THE CLAIMS HANDLING PROCESS OF ENGINEERING INSURANCE IN SOUTH AFRICA

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Abstract

Due to technological developments, the complicated world of engineering and its associated products are continuously becoming more specialized. Short-term insurers provide engineering insurance to enable the owners and operators of engineering assets to combat the negative impact of the associated risks. It is, however, a huge challenge to the insurers of engineering insurance to manage the particular risks against the background of technological enhancement. The skills gap in the short-term insurance market and the engineering environment may be the main factor which inhibits the growth of the engineering insurance market. The objective of this research embodies the improvement of financial decision-making concerning the claims handling process of engineering insurance. Secondary as well as primary data were necessary to achieve the stated objective. The secondary data provided the background of the research and enabled the researchers to compile a questionnaire for the empirical survey. The questionnaire and a cover letter were sent to the top 10 short-term insurers in South Africa that are providing engineering insurance. Their perceptions should provide guidelines to other short-term insurers who are engaged in engineering insurance, as they are regarded as the market leaders of engineering insurance in South Africa. The empirical results of this research focus on the importance of various claims handling factors when assessing the claims handling process of engineering insurance, the problem areas in the claims handling process concerned, as well as how often the stipulations of engineering insurance policies are adjusted to take the claims handling factors into account.

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

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1. Introduction and Objective of Research

The world of engineering and all its associated products are highly complicated and they are becoming more specialised due to technological enhancement. To combat the detrimental impact of engineering risks, short-term insurers provide engineering insurance to the owners and operators of engineering assets. The continuous technological developments however bring a huge challenge to the underwriters of engineering insurance to manage the particular risks in a proper manner (Heidenhain, 2001:268 & 276). Various techniques are available to assess the particular risks of engineering industries, such as the process hazard analysis and the application of a probabilistic framework (Codd, 2008:30-31; Ranasinghe, 1998:31-39). The skills gap in the engineering environment and the short-term insurance market is however perceived as the main factor which limits the growth of the engineering insurance market (Jones, 2011).

Engineering insurance includes a wide range of products, amongst others plant and machinery, boilers, cranes, lifts, computers, various electrical equipment (Diacon & Carter, 1988:20-21). Cover is sometimes extended to include property losses which are not connected to the failure of plant and machinery (for example fire, earthquakes and floods), losses when business interruption occurs due to the breakdown of plant and machinery, as well as liabilities to third parties when the liabilities are not covered by other insurance policies (Diacon & Carter, 1988:21). It is therefore clear that engineering insurance addresses a wide range of products and associated risks. Although the range of insurance products which short-term insurers offer, may be very similar, a short-term insurer can differentiate itself

from other insurers by focusing on the service level that it provides (Barkur et al., 2007:513; Danckwerts, 2012:20).

The objective of this research focuses on the improvement of financial decision-making regarding the claims handling process of engineering insurance. To achieve the stated objective, secondary data was necessary to provide the background of this study and to compile a questionnaire for the empirical survey. The primary data was obtained by sending a questionnaire and an accompanying cover letter to the top 10 short-term insurers in South Africa that are engaged in engineering insurance. They are regarded as the South African leaders in the engineering insurance market and their perceptions should provide guidelines to other short-term insurers who are involved in engineering insurance. The following section will pay attention to the claims handling process concerning engineering insurance.

2. The Claims Handling Process of Engineering Insurance

The claims handling process consists of various steps, which can be summarised by the notification of a claim, the proof that the claim has occurred, the assessment of the claim by a loss adjuster and finally the indemnity and settlement thereof. These steps will be discussed in the following sections.

2.1 Notification of the claim

A policyholder should usually notify a short-term insurer orally about a claim that will be filed as soon as possible, as well as in writing within a period stipulated in the insurance policy (McGee, 2001:259). It must be emphasised that a short-term insurer may reject a claim when the notification was not done within the stipulated timeframe, as such conduct by a policyholder may be considered as a breach of contract by a short-term insurer. Prompt notification of a claim will give a short-term insurer the opportunity to investigate a claim properly (Dorfman, 1996:230-231).

