

## Insurance claims, the potential for racial discrimination in the handling of claims: surveying the field

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### Insurance and Discrimination at Placement and the Claims Stage

Insurance has a difficult relationship with discrimination law. This was most apparent in the *Test Achats* litigation,<sup>1</sup> which found that sex discrimination in motor insurance was unlawful, despite a specific exemption for insurance in the relevant EU Directive.<sup>2</sup> There is a substantial literature on the relationship between the insurance industry's need to differentiate on actuarial risk and society's desire to avoid unjustified discrimination.<sup>3</sup>

This blog is concerned with the potential for racial discrimination in insurance practice. In English law, any direct discrimination in the provision of insurance on the basis of race is unlawful.<sup>4</sup> Recent 'mystery shopping' and related research carried out by Citizens Advice suggests that ethnicity remains a factor in motor insurance pricing,<sup>5</sup> although its findings are disputed by insurance trade bodies.<sup>6</sup> We note that the regulator- the body with the greatest access to data- expressed concern in a 2018 'Dear CEO' letter that discriminatory pricing was still in existence.<sup>7</sup> These letters are used to signify regulatory concerns and often come before formal intervention. As little as fifty-five years ago, insurance was an openly racist industry<sup>8</sup> and it is legitimate to question whether that culture has been eradicated.

This blog takes the conversation beyond the Citizens Advice research and into the potential for discriminatory treatment within the claims process. This might manifest itself in a range of different ways, including slower payment of claims, heightened demands for evidence of loss, different treatment during the claims investigation stage including additional interviews and onerous requests for information, and ultimately might lead to an increase in coverage defences

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<sup>1</sup> Case C-236/09 [Association belge des Consommateurs Test-Achats ASBL v Conseil des ministres](#) [2012] 1 WLR 1933. For a review of the wider consequences of this decision, see J Davey 'Genetic discrimination in insurance: Lessons from Test Achats' in G Quinn, A de Paor and P Blanck (eds) in *Genetic Discrimination: Transatlantic Perspectives on the Case for a European Level Legal Response* (2014, Routledge).

<sup>2</sup> The exemption was reflected in English law (sch 3, para 22 of the Equality Act 2010) but was removed by reg 2, Equality Act 2010 (Amendment) Regulations 2012/2992.

<sup>3</sup> For a general introduction in the UK context, see the Davey chapter in fn 2. In the US, [R Avraham, K Logue and D Schwarcz 'Towards a Universal Framework for Insurance Anti-Discrimination Laws' \(2014-15\) 21 Conn Ins LJ 1](#).

<sup>4</sup> Direct discrimination in the provision of services on the basis of race is unlawful under ss. 4, 9 & 29 Equality Act 2010. Indirect discrimination is defined in s. 19. The limited exemptions for insurance in Sch 3 do not apply to racial discrimination.

<sup>5</sup> [T Cook, A Greenall, E Sheehy for Citizens Advice Discriminatory pricing: Exploring the 'ethnicity penalty' in the insurance market \(2022\)](#).

<sup>6</sup> See e.g. the [Association of British Insurers response](#) to the Citizens Advice research.

<sup>7</sup> [Financial Conduct Authority, 'Dear CEO', 31/10/2018](#): 'During the review, we identified the following issues regarding firms' pricing practices that could cause significant harm and poor outcomes for consumers... iii. The risk of discriminating against consumers through using rating factors in pricing based (directly or indirectly) on data (including third party data) relating to or derived from protected characteristics'.

<sup>8</sup> See [Hansard \(HC Deb 17 January 1967, vol 739, cols 365-392\)](#), which contains David Marquand's review of industry attitudes in the late 1960s. Whilst not unlawful at the time, the Minister for the Board of Trade noted that racial discrimination in insurance pricing was contrary to self-regulatory norms agreed in 1961. It was outlawed by legislation by s. 20, Race Relations Act 1976 (with specific reference to insurance in s. 20(2)).

being raised by the insurer against the policyholder including allegations of dishonesty and fraud both pre-inception and during the claims adjustment process. Establishing these changes in attitude by claims handlers is even more difficult than testing for racial discrimination in insurance pricing, as ‘mystery shopping’ cannot be easily undertaken in the claims environment.<sup>9</sup> Risk classification in insurance generates a single, comparable outcome: whether the same risk generated the same price. Differences in outcome in claims handling are likely to be more subjective, and largely visible at the macro level.<sup>10</sup> This is likely to require the kind of data resource held by regulators, Ombudsmen, large insurers, or associated trade bodies.<sup>11</sup> We now move to a review of what evidence exists of racial discrimination in claims handling, by drawing on data from both sides of the Atlantic.<sup>12</sup>

