

## **THE CLAIMS HANDLING PROCESS OF LIABILITY INSURANCE IN SOUTH AFRICA**

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### **Abstract**

Liabilities play a very important financial role in business operations, professional service providers as well as in the personal lives of people. It is possible that a single claim may even lead to the bankruptcy of the defendant. The claims handling process of liability insurance by short-term insurers is therefore very important to these parties as it should be clear that liability claims may have enormous and far-reaching financial implications for them.

The objective of this research paper embodies the improvement of financial decision-making by short-term insurers with regard to the claims handling process of liability insurance. Secondary data was initially studied which provided the basis to compile a questionnaire for the empirical survey. The leaders of liability insurance in the South African short-term insurance market that represented 69.5% of the annual gross written premiums received for liability insurance in South Africa were the respondents of the empirical study. The perceptions of these short-term insurers provided the primary data for the vital conclusions of this research.

This paper pays special attention to the importance of the claims handling factors of liability insurance, how often the stipulations of liability insurance policies are adjusted by the short-term insurers to take the claims handling factors into consideration, as well as the problem areas which short-term insurers may experience during the claims handling process. Feasible solutions to address the problem areas are also discussed.

**Keywords:** Adjustment of Policy Stipulations, Claims Handling Factors, Claims Handling Process, Liability Insurance, Problem Areas

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### **1. Introduction**

Liabilities play an important role in business operations, professional service providers as well as in the personal lives of people. While liability cover is vital for businesses and professional people where the financial, physical and legal interests of the public are involved, individuals realise that their pursuits and habits may lead to liability claims which may have enormous financial implications. The claims handling process of liability insurance is therefore of prime importance to business enterprises, professional services providers as well as individuals.

It should be born in mind that the main reason why short-term insurance is obtained by policyholders is situated in the successful and effective settlement of a claim when it is filed (Apte & Cavaliere, 1993:67). According to current literature there are some problems which may exist concerning the claims handling process in general and the research question focuses on the mitigation of the problems. The

challenges of technology development, changes in the activities of the business sector and the competence of the claims handling personnel are but a few factors that may cause ineffective claims handling (Roberts, 2006:20-21).

The objective of this research paper embodies the improvement of financial decision-making by short-term insurers concerning the claims handling process of liability insurance. The research consists of two important components, viz. the secondary data in order to provide the basis for the empirical study. The secondary data will address the main types of liability insurance, the claims handling process in general, as well as the factors which influence the claims handling process of liability insurance.

The primary data focuses on an opinion survey which includes the top short-term insurers in South Africa which are occupied in liability insurance. Their perceptions regarding the claims handling process of liability insurance are of prime importance as they are the market leaders of this type of short-term insurance

in South Africa. The importance of particular factors when handling liability insurance claims, how often the stipulations of liability insurance policies are adjusted to take the claims handling factors into account, as well as the problem areas which short-term insurers may encounter during the claims handling process, will receive the necessary attention in this research paper.

The results of this research should not only benefit the short-term insurance industry in South Africa. As this country is a member of the BRICS countries and has an emerging market economy, the empirical results should also be valuable to other developing countries, enabling them to improve their financial decision-making concerning the claims handling process of liability insurance. The secondary data is addressed in the next section.

## **2. Main Types of Liability Insurance**

Liability insurance provides various types of coverage. This description will however only focus on the main types of liability insurance, which include the following:

- Employer's liability insurance,
- Public liability insurance,
- Product liability insurance,
- Professional liability insurance,
- Personal liability insurance, and
- Householder's liability insurance.

It should be pointed out that the first four types of liability insurance mentioned above mainly have the business operations, professional service providers and/or individuals in mind, while the remaining two types of liability insurance primarily should be to the benefit of individuals.

### **2.1 Employer's liability insurance**

This type of liability insurance is often compulsory for employers, not only because it protects the employers from claims made by their employees, but also because it provides coverage to the employees when they are injured or contract a disease in the course of their employment (Diacon & Carter, 1988:24). It is important to note that even if the correct procedure is followed, an employer may sometimes be sued when he/she interviews, employs, disciplines or dismisses an employee. The limit of indemnity is usually stated in the insurance policy. Claims may be made in future by employees based on the current insurance policy and situation.

