

THE CLAIMS HANDLING PROCESS OF PROPERTY INSURANCE IN SOUTH AFRICA

D Naudé, F J Mostert**, J H Mostert****

Abstract

Property insurance is the second largest class of short-term insurance in South Africa. As South Africa is a developing country and has an emerging market economy, the conclusions of this paper, which are based on a literature study and an empirical survey, should accordingly also be valuable to short-term insurers in other countries with emerging market economies.

The objective of this research paper endeavours to improve financial decision-making relating to the claims handling process of property insurance. It therefore focuses on the insurance of buildings, the contents of buildings, as well as all-risks insurance. After paying attention to the main factors, necessary to contemplate in the claims handling process of each of the three types of subject matter, the applicable problem areas and the effectiveness of the short-term insurers who participate in the empirical survey, are addressed.

Keywords: All-Risks Insurance, Buildings, Claims Handling Process, Contents of Buildings, Property Insurance

**Department of Business Management, Department of Business Management, University of Stellenbosch, Private Bag X1, Matieland, 7602, South Africa*

Tel: +27 78 893 6422

Fax: +27 21 808 2226

Email: dianmaude@gmail.com

***Corresponding Author, Department of Business Management, University of Stellenbosch, Private Bag X1, Matieland, 7602, South Africa*

Tel: +27 21 927 6417

Fax: +27 21 808 2226

Email: Jan.Mostert@absacapital.com

****Prof., Department of Business Management, University of Stellenbosch, Stellenbosch, South Africa*

1. INTRODUCTION AND OBJECTIVE OF THE RESEARCH

This research paper addresses the claims handling process concerning property insurance. Property insurance is the second largest class of short-term insurance in South Africa, as it was responsible for R18 946 million of gross written premiums in 2007 (Santam, 2008:6). This represented more than 32% of the total written premiums of the South African short-term insurance industry in 2007.

The *objective* of this research comprises of the improvement of financial decision-making concerning the claims handling process of property insurance. Claims handling with regard to the insurance of buildings and the contents of buildings, as well as all-risks insurance, will receive due attention. The problem areas relating to the topic will also be addressed, in order to achieve the stated objective. The effectiveness of the claims handling process during the past five years as perceived by the executive managers, also forms part of this research paper. The various aspects of this topic will be

addressed by means of the following literature study, after which the results of an empirical survey follow.

2. PROPERTY INSURANCE REGARDING BUILDINGS

It is important to understand the basic concept of what a building is. According to Outsurance (2009), a building is an immovable structure with permanent fixtures such as the walls, roofs, gates and underground pipes and cables. Ownership of a building, with all its fixtures, has a very significant financial impact on any person or enterprise, as it is very expensive. The owner of such property will have a financial and/or legal interest in the building, and an insurable interest is thus created (Gerber, 1999:48-49). An insurer therefore offers financial security by insuring the building in the event of a loss for a set monthly/annual premiums paid by the insured (Apte & Cavaliere, 1993:67).

In property insurance there are several events that may have a detrimental impact on the building structure. The Great Fire of London in 1666 opened

the market to fire insurance (Diacon & Carter, 1992:17). Property insurance of buildings is also combined with a Standard Fire Policy which reimburses policyholders for any losses that might occur as a result of fire, lightning or explosion, where fire is defined as an actual ignition of something that should not be on fire and the origin thereof is fortuitous or accidental (Diacon & Carter, 1992:18; Snow, 2002:38/3). Although the cover of the Standard Fire Policy is quite limited, there are several other risks that can be covered in property insurance at an additional premium. These risks include a wider cover for explosion, malicious damage, storm (wind, water, and hail), theft, floods, burst pipes, earthquakes and impact damage against property, to name a few (Diacon & Carter, 1992:18; Treby, Clark & Priest, 2006:351). Special stipulations may also be applicable on the location of the building and the types of material used in the construction thereof (Bryan, 1986:15; Schuster, Blong & McAneney, 2006:222).

Insurance is based on the mutually loss sharing principle where insurers pool their risks together. These risks should be quantifiable (where risks are expressed in monetary terms over the period of insurance), diversifiable (where risks can be offset against one another), fortuitous (on the basis of chance) and economically priced (affordable to the policyholder). Risks cease to be insurable when these requirements are not met (Maynard, 2008:141).

