

FROM: Secretary to the Lloyd's Disciplinary Board,
LOCATION: 58/NW1
EXTENSION: 5530
DATE: 22 December 2000
REFERENCE: 093/2000
SUBJECT: **ALEXANDER HOWDEN GROUP LIMITED**
SUBJECT AREA(S): Disciplinary Proceedings
ATTACHMENTS: Notice of Censure
ACTION POINTS: **For information**
DEADLINE: **None**

Alexander Howden Group Limited (now known as Aon Group Limited), has admitted two charges of conducting insurance business in a discreditable manner, and two charges of conducting insurance business in a detrimental manner.

This case was concluded before the Lloyd's Disciplinary Board. The following penalties have been imposed on Aon Group Limited:

- (1) A fine of £75,000; and
- (2) A Censure in the terms of the Notice of Censure attached to this bulletin.

In addition, Aon Group Limited has agreed to pay the costs of Lloyd's in the sum of £35,885.

Details of the events giving rise to the charges against Aon Group Limited are set out in the attached Notice of Censure.

This bulletin has been sent to all underwriting agents and members agents (corporate advisers), corporate members, market associations, the ALM and recognised accountants.

A.P Barber
Secretary to Lloyd's Disciplinary Board

NOTICE OF CENSURE

**THE AON GROUP LIMITED
(FORMERLY KNOWN AS THE ALEXANDER HOWDEN GROUP LIMITED)**

Lloyd's broking firm Aon has admitted four charges of misconduct namely;

- (i) Discreditable conduct contrary to both the Misconduct, Penalties and Sanctions Byelaw (No.5 of 1983) in respect of conduct that occurred prior to 1993; and the Misconduct, Penalties and Sanctions Byelaw (No.9 of 1993) in respect of conduct that occurred thereafter.
- (ii) Detrimental conduct contrary to both the Misconduct, Penalties and Sanctions Byelaw (No.5 of 1983) in respect of conduct that occurred prior to 1993 and the Misconduct, Penalties and Sanctions Byelaw (No.9 of 1993) in respect of conduct that occurred thereafter.

Aon was at the relevant times known as Alexander Howden Group Limited, and acted through Alexander Howden Reinsurance Brokers Limited ("AH").

AH acted as the placing broker placing reinsurance on behalf of two Nigerian state owned insurance and reinsurance companies ("the insurance companies"). The original assured was a state owned energy company (the assured).

In 1989, the insurance companies appointed AH to lead a consortium of brokers to arrange to place for them various reinsurances of the assured as part of a Consolidated Insurance Package ("CIP") for which the insurance companies issued to the assured a direct policy for 100%. Pursuant to that appointment, AH placed the reinsurances with various reinsurers for the year beginning 1.1.90. The reinsurances were renewed for each of the years 1991 to 1996.

The Cover Notes & Debit Notes

In respect of the reinsurances, AH raised and issued Cover notes and Debit notes ("the Notes") addressed to the insurance companies. The Notes were produced in a format which permitted the insurance companies to forward them to the assured as evidence of the terms of the cover which the insurance companies had agreed with reinsurance underwriters.

The Notes were inaccurate and potentially misleading as to the level of premium which had been charged by reinsurance underwriters by specifying a "gross premium" figure that did not relate to the reinsurances placed with the reinsurance underwriters at all. The Notes contained both "gross" and "net" premium information. The gross premium figure on the Notes in fact represented the gross premium payable by the assured in respect of its direct insurance covers placed with the insurance companies. This included fronting fees and commission due to both of the insurance companies and commissions due to local brokers appointed by the assured. Neither the assured nor the insurance companies paid to AH the higher "gross premium" figure.

The “gross premium” figure which in fact related to the separate direct local insurances was included in the Notes by AH at the insurance companies’ request because they wished AH to calculate the full premium due to them from the assured in respect of the direct CIP cover allowing for the insurance companies’ fronting fee of 12.5% and the commissions due to the local brokers appointed by the assured.

The difference between the level of ‘gross premium’ recorded on the Notes that was paid by the assured for its local direct insurances and that charged by reinsurance underwriters to the insurance companies as recorded on the reinsurance slips was at least US\$45,399,193 for the years 1990 to 1996.

The ‘gross premium’ figure ultimately paid by the assured should not have been included as part of the Notes sent by AH to the insurance companies.