### **2.2 Public liability insurance**

Public liability insurance covers claims from the general public against a business which are not covered under more specific liability policies (Diacon & Carter, 1988:24). Claims from the employees of an enterprise will be excluded as they are covered by

employer's liability insurance. It should be mentioned that acts of the policyholder and his/her employees against the community should be fair and reasonable in order to be covered by a public liability policy (Juma, 2013:60). The protection provided to the policyholder focuses on claims from third parties for damage to property and/or bodily injury to people (Diacon & Carter, 1988:24 & 25). It must be emphasised that coverage is usually provided only for unpredictable negligent acts during the operation of the business or by an individual.

There is often not a legal obligation to obtain public liability insurance, although it should be beneficial to policyholders when accidental events occur which lead to public liability claims. The indemnity limit of a public liability policy may be limited to any one occurrence while no limit for the period of the policy may apply (Bishop, 2011). An aggregate indemnity limit for a period may however sometimes be specified in the insurance policy.

### **2.3 Product liability insurance**

Product liability may arise somewhere during the cycle of a product which starts at the design phase and proceeds to the production, distribution, marketing and disposal thereof (Ryan, 2003:20). The designer, manufacturer and/or seller of a product can be held liable for injuries to a person or damage to property caused by the use, according to its intended purpose, of a defective product. The legal approaches towards product liability may however differ between various regions in the world (Skipper, 1998:217-221).

Designers, manufacturers and sellers of products are facing an increasing challenge because of a growing market, where products are developed in order to get them as quickly as possible to the highly competitive market. Due to a higher level of education and expectations, product safety is of prime concern to consumers who continuously evaluate existing as well as new products (Rados, 1969:144-145). Designers, manufacturers and sellers of products therefore need product liability insurance to protect them when consumers sue them for bodily injuries or damage to property due to accidental defects in their products.

### **2.4 Professional liability insurance**

Professional people are often under pressure to meet their clients' demand for cost-effective solutions and/or quick answers. As professionals are only human beings they may err due to the pressure put on them by their clients and the requirements of their professional bodies. Professionals may therefore become liable to their clients due to their negligence as they may not always apply reasonable care and skills as required by their professions (Diacon & Carter, 1988:26).

The intension of professional liability insurance is to indemnify professional people when they are negligent. If the service or act of a professional was fraudulent or dishonest, a short-term insurer may reject the claim of a client against a professional person, although the professional person may still be liable to his/her client. It is of prime importance to professional people to obtain adequate professional liability coverage which covers all their activities in every country where they operate (Ziss, 2012:1-3).

### **2.5 Personal liability insurance**

This type of liability insurance provides coverage to the insured and the members of the insured's household against liability claims arising from bodily injury and/or property damages to third parties when they are not at their home due to their personal negligence acts (Rejda, 1995:144-145; The Insurance Institute of South Africa, n.d.:9/8). A personal liability insurance policy will usually have an upper limit of liability stated in the policy (Crane, 1984:177). It should be mentioned that damage to property which belongs to the insured and/or the insured's household will not be covered by this type of liability insurance policy (as property insurance is available to property owners as a separate type of insurance policy). Personal liability insurance may be provided by a short-term insurer as a separate insurance policy or it may be included as part of another short-term insurance policy (Rejda, 1995:144).

### **2.6 Householder's liability insurance**

A householder's liability insurance policy covers the insured for bodily injury or damages to the property of a third party due to accidents occurring on or about the insured's premises (The Insurance Institute of South Africa, n.d.:9/8). It should be emphasised that a householder is not necessarily the house-owner as the property may be rented to a householder. Problems may occur when a property which only has house-owner's coverage is rented, while the tenant does not have householder's liability insurance (Trupin, 2012:12). Householder's liability insurance coverage may exclude the injury of employees as well as damage to the property not caused by accidents occurring on or about the insured's premises, as other types of insurance policies are available to cover these risks.

## **3. The Claims Handling Process**

The claims handling process can be divided into various important steps which will be briefly discussed in this section (Greene & Trieschmann, 1988:119; OECD, 2004:2-10). Insurance policies usually require that claims must be verbally reported by the policyholder as soon as possible and in writing

within a specified number of days after the occurrence of the detrimental event. If the insured does not report the claim within the specified period, the short-term insurer may reject the claim. A claim form must be duly completed by the insured while official and supporting documents must also be provided to the short-term insurer.