When evaluating the risks of insuring a building, insurers look at the frequency and impact of the damage. The frequency of loss of or damage to the structure alone may be low, but when a loss does occur, the impact of that event could be high. The cover of private houses and industrial buildings are very much the same, but sometimes the insurance of industrial buildings are more strict and specific stipulations may be applicable concerning their operations.

3. PROPERTY INSURANCE REGARDING THE CONTENTS OF BUILDINGS

Although building and contents of buildings are closely related topics, this section pays attention to the items inside the building, closely related to the perils that influence the building structure. Any risk that befalls a building will have a direct influence on the contents thereof. As stated, once a building sustains fire damage the contents thereof will also be damaged (Bonato & Zweifel, 2002:475). The property insurance of buildings and the contents of the buildings are included under a householder's or home-owner's comprehensive policy. The content is also insured against the same risks against which the building is insured (Diacon & Carter, 1992:18). Contents of buildings also cover those items that are currently within the proximity of the main property. That will include, amongst others, garden furniture

and tools, washing on the line and swimming pool equipment.

Damage to the contents of buildings can arise from different sources. As all risks must be managed effectively, reasonable care should be taken, as risk is inherent in any human endeavour which makes the involved risk elements diverse and varied (Odeyinka, 2000:519). It is important to have comprehensive cover within the policy to reduce the impact of a loss, should it occur. In the case of a fire hazard certain precautions can be taken to reduce the impact of the damage, such as automatic sprinkler systems and fire alarms. Theft is a very common type of risk that insurance of the contents of buildings guards against. The use of security alarms, burglar bars and other applicable measures, such as fences, may reduce the frequency and impact of theft, as well as lead to the discounting of premium rates (Snow, 2002:38/10-38/11). The cover of the contents of private houses and industrial buildings are very much alike, but the insurance of the contents of industrial buildings are often more strict and particular stipulations may be employed concerning industries' operations, machinery, equipment and inflammable liquids on the premises.

4. PROPERTY INSURANCE REGARDING ALL-RISKS INSURANCE

All-risks insurance is simply a wider spread of insurance that protects the insured against losses or damages from particular risks that are not included in the policy. All-risks insurance and contents of building insurance are closely related, as items can be included under both the categories. Specific stipulations on the policyholder's contracts can exclude coverage of items when it is not on the property of the insured. Under an all-risks insurance policy those items may have worldwide insurance cover. All-risks insurance may be applicable to private property, as well as industrial property, which will be discussed in the following sections.

4.1 Private property all-risks insurance

Although some detrimental events are covered within a standard home-owner's policy, not all items will have coverage due to particular contract stipulations. The advantages of an all-risks insurance policy is that it provides a wider coverage of risks on specified items, which are normally expensive personal items such as cameras and jewellery. All-risks insurance covers property irrespective of the location at the time of the loss (Diacon & Carter, 1992:19). Within all-risks insurance, items are either specified or unspecified. Unspecified items are those items below a maximum value amount, while specified items are all those items exceeding the maximum value amount. These items will be listed on the insurance policy of the insured.

4.2 Industrial all-risks insurance

Large corporations often require additional coverage for their operations, machinery and equipment which may be located worldwide. Industrial all-risks insurance also includes cover for a wider range of risks. The additional coverage may also include goods in transit, engineering risks and contractors' all-risks insurance. There is often a large excess applicable to claims regarding all-risks insurance (Diacon & Carter, 1992:94).

5. THE CLAIMS HANDLING PROCESS

The process by which short-term insurers *investigate*, *evaluate* and *settle* claims is known as the claims handling process. The claims handling process joins the whole relationship between the insured and the short-term insurer, as this is the point in time when the insured will see whether his coverage actually has any value or not. The contract between the insured and the short-term insurer is an agreement where the insured pays a set premium, based on the applicable risk profile of the individual. The short-term insurer will, in turn, pay for any claims that are filed by the insured in the event of a loss (Apte & Cavaliere, 1993:67). The three steps in the claims handling process are described in the following sections.

5.1 The investigation of the claims

Once a claim has been filed with a short-term insurer, the insurer will firstly investigate the current claim to determine the *validity* of the claim. An investigation will be launched irrespective of whether the insured is using an intermediary or working directly with the short-term insurer. The insured should complete a *claim form* with all the relevant information regarding the circumstances of the damage to or loss of the property. The principle of utmost good faith will also apply as all relevant material facts regarding the subject matter must be disclosed. Where certain facts are omitted or not disclosed the contract can be voided and the claim will not be settled (Wolowiecki, 2002:64).