2.2 Proof that the claim has occurred

Loss adjusters are employed by short-term insurers to manage the claims handling process. They should, amongst others, ascertain whether the proof of a claim which was filed by the policyholder is acceptable, against the background of possible false or fraudulent claims. The loss adjusters should therefore determine the validity of the proof that the filed loss has actually occurred and that it was due to the indicated cause or causes (Greene & Trieschmann, 1988:119). The next step will be addressed when the loss adjuster is satisfied with the proof of the particular claim.

2.3 Assessment of the claim by a loss adjuster

Loss adjusters who are in the service of short-term insurers usually assess the claims to determine the extent of the loss. A claims reserve to provide for the estimated amount of the claim will be created hence by the short-term insurer (Williams et al., 1998:218). The assessment of the claim can become very complicated and various techniques have been developed to assist in this process. When a subject matter has a sum insured based on the replacement or market value thereof, the assessment of a claim may be easier compared to a situation where a limit of indemnity exits and an estimation of the loss (for example of business interruption) must be made. Contracts of indemnity apply the basic principle of indemnity which states that an insured should be in the same position after indemnity was applied than before the detrimental event occured (Diacon & Carter, 1988:58-61; Williams et al., 1998:490-491).

2.4 Indemnity and settlement of a claim

Short-term insurers usually have the option to indemnify a policyholder by replacing or repairing the particular subject matter which was damaged. A short-term insurer may also opt to indemnify the policyholder by a cash settlement. If a policyholder is not satisfied with the settlement of a claim, the process of arbitration may be available. Insurance policies often have an arbitration clause according to which disputes between an insurer and a policyholder can be settled (Davis, 1997:308). When the two parties agree to an arbitration process, they usually accept in advance the judgement of a properly qualified arbitrator instead of expensive legal and court procedures (Diacon & Carter, 1988:278). The following section will pay attention to various claims handling factors of engineering insurance.

3. Various Claims Handling Factors of Engineering Insurance

Short-term insurers should take various factors into consideration during the claims handling process of engineering insurance. The factors which are perceived in the current literature as the prominent aspects are described in the following paragraphs.

The name and details of the policyholder are important as it indicates, amongst others, the geographical location of the policyholder, although the various subject matters which are covered by the engineering insurance policy may be insured under an all risks policy which implies worldwide coverage. The name and details of the policyholder also enables the short-term insurer to track the claims history of the insured. Whether the premium payments are paid up can also be determined by using the name and details of the insured. The existence of previous false and/or fraudulent claims by the policyholder can be

ascertained by applying the name and details of the insured and obtaining information from various internal and external sources (Deloitte, 2011:14).

The basic principle of the proximate cause states that the cause of the loss should be an insured risk before any indemnity will be paid to the insured (Diacon & Carter, 1988:170; Rejda, 1995:99). It is therefore very important that documentation as supporting evidence of the loss should be provided by the policyholder to enable the short-term insurer to determine the proximate cause as well as the extent of the loss (Ren et al., 2001:190).

Another basic principle should also be taken into consideration by short-term insurers. The basic principle of insurable interest requires that an insured should have a legal and/or financial relationship with the subject matter. This means that the policyholder should be the legal owner of the subject matter and/or that he/she should suffer a financial loss when the detrimental event occurs (Harrington & Niehaus, 1999:180).

The basic principle of utmost good faith entails that all material information must be disclosed by the policyholder and the short-term insurer concerning the insurance policy (Diacon & Carter, 1988:48-49; Harrington & Niehaus, 1999:181). If the insured does not adhere to this basic principle, the short-term insurer may treat the claim as a breach of contract. The existence of any information not mentioned by the insured since the underwriting of the engineering insurance policy may therefore represent vital information to the short-term insurer.

