



SECP
INSURANCE DIVISION
Islamabad

Before Tahir Mahmood, Commissioner (Insurance)

In the matter of

M/s. Aon Insurance Broker (Pvt.) Limited

Show Cause Notice No. and Issue Date: ID/Enf/Aon/2018/16003 dated
August 6, 2018

Date of Hearing: October 3, 2018

Attended By:

1. Syed Mustafa Ali Khan
Chief Executive Officer
M/s. Aon Insurance Broker (Pvt.)
Limited
2. Mr. Asim Nasim
Advocate
M/s. Orr, Dignam & Co. Advocates
3. Mr. Taha Alizai
Advocate
M/s. Orr, Dignam & Co. Advocates
4. Syed Aminuddin Fakir
Advocate
M/s. Orr, Dignam & Co. Advocates

Date of Order: October 29, 2018

ORDER

Under Rule 7 & Rule 23 of the Insurance Rules, 2002 and Section 165 of the Insurance Ordinance, 2000 read with Section 102(6) of the Insurance Ordinance, 2000.

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This Order shall dispose of the proceedings initiated against M/s. Aon Insurance Broker (Pvt.) Limited (the "Company"), its Chief Executive and Directors for alleged contravention of Rule 7¹ & Rule 23² of the Insurance Rules, 2002 (the "Rules") and Section 165 of the Insurance Ordinance, 2000 (the "Ordinance"). The Company and its Directors shall be collectively referred to as the "Respondents" hereinafter.

¹ Rule 18 of the Insurance Rule, 2017

² Rule 48 of the Insurance Rule, 2017



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2. The Company is licensed by the Commission as a broker to carry on the direct insurance broking business in Pakistan in pursuance of Section 102 of the Ordinance.

3. The Company earned a major portion of its revenue, almost 40% of its total revenue in the form of fees from reinsurance placements (treaty and facultative) of local insurance risks made through Aon London, Aon Singapore and other offices. When inquired about the role of the Company in these transactions by the inspection team, the management of the Company stated that it was not acting as a reinsurance broker and it merely received its share of earnings on such placements against providing local liaison and support services, just facilitating the process of risk placement.

4. The Company's agreement with Aon Benfield Singapore contains the following para in its foreword:

"Aon Benfield To assist ANC (the Aon Company Pakistan) in their efforts to provide reinsurance brokerage service, and to promote, sell and support reinsurance products.

5. Schedule 1, with the heading Specific Responsibilities of the Parties, and under Part B., the statement is as follows:

"ANC (Aon Pakistan) agrees to provide reinsurance broking services to the client in order to provide reinsurance brokerage services, and to promote, sell and support reinsurance products."

6. The Company's agreement with Aon UK mentions of the wholesale insurance broking services and does not use the word 'reinsurance services'. Whereas the Company has been licensed by the Commission to act only as a direct insurance broker where the term 'direct' has been defined in the Ordinance as follows:

"direct", in relation to the business of insurance, means insurance other than reinsurance"

7. Substantial involvement of the Company in reinsurance activity, it was *prima facie* observed that the Company was facilitating the fronting transactions. Fronting occurs when a broker or foreign reinsurer uses a local insurance company as a fronting agent to place risks outside Pakistan in the form of reinsurance. In such cases, a very small portion of the risk is retained in Pakistan and the bulk is placed abroad in the form of facultative reinsurance. In cases involving fronting, the broker, insured or foreign reinsurer often, dictate terms to the local insurer and try to restrict/ minimize local retention. Furthermore, as per Rule 23 of the Rules, no person can insure outside Pakistan any risk or part thereof in respect of any property or interest located within Pakistan, unless approved by the Federal Government. This implies that businesses or individuals situated in Pakistan must get their risks insured from local insurance companies. To bypass this requirement of the Ordinance, the prospective insureds, foreign reinsurers and brokers often employ the practice of fronting. The practice of fronting is also an indirect violation of Rule 7 of the Rules read with Section 41 of the Ordinance that stipulate that local insurance risks only be placed outside Pakistan in the form of reinsurance after determining that such risks cannot be suitably reinsured within the country.



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8. The inspection team noted that insured parties in a number of instances issued the Broker of Record Letters (BORLs) to the Company whereby they authorized the Company to act as reinsurance broker on behalf of the related insurer(s). It was observed that a business concern seeking insurance cover in no way could act as a proxy/ deputy/ agent of the insurer, authorizing the intermediary to seek reinsurance on behalf of the insurer, whosoever it may be. The inspection team noted that the Company received BORLs from the parties seeking insurance cover, wherein such parties included a para in the said letters by stating that:

'AON is authorized to negotiate with direct insurers and where necessary, to act as reinsurance brokers on behalf of direct insurers with respect to the requisite insurances.'