Identifying insurance fraud during this step of the claims handling process, short-term insurers must be able to discover the anomalies or inconsistencies in information when a claim is lodged (Morley, Ball & Ormerod, 2006:165). This is usually where front-line staff should be able to identify patterns of specific client claiming behaviour, or the recognition of the claimant's characteristics or inappropriate behaviour. When short-term insurers take on a collective action to combat insurance fraud on an industry-wide level, it helps the facilitation of a more efficient attack on fraud by decreasing the marginal cost to investigate and verify claims (Picard, 1996:28).

The short-term insurer will confirm whether the insured has a valid financial and/or legal *insurable interest* in the subject matter. If it is found that the insured has no insurable interest in the property or the insured's insurable interest had ceased before the occurrence of the loss, no claim will be paid and the loss will not be recovered by the insured (McClain, 1898:515). An insured with a limited interest or an interest that is less than full ownership of the subject matter, may have difficulty in determining the amount of indemnification under the policy in the case of a loss.

Once it has been established that an insurable interest exists, the short-term insurer will determine whether all necessary *premiums* have been paid fully and are up to date. As this is an insurance contract, it is based on the agreement of an insured paying a premium to the short-term insurer, who in turn pays for any losses or damages that the insured might suffer, according to the stipulations of the policy (Apte & Cavaliere, 1993: 67; Turnbull, 1983:217).

5.2 The evaluation of the claims

When the short-term insurer is satisfied that the insured has provided all relevant facts, has an insurable interest and has paid the premiums, the insurer will then proceed to evaluate the claim and determine if the *cause of the loss* is covered under the conditions of the insurance policy. The proximate cause of the damage or loss must be an insured risk under the insurance policy, in order for the insured to recover the damages or loss suffered.

When a claim is evaluated, it is important to take the *time and place* of the loss into consideration, as well as the *intentions and circumstances* of the insured with respect to the property. These factors will influence the replacement or repair value of the subject matter. If a particular risk has been excluded from the insurance policy, the short-term insurer would not have to indemnify the insured.

A loss adjustor would usually *assess the damages* to the subject matter. The loss adjustor will evaluate the property and investigate the relevant facts of the event, and make sure that the replacement value given by the contractors or repairers are priced at an acceptable level. The loss adjustor will compile a report which is sent to the short-term insurer to assist in the decision-making part of the claims handling process.

Before a short-term insurer agrees to indemnify an insured, the necessary *quotes* to repair or replace the property must be obtained. By using reputable contractors, the short-term insurer can evaluate the claim size by cross-referencing it with the information that was provided by the insured when the claim was lodged. Claims for amounts under a certain minimum value will often be settled without the need for a formal evaluation. Yet, short-term insurers rely on

reputable loss adjusters to assess the damages to the property of the insured.

5.3 The settlement of the claims

The short-term insurer has the *option* to either *reinstate* the items damaged or lost, or *pay* the insured a replacement value that represents the loss when a detrimental event occurs. Reinstatement of the subject matter will often deter potential fraudulent claims being processed. Once the agreed level of indemnification has been reached by both parties, the insured will sign an *agreement* of loss. Depending on the type of insurance, the agreed *excess* (or deductible) will be subtracted from the reimbursed amount.

The amount payable will also be subjected to a *limit of indemnity* as an insured cannot be indemnified for more than the total sum insured. In the case of property insurance, the obligation of indemnity indicates that a policyholder will be indemnified against damages or losses to the property and that the recovery for such a loss will not be more than the actual damages (McClain, 1898:524).

The contractor or repairer will go ahead to respectively replace or repair the property once the funds have been released by the short-term insurer. The claim will then form part of the insured's claims history and if it was a significant loss, it may influence the amount of the premium to be paid by the insured in the future.

The short-term insurer has the right to change the stipulations of the insurance policy with the due period of notice to the insured. The new stipulations may force the insured to reduce or prevent future similar damage and to take reasonable care of the property. The claim is then closed and filed by the short-term insurer for future reference.

