) including the Audatex system, which is currently used in the estimation of repair times for 55% of the damaged vehicle repairs undertaken worldwide. However, a key challenge is that these alternatives are either not based on a comprehensive and accurate database of 'realistic' times for all the possible repair operations that can be carried out on every make and model of vehicle available in Australia (eg eMTA) or is not widely accepted by the repair sector (eg Audatex). Thus, while Allianz continues to assess these alternatives, we are currently reliant on the traditional methodology that is still widely used across the Australian repair industry.

**Box: The 'traditional' repair quotation methodology**

The 'traditional' repair quotation method has been in widespread use in Australia for nearly half a century. It was introduced around 1970 at the initiation of repairers who had grown dissatisfied with the 'piece rate' approach (ie x dollars to do a certain repair operation). The, now called, traditional methodology, is based on repairers preparing quotes based on 'units' of work. These 'units', as they relate to particular repair operations (eg remove-and-replace (R&R) a rear bumper bar, 'repair' (ie panel beat) a dented bonnet, or paint a door), are mutually understood by repairers and assessors based on experience and industry knowledge.

A dollar rate is applied to the the assessed number of 'units' to arrive at an overall dollar amount to undertake each particular repair operation. The 'units' are not based on time as such (eg hours or minutes) and hence the dollar rates used cannot be regarded as, or compared to, an 'hourly' dollar rate. To give an idea of how the units used in the traditional quoting method relate to actual time, if one was to convert the number of units applied to a range of common repair operations, it may translate into around 2-4 units to the hour.

The Code allows insurers to determine the quoting methodology they wish to use. For example, Section 6(2)(a) states:

*“Insurers will state clearly the estimation method to be applied.”*

While most repairers are generally aware of Allianz’s quoting methodology, from dealing with us for many years. This is confirmed verbally by the assessor if need be and Allianz’s Repair Authorisation form, which is provided for every repair, clearly states the estimation (ie quotation) method that Allianz applies.

The traditional approach, at times referred to disparagingly as ‘funny time, funny money’, has been criticised by some as a quoting methodology, as have other commonly used quoting methodologies, such as competitive quoting. Indeed, the view has been put that, if only insurers ceased using these and other approaches (eg Preferred Repairer Schemes or, more recently, vertically integrated (ie insurer-owned) repairers), in favour of alternative approaches that have from time to time found favour among some repairers (or, more commonly, repairer representatives) all the commercial challenges facing the repair sector would miraculously disappear. Given the multitude of external factors and challenges (listed above) impacting on the commercial environment in which repairers operate, simple common sense suggests that this is untrue – at best, a false hope but in fact worse, a cruel hoax.

Under the single quote system that Allianz uses, the specifics of the quoting methodology itself are somewhat secondary to the underlying approach to determining a fair and reasonable price for repair work. Allianz’s underlying approach is based on a direct negotiation between two individuals with significant knowledge and experience in the repair of accident damaged vehicles (ie the assessor and the repairer) on a car-by-car basis, aimed at arriving at a mutually agreed, fair and reasonable price to do the job.

At any stage, the repairer can decide to not carry out the repair and Allianz will simply transfer the vehicle to an alternative repairer. A repairer is under no obligation to agree to undertake the repair at any price other than one that they are willing to accept. As noted, if the repairer has been nominated by our policyholder, Allianz’s obligation under our ‘choice of repairer’ policy provides a strong incentive for Allianz to reach an agreed outcome.

Allianz procures over 550 repairs each working day (over 110,000 per year) across Australia and finds our approach of direct negotiating a mutually agreed price is an effective way of balancing our need to obtain a fair and reasonable price with our policy of allowing our customers to choose the repairer (if they have a preference). At least in Allianz’s case, critics of the traditional quoting methodology would need to reconcile

their position with the research quoted above that indicates that, by far, repairers regard Allianz as the best insurance company to deal with.

## **Conclusions**

In Allianz's view, a natural and healthy competitive tension exists between insurers and repairers, as would be expected to exist between any two parties in a purchaser-supplier relationship in a competitive commercial environment. There is nothing to indicate a need for any government regulatory intervention into the insurance market, the repair sector, or the relationship between insurers and repairers.

Disputes will sometimes arise between commercial parties. In addition to the remedies provided by common law, contract law and statute, the Insurance and Repair Industry Code provides mechanisms to help resolve such disputes or, at least, assist in a better understanding of the issues between the parties. As indicated, Allianz supports an extension of the Code to allow for the arbitration of disputes to enhance the existing conciliation-based EDR mechanism.

All businesses and industry sectors exist in a dynamic economic and commercial environment which results in financial challenges, business failures, new entrants and consolidation, among other impacts. The repair sector is no different. The insurance sector has faced all of these and more over recent years. That is not to say that business failure and industry rationalisation does not present challenges to those most directly impacted. If the NSW Government was to consider any policy response to this, it could look at a Structural Adjustment program to assist repairers adapt to their changing operating environment or to exit the industry.