9. It was *prima facie* observed that the Company starts the process of fronting by receiving the BORLs from the parties seeking insurance cover. That is to say, that the Company already arranges the reinsurance and by issuing BORLs, the only job left to be accomplished by the Company is to find an insurer to front the risks.

10. The Company was also *prima facie* involved in fronting transactions routed through its foreign Aon affiliates, which were used to subvert the provisions of Rule 23 of the Rules read with Section 165 of the Ordinance. The following instances besides others were noted:-

- i. Hilal Foods (Policy number PL-0617-202009-F03-000255)
- ii. Hashoo Group-Pakistan Services Ltd (Policy number 2523031013/07/2017)
- iii. Getz Pharma (Policy number PL-0415-201001-TOi-000046)
- iv. Zorlu Solar Pakistan (Policy number 2017-07-104-To100IDP000048)

11. The above mentioned instances signified that, to circumvent the provisions of Rule 23 of the Rules and Section 165 of the Ordinance, local businesses like those quoted above, placed their insurance business outside Pakistan in the form of reinsurance through the practice of fronting. The Company assisted these insureds in this practice. Furthermore, in cases involving fronting it was also observed that reinsurance was placed before issuance of the policy by the local insurer. Hence the Company placed insurance business outside Pakistan in the form of reinsurance through the practice of fronting, circumventing the law cited above.

12. Furthermore, a reinsurance contract is drawn between an insurance company and a reinsurer without any involvement of the insured in the reinsurance placement. However, in these cases the Company was communicating directly with the original insured without the involvement of the insurer.

13. In view of the above, it appeared that the Company failed to comply with provisions of provision of Rule 7 & Rule 23 of the Rules and Section 165 of the Ordinance.

14. Section 41(5) of the Ordinance states that:

"Requirement to effect and maintain reinsurance arrangements:-

.....



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(5) *The Federal Government may make rules, not inconsistent with sub-section (1), governing the reinsurance outside Pakistan, other than on a treaty basis, of insurance business underwritten by an insurer in Pakistan."*

15. Rule 7 of the Rules states that:

"Reinsurance outside Pakistan. – (1) For the purposes of sub-section (5) of section 41 of the Ordinance, no insurer shall reinsure facultatively outside Pakistan any insurance business or any part thereof underwritten by it in Pakistan without the permission of the Commission.

(2) *The Commission may, grant permission under sub-rule (1) in any of the following circumstances, namely*

(a) *The insurance or any part thereof is in excess of the insurer's treaty arrangements, and the Commission is provided with documentary evidence that such excess cannot be reasonably placed within Pakistan;*

(b) *the insurance business, although covered by a treaty arrangement shall be desired to be reinsured facultatively for protecting the treaty or for any other special reason:*

Provided that such facultative reinsurance shall not run contrary to subsisting contractual obligations under the treaty; and

(c) *the insurance business is of special nature and there are no treaty arrangements for it.*

(3) *No insurer in Pakistan shall accept reinsurance on facultative basis in excess of its net retention if the insurer seeking such reinsurance so indicates in the reinsurance slip, request note or otherwise in writing.*

16. Section 165 of the Ordinance states that:

" Insurance of interests in Pakistan.- (1) The Federal Government may make rules, not inconsistent with this Ordinance, imposing conditions on the ability of any person to insure outside Pakistan any risk or part thereof in respect of any property or interests which are located in Pakistan at the time the insurance is effected.

(2) *The Federal Government may make rules, not inconsistent with this Ordinance, imposing conditions on the ability of any insurer to issue life insurance policies denominated in currencies other than the Pakistan Rupee to persons who are citizens of Pakistan and resident in Pakistan at the time the insurance is effected."*

17. Rule 23 of the Rules requires that:

Insurance of interests in Pakistan . – (1) For the purposes of subsection (1) of section 165 of the Ordinance, no person shall insure outside Pakistan any risk or part thereof in



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respect of any property or interest which is located in Pakistan at the time the insurance is effected.

(2) The Federal Government may grant exemption to any person from the requirements of sub-rule (1) –

- (a) Where any risk cannot be insured suitably in Pakistan; or*
- (b) Where there are reasons of exceptional nature for granting exemption.*

(3) The exemption under sub -rule (2) shall be for such property or interests, and for such period as the Federal Government may deem fit.

18. Accordingly, a Show Cause Notice (SCN) No ID/Enf/Aon/2018/16003 Dated August 6, 2018, was issued to the Respondents, calling upon them to show cause as to why the action under Section 102(6) of the Ordinance should not be taken against the Company for the aforementioned alleged contraventions of the law.