6. RESEARCH METHODOLOGY

At the commencement of this research paper, the *objective* of the research was formulated as the improvement of financial decision-making concerning the claims handling process of property insurance. In order to achieve this objective, not only a literature study, but also an empirical survey is of prime

importance, to obtain the views of executive managers.

This empirical survey focused on the rationale of the market leaders in South Africa regarding the claims handling process of property insurance. The top 10 short-term insurers providing property insurance in South Africa were contacted. One of them indicated that their enterprise was not involved in underwriting property insurance to the general public, as the enterprise is a cell captive insurer. The sample therefore consisted of the remaining nine insurers, which represented 73,7% of the total gross premiums written in South Africa for property insurance in 2007 (Santam, 2008:6 & 20). These nine short-term insurers are hence regarded as the market leaders concerning this topic.

Based on the literature study, a questionnaire was compiled and mailed, together with an invitation letter, to the executive managers of the nine short-term insurers involved. After following up, nine questionnaires were completed by the various functionaries. As there are 97 registered short-term insurers in South Africa which are occupied in various classes of short-term insurance, it should be clear that these nine insurers are the real leaders in their type of short-term insurance, accounting for more than 73% of the South African total gross premiums written for property insurance (Santam, 2008:3, 6 & 20).

It is crucial to mention that South Africa is a developing country with an emerging market economy. The empirical results of this study may therefore also serve as an industry-related example for other developing countries which also have emerging market economies. The results of the empirical survey appear in the following sections.

7. EMPIRICAL RESULTS

The empirical results obtained are presented under the following headings:

7.1 The importance of the claims handling factors concerning the buildings

The perceptions of the respondents about the factors which should be considered in the claims handling process of property insurance relating to buildings, appear in Table 1.

Table 1. The importance of the factors contemplated in the claims handling process of property insurance regarding buildings, according to the perceptions of the respondents

Factors	Extremely important	Highly important	Moderately important	Little important	Not important
Whether all the premiums are paid up to date	7	2			
Whether the insured has an insurable interest	7	1	1		
The particulars of the occurrence to determine the proximate cause of the loss/damage	6	3			
Use of the building at the time of the loss (nature of occupancy)	4	3	2		
Unoccupied buildings in terms of people	4	4	1		
Unoccupied buildings in terms of contents	2	4	2		1
Unlawfully occupied buildings by squatters	7	1	1		
Whether the stipulations in terms of safety and security precautions are met	5	3	1		
Condition of the building at the time of the loss/damage	4	4		1	
Facts not mentioned about the buildings by the insured since underwriting	6	2	1		
Previous claims history of the insured regarding property insurance in general	1	5	3		

Different weights were allocated to the responses received from the short-term insurers, to achieve a clear picture of how important the determining factors regarding the claims handling process of buildings were. As it was clearly stated on the questionnaire that the five point Likert interval scale which was applied in the questionnaire, forms a continuum, this weighting of the responses was feasible (Albright, Winston & Zappe, 2002:224-229 & 245). It was consequently possible to rank the determining factors in a declining order of importance. The following weights were allocated to the responses of the respondents:

Allocated a weight of 5 for: Extremely important
 Allocated a weight of 4 for: Highly important
 Allocated a weight of 3 for: Moderately important
 Allocated a weight of 2 for: Little important
 Allocated a weight of 1 for: Not important

The weighted responses on the importance of the factors considered in the claims handling process of property insurance relating to buildings, as perceived by the respondents is shown in Table 2.

Table 2. Weighted responses on the importance of the factors contemplated in the claims handling process of property insurance regarding buildings, in a declining order of importance

Total weighted score calculated	Declining order of importance	The importance of the factors taken into account in the claims handling process of property insurance with reference to buildings
43	1	Whether all the premiums are paid up to date.
42	2	Whether the insured has an insurable interest.
42	2	The particulars of the occurrence to determine the proximate cause of the loss/damage.
42	2	Unlawfully occupied buildings by squatters.
41	5	Facts not mentioned about the buildings by the insured since underwriting.
40	6	Whether the stipulations in terms of safety and security precautions are met.
39	7	Unoccupied buildings in terms of people.
38	8	Use of the building at the time of the loss (nature of occupancy).
38	8	Condition of the building at the time of the loss/damage.
34	10	Previous claims history of the insured regarding property insurance in general.
33	11	Unoccupied buildings in terms of contents.