Once the short-term insurer has received all the necessary information, the claim will be assigned to a particular loss adjuster who will handle the claim. The loss adjuster may be an employee of the short-term insurer or an independent loss adjuster may be nominated by the short-term insurer. The processing of a claim's information should focus on the details concerning the detrimental event and the particulars of the people involved. While the summary and validation of the data is of prime importance for the particular claim, it may also help the short-term insurer to detect possible fraudulent claims by analysing possible trends relating to previous claims by the insured.

During the assessment of a claim, a loss adjuster will, amongst others, ensure whether the insurance policy is valid, whether all the premiums are paid up to date, whether the insurance policy covers the particular loss or damage and whether all the conditions stated in the insurance policy are met by the policyholder. The loss adjuster must thereafter determine the proximate cause of the loss or damage as well as the amount that will be fair to pay out to the insured or the third party which is involved in the detrimental event.

When a short-term insurer decides to settle the claim, the policyholder must be informed about the amount involved as well as when the settlement will be done. Insurers usually have the option to pay, repair or reinstate the policyholder. In the case of liability claims short-term insurers often apply payments. In order to minimise negative effects on the insurer's image, the complaints of clients are usually managed in a timely and objective manner by the insurer. An arbitrator is sometimes used by a short-term insurer to settle disputes between the insurer, policyholder and/or the third party which are involved. Necessary improvements of the policy documentation and/or the coverage provided can be identified in this manner. It should be to the benefit of insurers to manage their claims handling process in a proper way as it has a major impact on an enterprise's image and its competitive advantage.

## **4. The Factors Influencing the Claims Handling Process of Liability Insurance**

Various factors will impact on the claims handling process of liability insurance and short-term insurers should pay special attention to them before settling a claim. The first factor to mention embodies the basic principle of insurable interest which emphasises the fact that a policyholder must have a legal and/or

financial relationship with the subject matter in order to obtain short-term insurance (Diacon & Carter, 1988:53-55; Dorfman, 1996:203; O'Connor & Moodley, 2014:93). A short-term insurer will probably reject a claim if the policyholder does not have an insurable interest in the subject matter of the insurance policy.

In order to adhere to the basic principle of utmost good faith, an insured must not only provide all material information to a short-term insurer when concluding the insurance policy, but the existence of any information since underwriting must also be reported to the insurer (Diacon & Carter, 1988:48-51). When material information is not duly reported to a short-term insurer, the underwriter may reject a claim as a breach of contract may have occurred.

Before settling a claim, the short-term insurer will thoroughly study the claims history of the policyholder. Special attention will be paid to possible previous false or fraudulent claims by the policyholder. The short-term insurer will also determine whether the proximate cause of the loss is covered under the particular insurance policy by studying particulars of the detrimental occurrence as well as the documentation and other supporting evidence (Harrington & Niehaus, 1999:336; Williams et al., 1998:515). The validity of the insurance policy should be verified by the short-term insurer by focusing on the name and details of the policyholder, whether all the premium payments are paid up to date and whether the safety and security precautions of the insurance policy are met.

A policyholder should also file a claim within the stipulated time frame specified in the insurance policy. Special attention should be paid by a short-term insurer to coverage of the particular risk provided by another insurer or insurers as the basic principle of contribution may play an important role

in the claims handling process (Diacon & Carter, 1988:63-65).

## 5. Research Methodology

Secondary as well as primary data are necessary to achieve the *objective* of this research, which was already defined as the improvement of financial decision-making by short-term insurers concerning the claims handling process of liability insurance. The secondary data which was discussed in the preceding sections served as the basis to compile a questionnaire that was sent (accompanied by an invitation letter) to the top 10 short-term insurers in South Africa who are occupied in liability insurance. These 10 short-term insurers received more than 77% of the annual gross written premiums in 2011 and they are therefore regarded as the South African market leaders of liability insurance (Santam, 2012: 6 & 25).