### Racial Discrimination in Claims- ‘known knowns’ and ‘known unknowns’

#### **What We Know**

The legal environment for the handling of insurance claims is reasonably well established. In addition to the contract terms agreed between the parties, s. 13A Insurance Act 2015, by way of implied term, provides that claims must be paid within a reasonable time.<sup>13</sup> This duty cannot be contracted out of in consumer transactions<sup>14</sup> and can only be amended as against a commercial assured where transparency requirements have been satisfied.<sup>15</sup> This is supplemented by ICOBS duties requiring that insurers handle claims promptly and fairly, do not unreasonably reject a claim and settle promptly once terms are agreed.<sup>16</sup> In addition to these specific insurance law duties, the general requirements of anti-discrimination law apply. The provision of services cannot vary by direct reference to ethnicity,<sup>17</sup> and processes which have an indirect effect would be unlawful unless specifically justified as a proportionate means of achieving a legitimate aim.<sup>18</sup>

#### **What We Do Not Know**

There is no direct empirical evidence of racial discrimination in claims in the United Kingdom. This does not mean that it does not exist; there is (to our knowledge) no public data either way.<sup>19</sup> There is, however, significant and growing evidence from the United States. We use this

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<sup>9</sup> It is worth noting that insurers’ anti-fraud measures were triggered – resulting in the denial of quotes – in the Citizens Advice mystery shopping exercise, see [Citizens Advice, \*Discriminatory Pricing\*](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20cover/Citizens%20Advice%20-%20Discriminatory%20Pricing%20report%20(4).pdf) (March 2022) [https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer publications/Report cover/Citizens Advice - Discriminatory Pricing report \(4\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20cover/Citizens%20Advice%20-%20Discriminatory%20Pricing%20report%20(4).pdf) (accessed 08/06/2023) pp.13-14. As we discuss below, accessing a sufficient data set is more difficult in the UK than in the US.

<sup>10</sup> It is likely that interview data from those working within the claims process or who suspect that they were discriminated against would enrich our macro view.

<sup>11</sup> The Insurance Fraud Bureau, for example, may be able to provide useful insights across the market.

<sup>12</sup> [T Baker & K McElrath, ‘Whose Safety Net? Home Insurance and Inequality’ \(1996\) 21 Law & Soc. Inquiry 229](#); [X Lin, M Browne & A Hoffmann, ‘Race discrimination in the adjudication of claims: Evidence from earthquake insurance’ \(2022\) 89 J Risk Insur 553](#).

<sup>13</sup> Reasonableness is a question of fact and s.13A(3) Insurance Act 2015 provides a non-exhaustive list of factors relevant to this assessment.

<sup>14</sup> Insurance Act 2015 s.15(1).

<sup>15</sup> Insurance Act 2015 s.16(2).

<sup>16</sup> ICOBS 8.1.1R (1)(3)(4).

<sup>17</sup> Equality Act 2010 ss.4, 9, 13(1)(5), 29.

<sup>18</sup> Equality Act 2010 s.19(2)(d).

<sup>19</sup> We note that the Financial Ombudsman Service does receive complaints from policyholders who consider they have been discriminated against e.g. Decision Reference DRN7653170 (03/07/2017) <https://www.financial->

evidence here as a useful indication of the kinds of issues that might arise and the methods that might uncover them.

We draw here upon three main sources, two published academic articles and some live litigation in the US courts. Each is concerned with differences in treatment in insurance claims handling on racial grounds. Unlike in the UK, the legal prohibitions on racial discrimination in the USA are much more varied, reflecting insurance's position as the archetypal industry regulated at the State, rather than Federal, level.