The coverage of the risk by the engineering insurance policy of another short-term insurer or insurers focuses on the basic principle of contribution (Diacon&Carter, 1988:63-65). This basic principle provides a right to a short-term insurer to demand that other insurers must contribute to the indemnity of the particular loss when all the short-term insurers concerned cover the same risk, the same subject matter of the policyholder and during the same period.

There are also claims handling factors of engineering insurance which have an operational and/or administrative nature that should receive the necessary attention from short-term insurers. The first factor requires that the claim should be filed within the time frame stipulated in the engineering insurance policy. Another factor focuses on whether the safety and security precautions of the engineering insurance policy were met by the policyholder who filed the claim.

The research methodology which was applied to obtain the empirical results of the opinion survey will be described in the next section.

4. Research Methodology

The objective of this research was already defined as the improvement of financial decision-making regarding the claims handling process of engineering insurance. Secondary as well as primary data were required to achieve the stated objective. The secondary data consisted of the literature study which was discussed in preceding sections. The literature study was used to compile a questionnaire which was sent to the top 10 short-term insurers in South Africa who are engaged in engineering insurance. Each questionnaire was accompanied by a cover letter, inviting the short-term insurers to participate in the opinion survey. Those top 10 short-term insurers are perceived to be the leaders in the South African engineering insurance market. Their perceptions concerning the claims handling aspects of engineering insurance should therefore provide guidelines to other short-term insurers who are engaged in engineering insurance. As South Africa is a developing country with an emerging market economy, the conclusions of this research should also be beneficial to short-term insurers in other countries which are classified similarly.

Some of the questions of the questionnaire used a five point Likert interval scale. It was explicitly stated on the questionnaire that the five point Likert interval scale forms a continuum which enabled the weighting of the answers (Albright et al., 2002:224-229 & 245). The answers of the respondents which appear in Section 5, were weighted by assigning the weights as depicted in Table 1.

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

5. Empirical Results

The empirical results obtained by the opinion survey will be discussed in this section where the following aspects receive attention:

- The importance of various claims handling factors when assessing the claims handling process of engineering insurance,
- The problem areas in the claims handling process of engineering insurance, as well as

- How often the stipulations of engineering insurance policies are adjusted to take the claims handling factors into account.

5.1 The importance of various claims handling factors when assessing the claims handling process of engineering insurance

The importance of various claims handling factors when assessing the claims handling process of engineering insurance, based on the perceptions of the respondents, appears in the following table.

Table 2. The importance of various claims handling factors when assessing the claims handling process of engineering insurance, as perceived by the respondents

Claims handling factors	Extremely important	Highly important	Moderately important	Little important	Not important
Name and details of the policyholder	6	4			
Whether the premium payments are paid up	8	2			
Particulars of the occurrence to determine the specific proximate cause of the loss	5	5			
Whether the insured has an insurable interest	3	7			
The existence of any information not mentioned by the insured since underwriting the insurance policy	3	5	2		
The claims history of the insured	1	6	2	1	
Previous false and/or fraudulent claims by the claimant	6	4			
The coverage of the risk by the engineering insurance policy of another insurer(s)	4	2	2	1	1
Documentation provided by the insured as supporting evidence of the loss	6	4			
Whether the insured has met the safety and security precautions of the insurance policy	5	4	1		
Whether the claim is filed within the stipulated time frame	6	2	2		

It is interesting to note from Table 2 that the following five claims handling factors were perceived by all 10 respondents to be at least highly important:

- Name and details of the policyholder,
- Whether the premium payments are paid up,
- Particulars of the occurrence to determine the specific proximate cause of the loss,
- Whether the insured has an insurable interest, as well as
- Documentation provided by the insured as supporting evidence of the loss.

The weights which were described in Section 4 of this paper were applied to weight the answers of the respondents that appear in the preceding table. The weighted responses on the importance of various claims handling factors when assessing the claims handling process of engineering insurance are depicted in a declining order of importance in Table 3.