19. The Respondents, vide letter dated August 13, 2018, sought extension until September 7, 2018 to submit reply to the aforesaid Show Cause Notice. However, the Respondents were allowed extension until August 30, 2018 to submit their reply. The Authorized Representative of the Company namely ORR, DIGNAM & CO sought further extension until September 17, 2018, which was approved by the Commission vide letter dated August 28, 2018.

20. Thereafter, the Authorized Representative submitted the reply on behalf of the Respondents, vide letter dated September 17, 2018, which is summarized hereunder:

Business Other than Direct Insurance Broking

- i. That in terms of Rule 18 of the Insurance Rules 2017 ("2017 Rules") the prohibition viz. reinsurance outside Pakistan is on "insurers" (and not insurance brokers) with respect to "facultative" reinsurance and not "treaty" insurance. Even" otherwise and without prejudice to the same, as further explained in the parawise reply below, Aon's major revenue of its reinsurance business relates to treaty insurance.
- ii. That it is most respectfully submitted, and as further explained below, the alleged offences stated (in the Show Cause Notice) to have been committed by Aon (which are denied) do not constitute offences under any law or rules.
- iii. Reinsurance broking has always been listed in the Objects Clause of the Memorandum of Association ("Memorandum") of our Client, which had also been the subject of discussions between our Client and the SECP from early to mid-2016. The SECP had, through its letter No. SECP/ID/PRDD/102/2016/2/4144 dated February 24, 2016, at first directed our Client to ""delete all such clauses from the Memorandum which indicate reinsurance broking as its business object."" Subsequently in a meeting between our Client and the SECP on May 5, 2016, a representative of our Client explained that: (i) the role of our



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Client as an insurance broker had expanded over time;(ii) the expansion included client consultancy and risk management services etc; (iii) these expanded services were extensions to the direct insurance broking services; (iv) since incorporation, our Client had been providing ancillary services relating to reinsurance; (v) as the law stands, reinsurance broking is not a licensed activity; (vi) our Client is willing to apply for a reinsurance broking licence, whenever it is introduced by the SECP; and (vii) revenues earned from Aon's ancillary services, as they relate to reinsurance business, is a share of revenue from Aon affiliate offices. Following these discussions, the SECP expressly allowed reinsurance broking to remain in the Memorandum, subject to any change which may be required after promulgation of the Reinsurance Brokers Regulations, (through its letter No. SECP/ID/PRDD/102/2016/25823 dated June 23, 2016). Accordingly, the objects clause in the Memorandum were amended, as approved by the SECP

- iv. Therefore, it was and remains our Client's understanding that SECP had no objection to our Client undertaking and providing reinsurance broking related services in addition to insurance broking, with the latter being regulated, inter alia, through its License, whereas the former was an unregulated area. In this regard, our Client was fortified in its position by (i) SECP accepting the retention of the words "reinsurance broking" in its Objects Clause; (ii) there being no specific bar under any law/rules prohibiting reinsurance broking and (iii) Rule 39 of the 2017 Rules clearly making reference to reinsurance commission
- v. Given the language of Section 102 of the Ordinance, it is clear that reinsurance business has deliberately been omitted from the purview of Section 102 and therefore is specifically not covered.
- vi. Neither the Ordinance nor the 2017 Rules currently (i) require any licence for the said purpose nor (ii) place any restriction on insurance brokers from engaging in reinsurance broking. Accordingly, the SECP's contention that a license to act as a broker for "direct insurance business" precludes our Client from acting as a reinsurance broker is, with utmost respect, denied as being incorrect. Had that been the case, then, a specific prohibition would have been mentioned in the law/rules, as for example is the case under Rule 5(6)(I) of the Non-Banking Finance Companies Rules, 2003 which clearly provides that an NBFC "shall not undertake any other activity except the licensed activity

Fronting

- vii. Fronting" is not defined under the insurance laws of Pakistan, nor is it specifically addressed or classified as an offence under the Ordinance or the 2017 Rules. Accordingly, it is respectfully submitted that SECP viewing it as a violation of the Ordinance or the 2017 Rules warranting the cancellation of our Client's license under Section 102 (6) of the Ordinance would not be in consonance with the laws. It is respectfully submitted that this interpretation

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must be considered in the context of market practice, economic drivers and international security requirements.