AH should only have sent to the insurance companies Notes showing the premiums payable by them to their reinsurers as stated in the relevant reinsurance policies between the insurance companies and the Reinsurance underwriters.

AH put into circulation documents that contained inaccurate and potentially misleading premium figures that potentially could have been used to mislead third parties who were not otherwise aware of the true position. AH knew or should have known that the Notes were inaccurate and potentially misleading to any person or entity who examined them and was not otherwise aware of the true position.

There was a risk that the assured was not aware of the said inaccurate and potentially misleading nature of the premium information in particular with regard to the levels of premiums that had actually been agreed by the insurance companies with reinsurance underwriters. There was a risk that the assured would rely upon the contents of the Notes as being an accurate summary of the terms agreed between the insurance companies and their reinsurers;

AH had taken no adequate steps to avoid or to minimise the risk that the assured might be being misled by the Notes and no adequate steps had been taken to document and record the instructions from the insurance companies to AH to create the Notes in the way that they were created.

AH ought not to have agreed to produce and to issue the Notes in their inaccurate and potentially misleading form. AH also failed to have in place any or any suitable systems and procedures which would, so far as reasonably practicable, have:

- (a) prevented its employees or employees of AH from raising and issuing inaccurate and potentially misleading Notes;
- (b) ensured that the Notes were properly checked against supporting documentation (such as the reinsurance slip) by a person within AH with the sufficient expertise, seniority and qualification as to be able properly to check for discrepancies between the Notes on the one hand and the supporting documentation on the other before being issued;

- (c) ensured that the Notes sent to the insurance companies were in a form which matched the said supporting documentation (such as the reinsurance slip) which contained an accurate summary of the level of the premiums allowed by the reinsurance underwriters;
- (d) ensured that any information required the insurance companies in respect of any separate dealings it had with the assured was not included on a Note dealing with the insurance companies' reinsurance transactions;
- (e) led to the discovery of such conduct by means of an effective system of monitoring or auditing of the activities of those employees involved in the production of the inaccurate and potentially misleading Notes.

Between 1990 and 1996, consortium fees and brokerage in respect of AH's part in the reinsurance were based upon a percentage of the inflated premiums charged to the assured by the insurance companies and recorded on the Notes rather than the premiums charged by underwriters as recorded on the slips. However, it did not receive or retain brokerage in excess of the amount to which they were entitled under the terms of the reinsurance contracts placed by them in London.

Local Nigerian Broker

On various dates during the course of 1990 to 1995, AH made payments to a local Nigerian broking firm ('the local broker') totalling \$US4,625,000 out of commissions received by AH pursuant to the Reinsurance contracts placed by AH for the insurance companies.

AH failed to have in place any adequate systems and procedures which would have ensured before making such payments that AH had a full audit trail in place in respect of such payments which would clearly identify the identity of the local broker; the reason why such payments were required; the basis of calculation of such payments; the local broker's connection with the reinsurances; and why it was entitled to receive such payments.

In addition, AH failed to have in place an adequate system of monitoring or auditing of the activities of those employees involved in authorising the said payments which would have identified as far as reasonably practical the absence of a full audit trail.

The following penalties have therefore been imposed upon NL:

- (i) a fine of £75,000; and
- (ii) a Censure in accordance with the terms of this notice; and
- (iii) £35,885 towards the costs of the Council of Lloyd's.

In assessing the penalties and costs in this matter account has been taken of the following facts:

1. Neither the assured nor the insurance companies paid to AH the higher "gross premium" figure referred to above.

2. The Notes were prepared on the instructions of the insurance companies, although this instruction is not documented.
3. Aon has always asserted that the local broker, who were paid from AH brokerage, provided valuable assistance such as ensuring prompt payment and assisting in payment being made in US dollars.
4. The matter has been taken seriously by Aon as evidenced by its commission, at their own expense, of an internal audit report and a report from its solicitors.
5. Following discovery of the matter, it was reported promptly to Lloyd's in accordance with the obligations set out in the Misconduct (Reporting) Byelaw (No. 11 of 1989).
6. Aon has co-operated fully with the Lloyd's investigations into this matter. Aon has settled these proceedings and has admitted liability at the earliest possible opportunity thereby avoiding the necessity of a hearing before a Disciplinary Tribunal.

LLOYD'S DISCIPLINARY BOARD