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L A W Y E R S

Date 9 February 2005

Our reference
ISW.RLD.02-1366-1734

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To Scott Gregson
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Dear Sir/Madam

Insurance Australia Group – Third Line Forcing Notification

We refer to the above matter and attach a reply to submissions lodged by interested parties on behalf of the IAG Insurers.

If you have any queries please do not hesitate to contact us.

Kind regards

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Number of pages including this cover sheet 10

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REPLY TO SUBMISSIONS PROVIDED TO ACCC

9 February 2005

1. Reply to Submissions

- 1.1 These submissions are provided to assist the Australian Competition and Consumer Commission (ACCC) in relation to submissions lodged by interested parties in respect of notifications of exclusive dealing lodged by Insurance Manufacturers of Australia Pty Limited ABN 93 004 208 084 (IMA), Insurance Australia Limited ABN 11 000 016 722 (formerly NRMA Insurance Limited) (NRMA Insurance), SGIO Insurance Limited ABN 30 058 277 866 and SGIC General Insurance Limited ABN 68 069 065 158, (collectively, the IAG Insurers).

2. Submissions from Interested Parties

- 2.1 In response to its request for submissions from a range of interested parties, the ACCC has received submissions from the MTAA (a national body representing the retail, service and repair sectors of the Australian automotive industry); the MTA(NSW) and VACC (both members of the MTAA); and AARA which purports also to represent automotive smash repairers throughout Australia, and which was formed for the stated purpose of challenging practices in the Insurance Industry, predominantly IAG's preferred smash repairer scheme. The IAG Insurers note that the persons making the submission on behalf of AARA have not identified themselves or the scope of their authority or representation and that orders were made for winding up of AARA on 4 February 2005.
- 2.2 The ACCC has not received any submissions from representatives of consumers. Nor has it received submissions from any competitors of the IAG Insurers. It must be assumed that competitors and consumers do not oppose the notified conduct. The Australian Consumers Association (ACA) might reasonably be assumed to support it (see para 7.3 below.)
- 2.3 Moreover, the ACCC has not received any submission establishing (or suggesting on any reasonable basis) any lessening of competition in any market likely to result from the notified conduct.

3. Purpose of Notifying Conduct

- 3.1 The IAG Insurers lodged a Form G notification dated 27 September 2004 (Notification) seeking limited statutory immunity from the third line forcing provisions of the Trade Practices Act 1974. The ACCC has power to confirm a grant of immunity where the ACCC is satisfied that the public benefits of the conduct outweigh any anti-competitive detriment.
- 3.2 There is authority¹ to suggest that the conduct the subject of the notification does not amount to illegal third line forcing and therefore does not need to be notified to the ACCC. However, the relevant decision remains at this stage on appeal. The IAG Insurers do not

¹ *Australian Automotive Repairers Association (Political Action Committee) Inc v Insurance Australia Limited (formerly NRMA Insurance Limited) No 6 [2004] FCA 700 (AARA).*

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consider that their conduct amounts to third line forcing but have lodged a notification out of caution to avoid technical claims and spurious litigation. The AARA litigation and the submissions lodged in respect of the notification have confirmed the appropriateness of this approach.

- 3.3 The submissions lodged by some interested parties substantially overstate the scope of the immunity sought by the IAG Insurers. The immunity is not immunity from the whole of the Trade Practices Act 1974 (TPA); it is limited immunity from liability for a technical prohibition on one form of exclusive dealing.
- 3.4 It is the view of the IAG Insurers that the interested parties have used this notification process as an opportunity to make a range of unsubstantiated complaints and base allegations of breaches of the TPA, including unconscionable conduct and/or misuse of market power in dealings with smash repairers. These allegations are strongly refuted and are not relevant to the issues which the ACCC must consider in relation to the notification. They are accordingly not addressed here.
- 3.5 IAG notes that a number of Government Inquiries and Reviews over recent years have examined the preferred supplier arrangements between the insurance industry and the smash repair industry and found that these supplier arrangements are *not* in breach of the TPA or any other legislation². The ACCC's notification process should not be used or politicised in this way. The Productivity Commission (or private action) was the appropriate forum for raising these complaints and the ACCC should consider only those matters bearing directly on the limited immunity granted.

4. Policy Change

Standard policy

- 4.1 Paragraphs 3.7 and 4.1 of the submissions in support of notification of exclusive dealing lodged on behalf of the IAG Insurers dated 27 September 2004 (**IAG Insurer submissions**) explain that the standard comprehensive motor vehicle insurance policy (**Standard Policy**) has or will be amended to remove the option for policyholders to choose a repairer with whom IAG does not have a business relationship (**Non Preferred Repairer**). Under the amended Standard Policy, the IAG Insurer and not the policyholder will be responsible for choosing and engaging a repairer when the vehicle is repaired under the policy. The repairer will be selected from the pool of PSRs and ASRs in the IAG repairer network.
- 4.2 IAG estimates that more than 90% of its customers will use a PSR or ASR to carry out repairs under the Standard Policy.