- viii. There are numerous circumstances in which a local insurer will either choose or is requested to cede its risk to reinsurers and those categories (i) Cedant facultative reinsurance, (ii) Global Insurance Programs, (iii) Security and/or capacity requirements. This demonstrate that there are real market forces and necessary conditions for local insurers to cede their risks to reinsurers.
- ix. The practice of "fronting" has also been explicitly dealt with under Indian law, allowing the relevant authority to direct insurers (but not brokers) to justify their retention policies to ensure they are not "fronting" for cross-border reinsurers. The said practice also seems to be well established and legal in the United Kingdom and United States. In all these jurisdictions, it is clearly recognized that "fronting" is conducted by an insurer and not a broker.
- x. Moreover, any allegations of our Client 'dictating' terms to local insurers and restricting or minimizing local retention of an insured risk are vehemently denied. It is submitted that brokers are acting on instructions in such scenarios provided by insureds or local insurers for whom they act. Our Client respectfully submits that there are many reinsurance brokers placing reinsurance on behalf of local insurers who do not have local offices in Pakistan for the provision of support services.
- xi. The requirement of obtaining permission is on insurers only and does not extend to insurance brokers. In connection with any reinsurance brokerage related services to be provided by a broker, the broker is entitled to assume that the local insurer has fully complied with the law in relation to its decision to enter into reinsurance arrangements, and has placed facultative reinsurance in accordance with SECP's Circular No. 22 of 2013, which is applicable to insurers.
- xii. As is apparent from the accounts of our Client, the majority of our Client's revenues from reinsurance related to treaty reinsurance. Hence, even otherwise, there has not been any violation of the law/rules in this regard.

BORLs

- xiii. BORLs referred to in the Show Cause Notice, Aon and its affiliate offices are both appointed by the principal insured in the BORL(s). The intention of the BORL(s) is to protect 100% of the risk at commercially viable terms. Annexures A, B & C of the BORLs are referred to wherein our Client acts for the principal insured as its direct insurance broker in Pakistan
- xiv. It is normal practice in global reinsurance markets (i.e. aviation) for reinsurers to satisfy themselves that the insured is aware of and has no objection to the ceding insurer's appointment of the reinsurance broker. This also creates transparency

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of the coverage being provided from reinsurer to insurer and in turn to the insured

- xv. Only the insurer, and not the insured, is able to provide authority to bind itself to the terms of the reinsurance policy. The BORLs are not capable under law and it is not their intention to create a proxy / deputy / agency relationship between the insured and insurer in respect of reinsurance since the insurer is not a party to the BORL.
- xvi. The BORLs are intended to be inclusive agreements and to cover the share of earnings on such placements for providing such services, even though not explicitly stated.

21. Thereafter, the Commission scheduled the hearing on October 3, 2018, at the Head Office of the Commission in Islamabad. The hearing was attended by Syed Mustafa Ali Khan, Chief Executive Officer of the Company along with the Authorized Representatives namely Mr. Asim Nasim, Mr. Taha Alizai and Syed Aminuddin Fakir representing all the Respondents before the Commission in the instant matter. During the hearing, the Representatives reiterated their written comments submitted to the Commission. They were of the view that the Company is only facilitating the reinsurance broker and insurers.

22. The Company received Broker of Record Letters (BORLs) from insured(s), which in almost all cases carried standard wording authorizing the Company to also act as reinsurance broker on behalf of the related insurer(s). In case of Hilal Foods, the client issued BORL, dated February 3, 2015 to the Company and then Adamjee Insurance Company Limited (AICL) and UBL Insurers (UBL) (as co-insurers) issued the policy number PL-0617-202009-F03-000255 for sum insured of Rs 8,686 million for the period July 1, 2017 to June 30, 2018. The email dated July 20, 2017 from AICL to the Company confirming the commission also mentioned that, "*except facultative and fronting business.*" This shows that the fronting practice was prevalent among the Company and the insurers.

23. It is pertinent to mention that a reinsurance contract is a contract between an insurance company and a reinsurer. However, in some cases, it was also observed that the Company was communicating directly with the original insured regarding the placement of reinsurance without the involvement of the insurer. In the case of Hashoo Group, Aon Pakistan through an email dated August 11, 2017 conveyed to the said group about placement of risk with Lloyd's without copying it to the direct insurer. The email also contained a statement that they (the Company) are advising to M/s. EFU General Insurance Limited to bind the risk. The Company through the correspondence exchanged with the insured, suggested different options for placement of the risk with the reinsurers and it was up to the insured to pick one with no involvement of the insurer and without copying it to the insurer. Yet there was a copy of the policy # 2525013831/07/2017, dated July 5, 2017 issued from the M/s. EFU General Insurance Limited to Hashwani Hotels. The Aon's Pakistan commission advice note with