During the collection process of the empirical data it was found that one of the companies changed their company's policy and that the particular company was outsourcing their insurance business to one of the other nine short-term insurers. To avoid a double counting of the same respondent, the sample size was reduced to nine short-term insurers. Eight of the remaining nine short-term insurers completed their questionnaires, which means that the respondents represented 69.5% of the annual gross written premiums received for liability insurance in South Africa during 2011 (Santam, 2012: 6 & 25).

It should be mentioned that some of the questions on the questionnaire applied a five point Likert interval scale. As it was explicitly stated on the questionnaire that the five point Likert interval scale forms a continuum, the weighting of the answers was possible (Albright *et al.*, 2002:224-229 & 245). The answers of the respondents, which are depicted in Section 6, were weighted by assigning the following weights:

**Table 1.** The weights assigned to the answers of the respondents

Answers of the respondents:		Weights assigned:
Extremely important	Always	5
Highly important	Very often	4
Moderately important	Sometimes	3
Little important	Seldom	2
Not important	Never	1

## 6. Empirical Results

This section contains the results which were obtained by the empirical survey. The following aspects will be depicted and addressed:

- The importance of particular factors when handling liability insurance claims,
- How often the stipulations of liability insurance policies are adjusted to take the claims handling factors into account, as well as

- The problem areas which are experienced by short-term insurers in the claims handling process of liability insurance and possible solutions to solve them.

### 6.1 The importance of particular factors when handling liability insurance claims

The perceptions of the respondents concerning the importance of particular factors when handling liability insurance claims are depicted in Table 2. One of the eight respondents did not provide his/her perception concerning *all* the claims handling factors of Table 2. The answers of this particular respondent

are therefore excluded from this table to obtain a fair comparison between the factors. The number of valid responses for this table, as well as Table 3 which is based on the information of Table 2, is therefore seven.

**Table 2.** The importance of the factors when handling liability insurance claims, as perceived by the respondents

Claims handling factors	Extremely important	Highly important	Moderately important	Little important	Not important
Name and details of the policyholder	4	3			
Whether premium payments are paid up to date	5	2			
Particulars of the occurrence and the documentation as supporting evidence to determine the specific proximate cause of the loss	5	2			
The coverage of the risk by the liability insurance policy of <i>another</i> insurer(s)	6		1		
Whether the insured met the safety and security precautions of the insurance policy	4	1	1	1	
The claims history of the claimant	2		3	2	
Previous false and/or fraudulent claims by the claimant	5	1	1		
Whether the claim is filed within the stipulated time frame	5	1		1	
The existence of any information <i>not</i> mentioned by the insured <i>since</i> underwriting the insurance policy	5	2			
Whether the claimant has an insurable interest	6		1		

Two of the factors mentioned in the preceding table were perceived as extremely important by six of the seven respondents, viz.:

- The coverage of the risk by the liability insurance policy of another insurer or insurers, as well as
- Whether the claimant has an insurable interest.

The preceding answers of the respondents, which are based on the five point Likert interval scale, were weighted by applying the weights discussed in Section 5 of this paper. The weighted responses on the importance of the claims handling factors appear in the following table.

**Table 3.** The weighted responses on the importance of the factors when handling liability insurance claims, in a declining order of importance

Total weighted score calculated	Declining order of importance	The various claims handling factors	Weighted mean value	Median value
33	1	Whether premium payments are paid up to date	4.71	5.00
33	1	Particulars of the occurrence and the documentation as supporting evidence to determine the specific proximate cause of the loss	4.71	5.00
33	1	The coverage of the risk by the liability insurance policy of <i>another</i> insurer(s)	4.71	5.00
33	1	The existence of any information <i>not</i> mentioned by the insured <i>since</i> underwriting the insurance policy	4.71	5.00
33	1	Whether the claimant has an insurable interest	4.71	5.00
32	6	Name and details of the policyholder	4.57	5.00
32	6	Previous false and/or fraudulent claims by the claimant	4.57	5.00
31	8	Whether the claim is filed within the stipulated time frame	4.43	5.00
29	9	Whether the insured met the safety and security precautions of the insurance policy	4.14	5.00
23	10	The claims history of the claimant	3.29	3.00

The weighted mean values as well as the median values are also provided as they enable the reader to obtain a better idea of the distribution of the results depicted in Tables 2 and 3. The weighted mean values range from 4.71 to 3.29 while the median values range from 5.00 to 3.00, which indicate that all the factors mentioned in Table 3 are *at least* moderately

important according to the perceptions of the respondents.