Table 3. The weighted responses on the importance of various claims handling factors when assessing the claims handling process of engineering insurance, in a declining order of importance

Total weighted scores calculated	Declining order of importance	Claims handling factors
48	1	Whether the premium payments are paid up
46	2	Name and details of the policyholder
46	2	Previous false and/or fraudulent claims by the claimant
46	2	Documentation provided by the insured as supporting evidence of the loss
45	5	Particulars of the occurrence to determine the specific proximate cause of the loss
44	6	Whether the insured has met the safety and security precautions of the insurance policy
44	6	Whether the claim is filed within the stipulated time frame
43	8	Whether the insured has an insurable interest
41	9	The existence of any information not mentioned by the insured since underwriting the insurance policy
37	10	The claims history of the insured
37	10	The coverage of the risk by the engineering insurance policy of another insurer(s)

The claims handling factor which obtained the highest total weighted score calculated according to the preceding table was whether the premium payments are paid up. In the event of premium payments not being paid up, the short-term insurer may often reject the insurance claims of the policyholders.

It is interesting to note that the following three claims handling factors obtained the same and second highest total weighted scores calculated according to Table 3, viz.:

- The name and details of the policyholder,
- Previous false and/or fraudulent claims by the claimant, as well as
- Documentation provided by the insured as supporting evidence of the loss.

These three claims handling factors address some of the information needed by a short-term insurer to assess the engineering insurance claim filed by the policyholder. The remaining claims handling factors depicted in Table 3 were also considered as important by the respondents, but the four claims handling factors mentioned above are the most important aspects based on the perceptions of the co-operating short term insurers. The problem areas experienced by the respondents in the claims handling process are addressed in the following section.

5.2 Problem areas in the claims handling process of engineering insurance

Each respondent was requested to indicate the three most important problem areas in the claims handling process which he/she has experienced. The perceptions of the respondents are shown in the following table.

Table 4. Problem areas in the claims handling process of engineering insurance, as perceived by the respondents

Problem areas	Number of respondents who mentioned the problem area
The absence of safety and security precautions as required by the engineering insurance policy	8
The insured is claiming for more than the actual value	5
The insured does not fully understand the terms, conditions and coverage of the insurance policy	5
The high cost of claims pay-outs	4
The high cost of legal representation during a litigation process	3
Non-disclosure by the insured of material facts at the time and place of the loss, filing for fraudulent and false claims and therefore causing a breach of contract (including a breach of utmost good faith)	3
Insured does not have an insurable interest	1
Obtaining the contract value, contract details and insurance information from the insured/broker on a Contract Works policy	1

Fifty per cent or more of the respondents indicated the following three problem areas in the claims handling process of engineering insurance:

The absence of safety and security precautions as required by the engineering insurance policy,

The insured is claiming for more than the actual value, and

The insured does not fully understand the terms, conditions and coverage of the insurance policy.

The solutions to address the preceding problem areas focus respectively on the following aspects:

The safety and security precautions can be addressed by the short-term insurer by carrying out risk surveys prior to the underwriting of the engineering insurance policies, presenting workshops to the policyholders concerning the safety and security requirements stated in the engineering insurance policies, as well as conducting regular check-ups during the coverage period.

The short-term insurer should employ competent loss adjusters to identify each and every time when a policyholder claims more than the actual value to ensure that appropriate remedial steps can be taken.

The education of policyholders about the terms, conditions and coverage of their engineering insurance policies should be to the advantage of the policyholders, as well as to the short-term insurers when they are assessing engineering insurance claims filed by knowledgeable insureds.

The following section focuses on how often the stipulations of engineering insurance policies are adjusted to take the claims handling factors into consideration.

5.3 How often the stipulations of engineering insurance policies are adjusted to take the claims handling factors into account

The perceptions of the respondents concerning how often the stipulations of engineering insurance policies are adjusted to account for the claims handling factors are depicted in Table 5.