The results of the preceding table corresponds to a great extent with the literature study, as the first three determining factors are as follows, viz. whether the premiums are paid up to date, whether the insured has an insurable interest and the particulars concerning the proximate cause of the damage or loss. It is interesting to see that the unlawfully occupation of buildings by squatters has the same weight as the preceding two factors. This emphasises the possibility in South Africa that squatters can unlawfully occupy a building and that a lengthy law court case will be necessary to remove them. Although there are other factors which are taken into account in the claims

handling process of property insurance relating to buildings, the four factors mentioned have the highest weighted score.

7.2 The importance of the claims handling factors concerning the contents of buildings

The factors which should be considered in the claims handling process of property insurance relating to the contents of the buildings, according to the perception of the respondents, appear in Table 3.

Table 3. The importance of the factors contemplated in the claims handling process of property insurance regarding the contents of buildings, according to the perceptions of the respondents

Factors	Extremely important	Highly important	Mode-rately important	Little important	Not important
Whether all the premiums are paid up to date	8	1			
Whether the insured has an insurable interest	7		2		
The particulars of the occurrence to determine the proximate cause of the loss/damage	6	3			
Unoccupied buildings in terms of people	3	6			
Unlawfully occupied buildings by squatters	6	3			
Use of the building at the time of the loss (nature of occupancy)	5	3	1		
Facts about the articles not mentioned by the insured since under-writing	6	2	1		
Whether the stipulations in terms of safety and security precautions are met	6	3			
Previous claims history of the insured regarding property insurance in general	6	2	1		

The information of Table 3 was weighted and the following table depicts the results obtained.

Table 4. Weighted responses on the importance of the factors contemplated in the claims handling process of property insurance regarding the contents of buildings, in a declining order of importance

Total weighted score calculated	Declining order of importance	The importance of the factors taken into account in the claims handling process of property insurance with reference to the contents of buildings
44	1	Whether all the premiums are paid up to date.
42	2	The particulars of the occurrence to determine the proximate cause of the loss/damage.
42	2	Unlawfully occupied buildings by squatters.
42	2	Whether the stipulations in terms of safety and security precautions are met.
41	5	Whether the insured has an insurable interest.
41	5	Facts about the articles not mentioned by the insured since underwriting.
41	5	Previous claims history of the insured regarding property insurance in general.
40	8	Use of the building at the time of the loss (nature of occupancy).
39	9	Unoccupied buildings in terms of people.

Three of the four factors which have the highest weighted score according to Table 4, correspond with the results obtained in Table 2. When contemplating the factors in the claims handling process of property insurance regarding the contents of buildings, the following three factors emerge from Table 4, namely whether the premiums are paid up to date, the particulars concerning the proximate cause of the damage or loss, and the unlawful occupation of the building by squatters. In the case of the contents of the buildings, the empirical results show that whether

the stipulations of the insurance policy in terms of safety and security precautions are met, is also very important, as movable assets are at risk.

7.3 The importance of the claims handling factors concerning all-risks insurance

The perceptions of the respondents about the factors which should be considered in the claims handling process of property insurance relating to all-risks insurance, appear in Table 5.

Table 5. The importance of the factors contemplated in the claims handling process of property insurance regarding all-risks insurance, according to the perceptions of the respondents

Factors	Extremely important	Highly important	Mode-rately important	Little important	Not important
Whether all the premiums are paid up to date	8	1			
Whether the insured has an insurable interest	7	2			
The particulars of the occurrence to determine the proximate cause of the loss/damage	5	3	1		
Whether the stipulations in terms of safety and security precautions are met	2	2	3	2	
Facts about the articles not mentioned since underwriting	4	3	2		
Proof of ownership (e.g. receipts/valuation certificates)	5	3	1		

After weighting the information of Table 5, the results of the following table were obtained.

Table 6. Weighted responses on the importance of the factors contemplated in the claims handling process of property insurance regarding the all-risks insurance, in a declining order of importance

Total weighted score calculated	Declining order of importance	The importance of the factors taken into account in the claims handling process of property insurance with reference to the all-risks insurance
44	1	Whether all the premiums are paid up to date.
43	2	Whether the insured has an insurable interest.
40	3	The particulars of the occurrence to determine the proximate cause of the loss/damage.
40	3	Proof of ownership (e.g. receipts/valuation certificates).
38	5	Facts about the articles not mentioned since underwriting.
31	6	Whether the stipulations in terms of safety and security precautions are met.