The preceding table shows that the following five factors are the *most* important factors when short-term insurers are handling liability insurance claims and that the five factors obtained the *same* total weighted score calculated:

- Whether premium payments are paid up to date,

- Particulars of the occurrence and the documentation as supporting evidence to determine the specific proximate cause of the loss,
- The coverage of the risk by the liability insurance policy of *another* insurer(s),
- The existence of any information *not* mentioned by the insured *since* underwriting the insurance policy, and
- Whether the claimant has an insurable interest.

Short-term insurers should therefore pay special attention to these five factors when they are handling the claims of liability insurance. The next section will address the adjustment of liability insurance policies to take the claims handling factors into consideration.

### 6.2 How often the stipulations of liability insurance policies are adjusted to take the claims handling factors into account

There are a number of possible stipulations which short-term insurers can adjust to account for the claims handling factors of liability insurance. The perceptions of the respondents on how often they adjust the stipulations of liability insurance policies to take the claims handling factors into consideration are depicted in Table 4.

**Table 4.** How often the stipulations of liability insurance policies are adjusted to take the claims handling factors into account, as perceived by the respondents

Stipulations of the insurance policy	Always	Very often	Sometimes	Seldom	Never
The insurer adjusts the level of the premium	2	1	1	3	1
The insurer adjusts the excess (deductible) to be paid when a claim is made	2			4	2
The insurer adjusts the safety and security precautions on the subject matter of the insured to reduce the risk of liability claims		2	2	3	1
The insurer excludes the application of the basic principle of contribution when the insured has liability coverage for the same risks, same subject matter and in the same period from <i>other</i> insurer(s)	2			1	5
The insurer adjusts the liability limits of the insured's liability insurance policy	3	1		2	2
The insurer adjusts the length of the coverage period	2		1	3	2

The information of the preceding table is based on the five point Likert interval scale. The weighted responses on how often the stipulations of liability insurance policies are adjusted to take the claims

handling factors into account (which appear in the following table) were obtained by applying the weights discussed in Section 5 of this paper.

**Table 5.** The weighted responses on how often the stipulations of liability insurance policies are adjusted to take the claims handling factors into account, in a declining order of frequency

Total weighted score calculated	Declining order of frequency	The stipulations which are adjusted	Weighted mean value	Median value
25	1	The insurer adjusts the liability limits of the insured's liability insurance policy	3.13	3.00
24	2	The insurer adjusts the level of the premium	3.00	2.50
21	3	The insurer adjusts the safety and security precautions on the subject matter of the insured to reduce the risk of liability claims	2.63	2.50
21	3	The insurer adjusts the length of the coverage period	2.63	2.00
20	5	The insurer adjusts the excess (deductible) to be paid when a claim is made	2.50	2.00
17	6	The insurer excludes the application of the basic principle of contribution when the insured has liability coverage for the same risks, same subject matter and in the same period from <i>other</i> insurer(s)	2.13	1.00

The preceding table also provides the weighted mean values and the median values. These values should enable the analyst to obtain a better idea of the distribution of the results as shown in Tables 4 and 5. While the weighted mean values range from 3.13 to

2.13 the median values range from 3.00 to 1.00. It can therefore be concluded that the stipulations of liability insurance policies are *at most* sometimes adjusted by short-term insurers to take the claims handling factors

into account, based on the perceptions of the respondents.

Table 5 indicates that short-term insurers *most* frequently adjust the liability limits of the policyholders' liability insurance policies to account for the claims handling factors. The adjustment of the premium level represents the stipulation *second* most frequently adjusted by the short-term insurers in this regard. The problem areas which short-term insurers

encounter during the claims handling process of liability insurance are addressed in the next section.

### 6.3 Problem areas in the claims handling process of liability insurance and possible solutions to solve them

The respondents were requested to indicate the three most important problem areas which they experienced when they were handling liability insurance claims. The results are depicted in Table 6.