Choice of Repairer Option

- 4.3 The Choice of Repairer option is an optional add-on to the Standard Policy. The Choice of Repairer option provides an additional level of choice and certainty for customers in a

² Extract from Executive Summary of IAG submission to Productivity Commission dated 13 October 2004

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niche market who wish to select a particular repairer in the event their vehicle is repaired under the policy.

- 4.4 At the time of purchasing or renewing a Standard Policy the customer will have the option of paying an extra premium to have the right to choose any repairer, including a Non Preferred Repairer.
- 4.5 Current take up rates for the Choice of Repairer option are less than 5%, in line with the IAG Insurers' expectations.

5. Cash Settlement

- 5.1 While it is anticipated that in almost all cases, repairs will be carried out with the chosen repairer, the IAG Insurers have imposed prudent and reasonable restrictions on the Choice of Repairer option to control their risk and costs. In particular:
- (a) the chosen repairer must be a properly qualified and (where required) licensed smash repairer within a reasonable distance of the location of the vehicle;
 - (b) the IAG Insurers retain the right to cash settle for the fair and reasonable cost of repairing the vehicle (or use one of the other cash settlement options as described in pages 6 to 15 of the NRMA Motor Insurance Product Disclosure Statement and Policy Booklet which comprises Annexure "B" to the notification (PDS)) in the event that the IAG Insurers and the repairer cannot agree the amount of the quote.
- 5.2 The IAG Insurers must retain the right to cash settle under both the Standard Policy and Choice of Repairer policy option, for use in the inevitable but small percentage of cases where:
- (a) quotes are manifestly extravagant (not fair or reasonable);
 - (b) IAG is not willing to guarantee the workmanship, eg where they have had previous negative experiences with repair quality;
 - (c) it is unsafe for an IAG assessor to attend the repair shop either because of prior knowledge / experience of an unacceptable occupational health and safety risk or similar intimidating or unacceptable behaviour towards an assessor.
- 5.3 The IAG Insurers intend to authorise 100% of fair and reasonable claims given that the customer has paid for Choice of Repairer. However, in some cases cash settlement is necessary, for example:
- (a) OH&S issues
- The IAG insurers have had experience of assessors being physically threatened by some repairers. Obviously it is not safe for any IAG Assessor to attend such premises and any repairs carried out there would be cash settled.

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(b) Excessively Expensive Quote

An IAG Assessor determines the fair and reasonable cost of repairs at \$1500. Repairer quotes \$4500 and refuses to negotiate on price. The insured would be contacted to explain the situation, and if the customer still wished to have their vehicle repaired there, they would be cash settled for \$1500. It is important for the IAG Insurers to retain the right to cash settle, to minimise the risk of over quoting by Non Preferred Repairers.

5.4 The fact that IAG retains the right to cash settle is clearly disclosed in the relevant Product Disclosure Statements. See for example page 24 of the PDS. The IAG Insurers do not consider that they have engaged in misleading or deceptive conduct in seeking to inform consumers of the choice of repairer policy option.

5.5 There will not be any automatic process of comparing a quote from a Non Preferred Repairer with a quote from a preferred repairer. An assessor would use his own experience and if in the assessor's opinion the quote seems excessive, a second quote may be obtained to ensure that what the IAG Insurer agrees to pay is in the ball park of what is fair and reasonable.

6. **Pricing**

6.1 Further to paragraphs 5.6 to 5.9 of the IAG Insurer submissions, it is noted that pricing of the choice option reflects:

- (a) the additional average cost to the IAG Insurers in the relevant states (where average repair costs differ) of working with repairers with whom they have no relationship taking into account increased risk of higher quotes, a generally higher than average cost of repairs, additional administrative costs (eg no online billing), and related inefficiencies and potential difficulties in dealing "one off" with the selected repairer;
- (b) the cost and risk of providing a lifetime guarantee not previously offered in respect of work carried out by Non Preferred Repairers;
- (c) additional time spent by an assessor in visiting the premises and checking quotes (the quote cannot be checked via an online repair management system as is currently in place for PSRs and many ASRs).

6.2 The pricing of the option does not include a component of profit for the IAG Insurers. The pricing is inclusive of GST and Stamp duty (eg the additional premium for Choice of Repairer in NSW is \$60 + \$9 in government taxes).

