ANALYSIS OF AUTO INSURANCE
DIRECT REPAIR AND REFERRAL PROGRAMS

Abstract
Direct repair and referral programs (DRPs) allow insurance companies to offer names of auto body and glass repair shops to their insureds and claimants so they can have their vehicles repaired quickly and properly after an auto accident. Laws in some states prevent carriers from providing names of reputable facilities to their customers, hence limiting their ability to make an informed choice about repair options. These more restrictive states are found to have higher auto physical damage insurance premiums and claim costs resulting from higher repair and parts costs, more labor hours and parts used per claim, and higher claim settlement expenses than states with less restrictive laws.

Introduction
In many states, insurance companies and auto body and glass repair facilities are able to enter into business relationships with one another for the purpose of repairing vehicles that are damaged in automobile accidents. The concept began in the late 1970s and is becoming more widespread today. This type of arrangement, known as a direct repair and referral program (DRP), allows an insurance company to refer an owner of a damaged vehicle to one or more repair facilities that have an established relationship with the insurer. Certain body and glass shops are selected to be part of an insurer’s network of affiliated facilities because they meet the insurer’s criteria, consistently perform high-quality repair work and provide excellent service. In essence, these shops represent the insurer and are trusted to manage positive repair outcomes to the customers’ advantage in a more efficient manner. DRPs also have been found to be successful in reducing the overall cost of collision repairs.

In those states that allow referrals, the insurance company can recommend specific shops (within a reasonable distance) to help a claimant make a more informed decision on the appropriate place for repair. The individual still has the right to take the vehicle to any shop desired, but having options provided by the insurer reduces the hassle and time in gathering repair estimates from different – and potentially unknown – shops on one’s own. The vehicle owner still retains control in selecting the repair options that best suit his or her needs and authorizing the repairs based on a thorough and agreed-upon evaluation of the damage(s). In this way, there is a greater likelihood for quality repairs at reasonable prices, comprehensive guarantees and a satisfactory auto body repair experience.

A direct repair and referral arrangement benefits vehicles owners and insurers alike. Insurance companies and the body or glass shops do the leg work, take care of the details and resolve unforeseen problems. They directly handle the administrative paperwork, thus increasing the overall efficiency of the claims handling process. Vehicle owners can get their cars fixed quickly and conveniently in a more streamlined fashion.

Since the repair facility and the insurance company already have a working relationship, there is consensus in using more state-of-the-art repair technologies that help to control costs and provide top-quality repairs. Insurers can manage their claim severities and claims handling process better. Furthermore, since companies are familiar with the level of quality and service provided by shops within their networks, they frequently will provide an additional warranty on the workmanship. Lower costs, faster settlements and additional
guarantees all result in satisfied policyholders and claimants, hence maintaining good customer relations and enhancing customer loyalty.

Repair facilities can also expand their client base and volume of sales from additional insurer referrals, which in turn helps to reduce their marketing expenses. According to Collision Repair Industry Insight, the number of claims processed through DRPs as a percentage of total claims quadrupled during the 1990s. This growth suggests that DRPs help to enhance a solid relationship between collision repair shops and insurance companies for the benefit of customers.

A survey conducted by J.D. Power and Associates found that people who take their vehicles to a direct repair facility are more satisfied than those who use a body shop without a referral or recommendation. Not only do owners of damaged vehicles benefit from DRPs, but all insured drivers in states that permit referrals benefit from overall lower loss experience and lower insurance rates. In addition, these networks strengthen competition among repair facilities since more shops will need to provide high quality repairs at reduced costs in order to gain market share.

State DRP laws vary in terms of the ability to offer auto repair or glass shop referrals. Most states either are silent with regard to referrals or allow referrals to be made. Although provisions in many states typically ban insurance carriers from requiring an insured or a claimant to use a particular shop or anyone to travel an unreasonable distance to a shop, referrals can still be made.

At the present time, five states – Indiana, Massachusetts, Minnesota, New York and Rhode Island – have DRP laws that are very restrictive in terms of referring customers to body or glass repair facilities. (Until October 2009, California also had a very restrictive DRP law, but it was amended and now allows insurers to explain their direct repair programs to customers without a specific request. In states with rigid referral laws, insurers cannot even recommend or suggest specific body shops unless expressly asked by the customers. As such, their laws do not benefit those involved in auto accidents, i.e., at times when such information would be most helpful. Indeed, some individuals tend to be under great stress after an auto accident that they do not think to ask what their options are. The "choice" of a shop might simply be where the vehicle is towed from the accident scene, whereas laws allowing referrals would enable the victim to have, at a minimum, more carefully considered options from which to select.

Data Analysis and Conclusions
Using data reflecting average insurance premiums and expenses, damage costs, and repair parts, PCI has analyzed the group of six states (California, Indiana, Massachusetts, Minnesota, New York and Rhode Island) with more rigid DRP laws compared with the group of states with less restrictive DRP laws.