**Table 6.** Problem areas which were experienced in the claims handling process of liability insurance, as perceived by the respondents

Problem areas	Number of respondents who mentioned the problem area
The insureds do not fully understand the terms, conditions and coverage of the insurance policy	6
The absence of safety and security precautions as required by the liability insurance policies	5
The high cost of legal representation during a litigation process	5
The high cost of claim pay-outs	4
The insureds are filing fraudulent and/or false claims, do not disclose material facts at the time and place of the loss and therefore causing a breach of contract (including a breach of utmost good faith)	1
Insureds do not have an insurable interest	1
The application of the basic principle of contribution when the insured has liability coverage from more than one insurer	1
Pre-existing conditions which have an impact on the claim	1

Four prominent problem areas which the respondents experienced evolved from this empirical study, namely:

- The insureds do not fully understand the terms, conditions and coverage of the insurance policy,
- The absence of safety and security precautions as required by the liability insurance policies,
- The high cost of legal representation during a litigation process, and
- The high cost of claim pay-outs.

The policyholders' lack of knowledge concerning liability insurance policies, the absence of the insureds' due diligence to apply safety and security precautions, as well as the high cost of legal representation and claims pay-outs seem to be the main causes of the related problem areas. Possible solutions to address these problem areas are therefore as follows:

- Better communication between the short-term insurer and/or the insurance broker on the one hand and the policyholders on the other hand should contribute to the policyholders' comprehension of the terms, conditions and coverage of the insurance policy.
- The premises of policyholders should be randomly surveyed by the short-term insurers to check whether the policyholders adhere to the safety and security precautions as required by the liability insurance policies. Insurance policies should

immediately be cancelled by the short-term insurers when policyholders do not maintain the safety and security precautions.

- It is very difficult for short-term insurers to steer clear of the high cost of legal representation and claims pay-outs of liability insurance. A possible solution for this problem may be to implement available technology to ease the claims handling process by providing relevant information at various stages of the process. Short-term insurers can only make proper decisions regarding legal representation and claims pay-outs when they have adequate and applicable information at their disposal.

## 7. Conclusions

The *objective* of this research paper embodies the improvement of financial decision-making by short-term insurers regarding the claims handling process liability insurance. The conclusions of this research are based on a literature study as well as an empirical survey which focused on the leaders of liability insurance in the South African short-term insurance market. As this country has an emerging market economy, the following conclusions should be valuable to short-term insurers in other countries which are classified similarly:

- (1) All the factors mentioned in this study for the handling of liability insurance claims are perceived by the respondents as *at least* moderately important. The following five factors are however the *most* important

factors when short-term insurers are handling liability insurance claims and short-term insurers should therefore pay special attention to them during the claims handling process:

- Whether premium payments are paid up to date,
- Particulars of the occurrence and the documentation as supporting evidence to determine the specific proximate cause of the loss,
- The coverage of the risk by the liability insurance policy of *another* insurer(s),
- The existence of any information *not* mentioned by the insured *since* underwriting the insurance policy, and
- Whether the claimant has an insurable interest.

(2) The stipulations of liability insurance policies are *at most* sometimes adjusted by short-term insurers to take the claims handling factors into account, based on the perceptions of the respondents. When short-term insurers however adjust the stipulations of liability insurance policies for this purpose, they *most* frequently adjust the liability limits of the policyholders' liability insurance policies to account for the claims handling factors. The adjustment of the premium level represents the stipulation *second* most frequently adjusted by the short-term insurers in this regard.

(3) Four prominent problem areas are experienced by short-term insurers during the claims handling process, viz.:

- The insureds do not fully understand the terms, conditions and coverage of the insurance policy,
- The absence of safety and security precautions as required by the liability insurance policies,
- The high cost of legal representation during a litigation process, and
- The high cost of claim pay-outs.

The policyholders' lack of knowledge concerning liability insurance policies can be addressed by better communication between the short-term insurer and/or the insurance broker on the one hand and the policyholders on the other hand. The premises of policyholders can further be randomly surveyed by the short-term insurers to check whether the stipulated safety and security precautions are adhered to, which may lead to immediate cancellation of the liability insurance policy when the precautions are not applied.

Although the high cost of legal representation and claims pay-outs associated with liability insurance remains a real challenge, the implementation of available technology to ease the claims handling process by providing adequate and applicable information at various stages of the

process, may lead to proper decision-making regarding these two aspects.

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