Our first source of interest is early work by Professors Tom Baker and Karen McElrath.<sup>20</sup> Drawing on survey data produced at the University of Miami, it investigated the claims experiences of a wide range of staff at the university in the aftermath of Hurricane Andrew in 1992. In outlying districts, beyond the immediate impact of the storm, Hispanic claimants were significantly less likely to receive an interim payment within 30 days of a loss adjuster visit. For Baker and McElrath, the best explanation of this was that loss adjuster discretion was more significant in these marginal cases and tended to favour non-Hispanic households. When challenged on this, adjusters suggested a language difference as the cause, even though University of Miami employees had to establish their English language competence prior to appointment. As Baker and McElrath stated:

‘Our most significant finding is that the distribution of residential insurance differs along the race/ethnicity and income fault lines of late 20th-century American society. This study also shows that insurance law in-action has a similar effect. The first-party insurance claims process favors the advantaged, through the discretion of the private, street-level bureaucrats who administer the insurance contract. If, as we began, insurance offers "good people" protection against "bad things," then we might also say that the more difficult it is for the adjuster to see the claimant as a good person, the less protection that claimant will receive. As a result, disaster increases inequality, not only between those who are and who are not insured against that disaster but also among those who are insured.’<sup>21</sup>

More recent work conducted by Lin, Browne and Hoffmann identified that race may also have played a role in the adjudication of claims following a series of fracking-induced earthquakes in Oklahoma.<sup>22</sup> Relying on postcode-level census data for ethnicity, these authors found that claims from postcodes with higher numbers of black inhabitants were less likely to be paid and, when claims were paid, were paid at a lower amount.

‘Since we use zip-code to proxy for race (individual-level race data are not collected by insurers), we cannot assert that individuals are treated differently based on their race, all else equal. However, finding disparities in claims approval rates, while controlling

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[ombudsman.org.uk/decision/DRN7653170.pdf](https://www.ombudsman.org.uk/decision/DRN7653170.pdf) (accessed 17/07/2023); Decision Reference DRN3613219 (13/10/2022) <https://www.financial-ombudsman.org.uk/decision/DRN-3613219.pdf> (accessed 17/07/2023).

<sup>20</sup> T Baker & K McElrath, ‘Whose Safety Net? Home Insurance and Inequality’ (1996) 21 *Law & Soc. Inquiry* 229. A shorter review of the findings was produced by the same authors: ‘Insurance Claims Discrimination’ in G Squires (ed) *Insurance Redlining: Disinvestment, Reinvestment and the Evolving Role of Financial Institutions* (Urban Inst Press, 1996).

<sup>21</sup> At 230.

<sup>22</sup> X Lin, M Browne & A Hoffmann, ‘Race discrimination in the adjudication of claims: Evidence from earthquake insurance’ (2022) 89 *J Risk Insur.* 553.

for policy-level characteristics and other zip-code-level characteristics, is significant in and of itself. In the mortgage lending literature, “disparate impact” is defined when decision-makers do not explicitly account for individual characteristics such as race and gender, but use variables that are highly correlated with these characteristics such as zip-code (Ross & Yinger, 2002). Disparities breed discrimination, as they can lead to less equitable outcomes through self-fulfilling discrimination.<sup>23</sup>

Moreover, this difference in payment (the amount recovered) could not be attributed to increased marginal claims, defined as claims emanating from neighbourhoods outside the ‘damage possible’ zone.<sup>24</sup> Lin, Browne and Hoffmann determined that the only credible conclusion was that racial differences had infiltrated and impacted the claims process. The equivalent to ‘disparate impact’ in the United Kingdom context would be indirect discrimination. The claim is that the processes have an overall effect of reducing the value of insurance claims based on race, even if not directly discriminatory.

These objections to insurance practice have become the basis for litigation. *Huskey v State Farm Fire & Casualty Co* is a class action suit in the name of an African American policyholder,<sup>25</sup> filed in December 2022. She claims that policyholders in her position are subject to requests for ‘additional claims documentation’ and ‘must have more interactions with [insurer] employees to resolve their claim’. The claimants rely in part on a survey of 800 policyholders to support this claim.<sup>26</sup> The core suggestion is that algorithmic processes used by State Farm reflect ingrained discriminatory practices. We will return to this potential for automated processes to crystallise discriminatory practices in our conclusion.

### Next Steps

We can reflect on the US experience to sketch how research in the UK might be developed. This could be led by NGOs (such as Citizens Advice), regulators or insurers. What is key in the US is research at sufficient scale to generate statistically significant results. The nature of State regulation of insurance makes obtaining this data possible (as in the Lin, Browne & Hoffmann paper). No equivalent public data set exists in the UK, at least not at reasonable cost.<sup>27</sup> But what is vital is access to large cohort datasets encompassing claims details, ethnicity and outcomes. Some of this may already exist. The FCA has a vast array of data on the COVID-19 business interruption insurance settlement process.<sup>28</sup> If this contains a record of the ethnicity of the claimant (and this is not in the public data set) then the regulator could look for correlations or assist those who wish to interrogate the data for that purpose. Similarly, the Insurance Fraud Bureau operates a database of those considered by the industry to have committed insurance fraud. It might also provide a sufficiently large-scale data set for genuine insights to be obtained. What cannot be done is something akin to a simple mystery shopping

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<sup>23</sup> Lin, Browne & Hoffmann, at 555.