One finding shows that states with limitations placed on DRPs have, on average, higher physical damage premiums than other states with fewer limitations. In 2007 (latest year available), drivers in the six states that do not permit unsolicited body or glass shop referrals paid almost 7 percent (6.9 percent) more for physical damage coverages than drivers in states that allow referrals ($457.47 – more rigid DRP laws vs. $429.56 – less rigid DRP laws).

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2 California AB 1200, approved by Governor on October 11, 2009
3 California is included in this data analysis since it still had a restrictive DRP law during the time period evaluated.
4 PCI, based on average premium data compiled by the National Association of Insurance Commissioners (NAIC), Auto Insurance Database Report, 2006/2007; 2009 Edition
Moreover, while auto insurance premiums throughout the country have generally been lower in recent years (due primarily to a decline in claim frequency), drivers in less rigid DRP states fared even better than their counterparts in more rigid DRP states. From 2003 to 2007, the average price for collision and comprehensive coverages in the states permitting referrals dropped 6.1 percent overall, with drivers here paying about $430 in 2007 compared to $457 in 2003. Drivers in the six states not permitting referrals also benefited from premium reductions but theirs were not as great; on average, these drivers received a decrease of only 2.3 percent overall, paying $459 in 2007 compared to $470 in 2003 (Figure 1).

The higher average physical damage prices found in the six more rigid DRP states are influenced by claim severities that are not only higher but have increased at a faster pace than severities found in less rigid DRP states. In 2003, the six states had a combined average collision and comprehensive claim cost that was 14.3 percent higher than the average claim cost of the less restrictive states ($1,950 – more rigid laws vs. $1,706 – less rigid laws). By 2007, the gap in severities between the two groups of states widened to 16.1 percent ($2,239 – more rigid laws vs. $1,928 – less rigid laws)\(^5\) (Figure 2).

\(^5\) Source: Fast Track Monitoring System, a publicly available report prepared by PCI, Insurance Services Office, Inc. and National Independent Statistical Service. Data for 2007 are used to be consistent with the latest 2007 data available from the NAIC and collision information providers, CCC Information Services, Inc. and Mitchell International.
The increased gap between the two groups of states in 2007 is due to the claim severity for the more restrictive DRP states growing more quickly than the severity for the less restrictive DRP states. The average physical damage claim cost for the group with more rigid referrals rose 14.8 percent from $1,950 in 2003 to $2,239 in 2007. During this time, its growth rate was almost two (1.8) percentage points faster than the group with less rigid referrals, whose average claim cost rose 13 percent from $1,706 in 2003 to $1,928 in 2007.

<table>
<thead>
<tr>
<th>Average Physical Damage Claim Cost</th>
<th>2003</th>
<th>2007</th>
<th>Overall Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>More Restrictive DRPs</td>
<td>$1,950</td>
<td>$2,239</td>
<td>14.8%</td>
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<td>$1,706</td>
<td>$1,928</td>
<td>13.0%</td>
</tr>
</tbody>
</table>

*Source: Fast Track Monitoring System*

The higher and more rapidly rising claim severity experienced by the group of six states (California, Indiana, Massachusetts, Minnesota, New York and Rhode Island) with more rigid DRP laws is attributable to:

- higher total average cost of repairs;
- more rapidly rising cost of repairs;
- higher parts cost;
- greater number of replacement parts used per claim;
- more labor hours per claim; and
- higher loss adjustment expenses (LAE), as a percent of incurred losses.

<table>
<thead>
<tr>
<th></th>
<th>Six States w/ More Rigid DRP Laws</th>
<th>Other States w/ Less Rigid DRP Laws</th>
<th>‘More Rigid’ is Greater by..</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Average Cost of Repairs</td>
<td>$2,623</td>
<td>$2,383</td>
<td>10.1%</td>
</tr>
<tr>
<td>Growth in Avg. Repair Cost (‘03 to ‘07)</td>
<td>9.5%</td>
<td>9.2%</td>
<td>0.3 point</td>
</tr>
<tr>
<td>Average Cost of Parts</td>
<td>$992</td>
<td>$939</td>
<td>5.6%</td>
</tr>
<tr>
<td>Avg. No. of Parts Replaced Per Claim</td>
<td>8.9</td>
<td>8.1</td>
<td>9.9%</td>
</tr>
<tr>
<td>Avg. No. of Labor Hours per Claim</td>
<td>25.5</td>
<td>23.0</td>
<td>10.9%</td>
</tr>
<tr>
<td>LAE as a Percent of Incurred Losses</td>
<td>17.3%</td>
<td>16.7%</td>
<td>0.6 point</td>
</tr>
</tbody>
</table>

*Source: PCI, based on 2007 data (latest available) compiled by CCC Information Services, Inc. and Mitchell International, and 2003-2007 loss adjustment expense data compiled by the NAIC*

*The Property Casualty Insurers Association of America* (PCI) is a trade association consisting of more than 1,000 insurers of all sizes and types, and representing 37.4 percent of the property/casualty business and 43.6 percent of the personal auto market in the nation.

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6 The physical damage LAE includes but is not limited to defense and litigation fees and fees or salaries for adjusters, appraisers, private investigators, hearing representatives, and fraud investigators.