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transaction date August 30, 2017 to the M/s. EFU General Insurance Limited stated as under:-

Gross Premium	44 000,000
Order hereto 90%	39,600,000
Your commission 12.5%	4,950,000
Amount due to you	4,950,000

24. M/s. Adamjee Insurance Company Limited sent an email dated March 31, 2015 to the Company, referring to the previous discussion, requested for the order 85% of the 100% on both covers. Subsequent to exchange of emails, M/s. Adamjee Insurance Company Limited issued a policy # PL-0415-201001-T01-000046 to Getz Pharma (Pvt.) Ltd. for the period from April 1, 2015 to April 1, 2018 with sum insured of Rs. 7 billion on property damage and business interruption. An invoice dated April 27, 2015 from Adamjee to M/s Getz Pharma (Pvt.) Ltd. states as under:-

Gross Premium	23,500,000
Add: Fronting Fee	705,000
Total Gross Premium	24,205.000

25. On June 20, 2017, an official of Aon Istanbul emailed to Aon Pakistan that their client Zorlu Enerji was planning to build a solar power plant in Pakistan and reinsurance activities would be carried out by their office. Aon Istanbul in the same email requested for Aon Pakistan's support for fronting and requested to confirm the fronting fee amount, while informing that the fronting company will continue to front the main program. On the same day, Aon Pakistan thanked Aon Istanbul for approaching Aon Pakistan and stated that Aon Pakistan would be able to place the risks with fronting insurer in one go for the whole project period if Aon Istanbul can arrange reinsurance protection at an early date. On June 29, 2017, Aon Pakistan in reply to a query by Aon Istanbul sent an email to the client also stated that insurers generally charge 3 to 5 percent of gross premium as fronting fee. Furthermore, on June 30, 2017, Aon Pakistan sent an email to Aon Istanbul stating that M/s. Jubilee General Insurance Company Limited would front the main program, post all the underwriting and reinsurance arrangements are met. Subsequently, on July 26, 2017, M/s. Jubilee General Insurance Company Limited issued a policy to the insured with sum insured of Rs 102 million plus for two months.

26. This signifies that, to circumvent the provisions of Rule 23 of the Rules and Section 165 of the Ordinance, local businesses like those quoted above placed their insurance business outside Pakistan in the form of reinsurance through the practice of fronting. The Company assisted the said insureds in this practice. Furthermore, in cases involving fronting, it was also observed that reinsurance was placed before the issuance of the policy by the local insurer. This further signifies that the Company assisted the said local businesses to make reinsurance arrangements and subsequently find a local insure for fronting. Hence the Company was fully involved in placing the insurance business outside Pakistan in the form of reinsurance through the practice of fronting, circumventing the law cited above.



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27. Furthermore, a reinsurance contract is drawn between an insurance company and a reinsurer. However, in the cases highlighted by the inspection team, the Company was directly communicating with the original insured without involvement of the insurer. It is notable that while fronting is apparently riskless, it poses a number of risks to local insurers and is against the spirit of Rule 7 and Rule 23 of the Rules, and Section 165 of the Ordinance. Firstly, risk of insurance is always borne by an insurer despite having reinsurance arrangements. In case of failure of the reinsurer(s), the insurer is responsible to bear all risks incurred by the insured. Secondly, fronting often distorts the underwriting practices of a jurisdiction where insurers focus on commission instead of premium retention and the performance of the underlying risk. Finally, fronting negates the spirit of local legislation by allowing foreign companies to circumvent local licensing and retention requirements.

28. I have carefully examined and given due consideration to the written and verbal submissions of the Respondents, and have also referred to the provisions of the Ordinance, the Rules made thereunder and/or other legal references. I am of the view that the violations of Rule 7 & Rule 23 of the Rules and Section 165 of the Ordinance are clearly established, for which the Respondents may be penalized in terms of Section 102(2) of the Ordinance.

29. Section 102(6) of the Ordinance provides that:

"The Commission may cancel or refuse to issue or renew a broking licence, where the Commission believes on reasonable grounds that the broker has contravened a provision of the Ordinance, including without limitation that the broker has failed to maintain prescribed minimum levels of paid-up capital, statutory deposit or professional indemnity insurance."

30. In exercise of the power conferred on me under Section 102(6) of the Ordinance, I, instead of cancelling the licence as provided under the said provision hereby advise the Company to desist from facilitating / indulging in the fronting transactions. The Company is also directed to review the practice of BORLs issued by the intending insureds.

31. This Order is issued without prejudice to any other action that the Commission may initiate against the Company and / or its management (including the CEO of the Company) in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

Tahir Mahmood
Commissioner (Insurance)