6.3 The IAG Insurers confirm and reiterate their offer to show the ACCC, on a confidential basis, the modelling for calculation of the additional premium for the Choice of Repairer option.

6.4 IAG made a commercial decision to charge an additional amount for the Choice of Repairer option rather than reducing Standard Policy prices. The purpose of introducing an optional additional premium was not to discourage customers from exercising choice, but

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to remove cross-subsidisation by those for whom choice is not important (on current experience the vast majority of customers – see paragraph 4.5 above). The Choice of Repairer option is a "user pays" system.

6.5 The IAG Insurers face significant competition in the market for supply of motor vehicle insurance. The IAG repairer network helps control repair costs. Lower repair and other claim costs result in premiums for customers as a whole being lower than they otherwise would be in the presence of higher repair and other claim costs. Annexure 1 contains relevant extracts from IAG's submission to the Productivity Commission dated 13 October 2004 in relation to insurance premium rate movements.

7. Likely Public Benefits

7.1 The public benefits of the conduct are generally set out in paragraphs 5.1-5.10 of the IAG Insurer submissions. The ACCC should also note that the IAG Insurers will provide a lifetime guarantee on authorised repairs by the repairer of choice. This benefit was not previously available to customers if the repairer of choice was a Non Preferred Repairer.

7.2 Contrary to what is submitted by some of the interested parties, there is no "fundamental right" for an insured to choose a repairer and not all Insurers offer a choice of repairer. IAG Insurer customer research indicates that 95% of consumers prefer the insurer to manage their repairs.

7.3 In a recent submission to the Productivity Commission Inquiry into Smash Repair and Insurance dated December 2004, the ACA states that "*In the ACA's experience most consumers do not have a preferred repairer*" and "*most consumers are happy, in fact prefer, to let their insurer manage the repair*". This is reflected in low take up rates of the Choice of Repairer option to date.

7.4 The ACA also notes that many consumers do not wish to deal directly with the repairer and would prefer the Insurer to manage the repairs. This is an important benefit of both the Standard Policy and the Choice of Repairer option i.e, that the IAG Insurer manages the repairs.

7.5 Another important aspect of having a separate Choice of Repairer option is that choice is transparent and customers are not locked in year after year without realising it. The option can be selected or deselected on an annual basis when the policy is renewed.

7.6 Annexure 2 contains relevant extracts from IAG's response to the Productivity's Draft Report into Smash Repair and Insurance dated December 2004 in relation to the benefits for consumers of preferred repairer schemes.

8. Likely Detriment

8.1 The submissions lodged by interested parties contain no evidence of any actual or likely anti-competitive detriment in any relevant market; they merely contain a few bare assertions.

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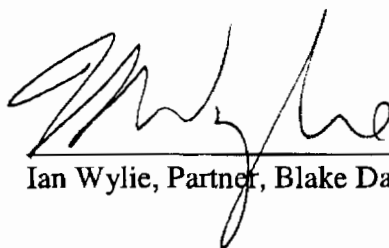
- 8.2 The IAG Insurers refer to paragraph 6.1 of the IAG Insurer submissions and reiterate that the notified conduct will not have any detrimental effect on competition in any market for the reasons set out in sub-paragraph 6.1 (a) to (f).
- 8.3 The Choice of Repairer policy, being optional and user pays, involves no consumer detriment.
- 8.4 In relation to potential impact on ASRs, nothing should change by reason of the introduction of the Choice of Repairer option. The Standard Policy continues to operate to refer business to the repairer network and issues and complaints concerning allocation of repair work within that network are being aired and dealt with in other fora. It would be inappropriate and unhelpful to address those matters further here.

9. **Other Claims**

- 9.1 In relation to criticism of confidentiality claims made by the IAG Insurers, the IAG Insurers note that they have no objection to publication of the summary material released by the Productivity Commission. However, the detailed material provided to the ACCC in confidential annexures "A" and "C" to the notification is confidential and this remains the consistent position of the IAG Insurers.
- 9.2 In relation to the incorrect MTA (NSW) submission that the two tier system was an Insurer initiative and not an Association proposal the IAG Insurers refer to the ACCC's Issues Paper dated September 2003 and paragraph 5.1 of the IAG Insurer submissions.