<sup>24</sup> Lin, Browne & Hoffmann at 555.

<sup>25</sup> *Huskey v State Farm Fire & Casualty Company* (US District Court Northern District of Illinois Eastern Division) 14/12/2022 Case no: 22-cv-7014; a review of the litigation is at: <https://www.claimsjournal.com/news/national/2022/12/16/314325.htm>.

<sup>26</sup> We are not privy to further detail of the techniques used to formulate these claims at this early stage of litigation. We hope to return to this point once the action has progressed.

<sup>27</sup> See, for example, the [ABI ‘external use’ data package](#) which is priced at around £20,000 per calendar year.

<sup>28</sup> See FCA, ‘Business interruption insurance test case – Insurer claims data’ (31/03/23) available: <https://www.fca.org.uk/data/bi-insurance-test-case-insurer-claims-data> (accessed 8/06/2023).

exercise. The operation of dummy claims by outside agencies would be very likely to trigger the sophisticated insurance systems surrounding customer identity and insurance fraud.

It might be thought that the lack of positive empirical evidence in the United Kingdom makes the cost of undertaking this kind of research unnecessary. But we have good evidence from the regulator that there are concerns on insurer behaviour around protected characteristics,<sup>29</sup> and of insurer behaviour around claims. The Liberty Mutual regulatory action is a good example of the latter issue.<sup>30</sup> Liberty Mutual relied on third party technology to review claims and was fined for a lack of proper control over its claims processes. The suggestion is that this would have included false accusations of insurance fraud against its customers.

### Conclusion

We do not deny that the ability to differentiate between risks using actuarially fair characteristics is a necessary part of insurance. However, the need for the insurer to discriminate in this way ceases once it has agreed to accept a particular risk. The process by which the decision is reached to pay or deny a claim depends solely on an assessment of the terms of the policy against the facts. The suggestion that race or ethnicity could have any impact on the handling or outcome of an insurance claim is deeply troubling. However, gone are the days in which the only source of racial discrimination stemmed from the personal biases of claims handlers and loss adjusters. Agency problems – exemplified in the Liberty Mutual action<sup>31</sup> in which the insurer was not sufficiently aware of the techniques the third party was employing – are only likely to increase with the introduction of Artificial Intelligence (AI). While Big Data promises cost and efficiency savings within the claims process, the use of algorithms and other AI tools trained on historic data carries a significant risk of further entrenching racial stereotypes and bias. In the *Huskey* class action, it is contended that the use of historical data employed by automated processes contributes to the discriminatory treatment of black policyholders in comparison to their white counterparts.<sup>32</sup> The risk that AI may replicate racial biases has been recognised in the Government's recent White Paper 'A pro-innovation approach to AI regulation'<sup>33</sup> and by the Chartered Insurance Institute.<sup>34</sup> Algorithmic bias is also likely to be encompassed by the New Consumer Duty. We already know that consumer insureds primarily choose insurance based on price comparisons since comparative data on claims handling and service is not readily available.<sup>35</sup> The introduction of AI is likely to further obscure claims processes and create conditions for greater (perceived) bias in decision making. Understanding the potential for racial bias in UK insurer claims processes and how this may be combatted is both vital and timely. This is clearly a sizeable task. It will require collaboration, data sharing and commitment to change law and/or regulation from insurers, industry bodies, regulators and academics from across the disciplines.

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<sup>29</sup> The FCA's 'Dear CEO' letter above.

<sup>30</sup> <https://www.fca.org.uk/publication/final-notice/liberty-mutual-insurance-europe-se-2018.pdf>

<sup>31</sup> <https://www.fca.org.uk/publication/final-notice/liberty-mutual-insurance-europe-se-2018.pdf>

<sup>32</sup> *Huskey*, [4].

<sup>33</sup> Department for Science, Innovation & Technology, *A pro-innovation approach to AI regulation* (March 2023), 11, 13.

<sup>34</sup> Chartered Insurance Institute, *Addressing Gender Bias in Artificial Intelligence* (2017)

<sup>35</sup> J Feinman, 'The regulation of insurance claims practices' [2015] 5 UC Irvine L Rev 1319, 1321-1322.