Table 5. How often the stipulations of engineering 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	4	4		
The insurer adjusts the amount of coverage to be paid for an engineering loss or damage	2	2	4	2	
The insurer adjusts the safety and security precautions on the subject matter of the insured to reduce the risk of engineering claims	1	1	5	3	
The insurer excludes the application of the basic principle of contribution when the insured has engineering coverage for the same risks, for the same subject matter and during the same period from other insurer(s)	1		1	6	2
The insurer adjusts the length of the coverage period	2	1	4	3	
The insurer adjusts the excess (deductible) to be paid by the insured when a claim is made	1	1	6	1	1

All the stipulations mentioned in the preceding table are respectively applied with a variation of frequency by at least eight of the 10 respondents, to take the claims handling factors into consideration. According to Section 4 of this paper, the perceptions were weighted when a five point Likert interval scale was used. The weighted responses on how often the stipulations of engineering insurance policies are adjusted to take the claims handling factors into account appear in a declining order of frequency in Table 6.

Table 6. The weighted responses on how often the stipulations of engineering insurance policies are adjusted to take the claims handling factors into account, in a declining order of frequency

Total weighted scores calculated	Declining order of frequency	Stipulations of engineering insurance policies
38	1	The insurer adjusts the level of the premium
34	2	The insurer adjusts the amount of coverage to be paid for an engineering loss or damage
32	3	The insurer adjusts the length of the coverage period
30	4	The insurer adjusts the safety and security precautions on the subject matter of the insured to reduce the risk of engineering claims
30	4	The insurer adjusts the excess (deductible) to be paid by the insured when a claim is made
22	6	The insurer excludes the application of the basic principle of contribution when the insured has engineering coverage for the same risks, for the same subject matter and during the same period from other insurer(s)

The stipulation of an engineering insurance policy that is most often adjusted by the respondents to account for the claims handling factors embodies the adjustment of the level of the premium according to the preceding table. The stipulation which is second often adjusted according to Table 6 focuses on the amount of coverage to be paid for an engineering loss or damage by the short-term insurer. The empirical results indicate that the respondents opt to adjust the length of the coverage period thirdly in a declining order of frequency. The main conclusions of this research are provided in the next section.

6. Conclusions

The following aspects represent the main conclusions of this research, which should be seen against the background of South Africa as a developing country with an emerging market economy:

The four most important claims handling factors when short-term insurers assess the claims handling process of engineering insurance are apparently as follows:

- Whether the premium payments are paid up by the policyholder,
- The name and details of the policyholder,
- Previous false and/or fraudulent claims by the claimant, as well as
- Documentation provided by the insured as supporting evidence of the loss.
- It was concluded that the majority of short-term insurers may experience the following problem areas in the claims handling process of engineering insurance:
- The absence of safety and security precautions as required by the engineering insurance policy,
- The insured is claiming for more than the actual value, and

- The insured does not fully understand the terms, conditions and coverage of the insurance policy.

Solutions to solve the preceding problem areas focus respectively on the following aspects:

Short-term insurers should carry out risk surveys prior to the underwriting of the insurance policies, should present workshops to the policyholders concerning the safety and security requirements stated in the engineering insurance policies, and should conduct regular check-ups during the coverage period to ensure that the safety and security requirements of the engineering insurance policies are met by the policyholders.

The short-term insurers should employ competent loss adjusters to identify each and every time when insureds claim more than the actual value and to apply appropriate remedial steps afterwards.

The education of policyholders concerning the terms, conditions and coverage of their engineering insurance policies should benefit the policyholders, as well as the short-term insurers when they are assessing engineering insurance claims filed by knowledgeable insureds.

The empirical results of this research lead to the conclusion that the level of the premium is the stipulation of an engineering insurance policy which is most often adjusted by the short-term insurers to account for the claims handling factors, while the following stipulations are respectively secondly and thirdly most often applied:

The insurer adjusts the amount of coverage to be paid for an engineering loss or damage, and

The insurer adjusts the coverage period.

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