DATE: 9 February 2005

SIGNED on behalf of the IAG Insurers:



Ian Wylie, Partner, Blake Dawson Waldron

ANNEXURE "1"

IAG information on premiums supplied as part of submission to Productivity Commission

Insurance Premiums

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

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

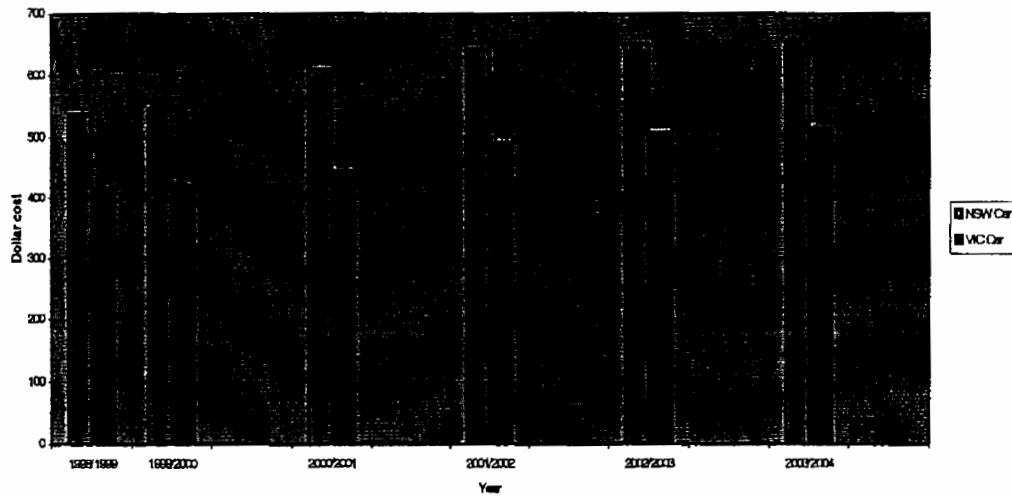
Insurance Class	2002	2003	2004	2005
Domestic Motor Vehicle	11	7	5	4
Householders	11	7	6	5
CTP (NSW)	5	-1	5	5
CTP (QLD)	na	12	5	1
• WORKERS' COMPENSATION	5	-6	-4	0
Fire & ISR (Property)	45	14	9	1
Commercial Motor Vehicle	11	5	0	1
Public & Product Liability	51	27	11	6
Professional Indemnity	51	29	18	10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

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

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

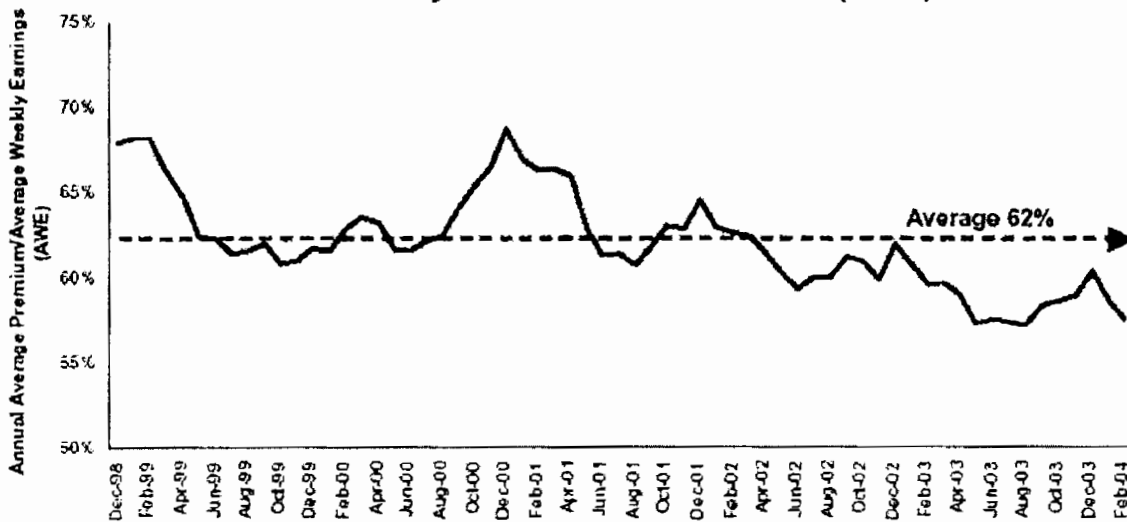
The following graph provides context around the trend in IAG's average premium by measuring affordability for motor vehicle insurance. It measures the annual cost of an average premium for a NSW motor comprehensive policy against average weekly earnings and shows affordability is 8% cheaper as at February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

Changes in IAG's NSW and Victoria Motor Vehicle Premiums



Source: IAG

Affordability of NRMA Car Insurance (NSW)



Full time adult ordinary time earnings - Gross pay before tax and overtime. Only full-time adult employee jobs.

— Annual Average Premium/AWE

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

ANNEXURE "2"

Reference from IAG response to Productivity Commission Draft Report in relation to "moral hazard"

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*)