Three of the four factors which have the highest weighted score according to Table 6, correspond with the results obtained in Table 2. The finding is therefore that whether the premiums are paid up to date, whether the insured has an insurable interest and the particulars of the proximate cause of the loss or damage, are very important factors which should be contemplated in the claims handling process of property insurance regarding the all-risks insurance. It is obvious that the fourth factor mentioned in the preceding table, is also important as the proof of

ownership regarding all-risks insurance is sometimes problematic to determine.

7.4 The problem areas in the claims handling process

Each respondent was requested to indicate the three main problem areas in the claims handling process of property insurance, according to his/her perception. The results attained appear in Table 7.

Table 7. The three most important problem areas experienced in the claims handling process of property insurance, as perceived by each respondent

Problem areas in the claims handling process of property insurance	Number of respondents who mentioned the problem area
Build-up fraud, viz. insured that <i>claims for more</i> than the actual value of the subject matter	6
Planned fraud, viz. deliberate <i>criminal</i> action of the insured and is <i>planned before</i> the detrimental event occurred	6
Non-disclosure by the insured of material facts at the time of the loss/damage	5
The absence of relevant safety and security precautions as stipulated by the policy	4
Opportunistic fraud, viz. claim for <i>previous unrelated damages</i> in their current claim.	4
The insured not having an insurable interest in the subject matter	1

Note: One respondent only mentioned two problem areas.

It is important to notice that the two problem areas mentioned by six of the nine respondents relate to fraud, namely:

- build-up fraud where the insured claims for more than the actual value of the subject matter which was damaged or lost; and
- planned fraud, where the insured deliberately planned criminal action before the detrimental event occurs.

The problem areas which are next in line relates to:

- the non-disclosure of material facts by the insured at the time that the damage or loss happens;

- the absence of relevant safety and security precautions as required by the insurance policy; and
- opportunistic fraud where the insured claims for previous related damages in the current claim.

It is clear from the previous description that fraud, non-disclosure of material facts and non-compliance with the stipulations of the insurance policy are the prime problem areas relating to the claims handling process of property insurance.

7.5 The effectiveness of the claims handling process during the past five years

The respondents were requested to allocate a score as a percentage for their effectiveness of the claims handling process during the past five years. The mean score was 78,9%, which range from 60% to 95%. The median is equal to 80%. Based on this information, it is apparent that the respondents are rendering a high-quality service concerning the vital problem areas of the claims handling process of property insurance.

8. CONCLUSIONS

At the commencement of this paper, the objective of the research was stated as the improvement of financial decision-making concerning the claims handling process of property insurance. The empirical study focused on the top short-term insurers in South Africa. It must be emphasised that South Africa is a developing country and has an emerging market economy. The conclusions of this study should consequently also be valuable to short-term insurers in other countries with emerging market economies. The main conclusions are as follows:

- 1) The main factors to contemplate, according to the perception of the respondents, in the claims handling process of *buildings*, are whether the premiums are paid to date, whether the insured has an insurable interest, and the particulars concerning the proximate cause of the damage or loss. It is appealing to see that the unlawfully occupation of buildings by squatters, as the fourth factor, has the same weight as the preceding two factors.
- 2) When considering the factors in the claims handling process of property insurance regarding the *contents* of buildings, the following four main factors emerge, namely whether the premiums are paid up to date, the particulars concerning the proximate cause of the damage or loss, the unlawful occupation of the building by squatters, and whether the stipulations of the insurance policy in terms of safety and security precautions are met.
- 3) The four main factors which should be taken into account in the claims handling process of property insurance relating to *all-risks insurance*, are whether the premiums are paid up to date, whether the insured has an insurable interest, the particulars of the proximate cause of the loss or damage, and whether ownership regarding the all-risks insurance can be proven.
- 4) The key problem areas which emerge from this research relate to various types of fraud, the non-disclosure of material facts by the insured, and the non-compliance with the stipulations of the insurance policy when the claims handling process of property insurance is in operation.
- 5) Calculating the respondents' perceptive effectiveness of the claims handling process during the past five years, a mean score of 78,9%, with a range from 60% to 95% and a median of 80% were obtained. It is hence clear that the respondents are rendering a high-quality service and that it is possible to solve the crucial problem areas of the claims handling process of property insurance to a large extent.

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