

## **Proposed Regulatory Changes to D&O Insurance in Brazil**

*(Published in Issue No. 1,535 of Migalhas Internacional newsletter of August 27, 2014)*

by **Paulo Eduardo Penna** and Bruno Haack Vilar

Directors and officers of Brazilian companies are progressively exposed to more and more risks. Legal actions against them are on the rise. Regulators such as the CVM have become more active in pursuing alleged wrong doings. New regulations have widened the situations in which they can be held liable (even if indirectly, as is the case of the recently enacted Brazilian anti-corruption act – Federal Law 12,846/13).

Not surprisingly, over the last decade there has been a dramatic growth in both sales and coverage levels of directors and officers (D&O) insurance in Brazil. According to data from SUSEP, the Brazilian private insurance regulating authority, the total amount paid as premium for D&O insurance has increased 340% from 2003 to 2013. Recent data shows that the sales of D&O insurance continue to escalate.

In view of such growth, SUSEP has taken steps to set specific standards for D&O insurance policies. Presently D&O insurance fall under the general regulation of claim-based or common civil liability insurances. According to the draft regulation prepared by SUSEP and disclosed to the market last semester[1], the intention is to have D&O insurance regulated separately in a specific regulation that addresses its peculiarities.

With the proposed regulation, SUSEP expects to bring innovation to D&O insurance in Brazil and align it with international practices. In spite of such objective, the draft regulation has attracted criticism from Brazilian insurance companies and other agents, mainly on the grounds that it is not fully aligned with Brazilian market practices.

One of the criticized points is the lack of provisions regarding the coverage of regulatory fines imposed by government authorities. In more than one opportunity SUSEP has held that regulatory fines should not be covered by D&O insurance. It argues that such coverage would undermine the whole purpose of the fine, which is to punish the perpetrator for his or her improper conduct. Certain insurance companies, however, do offer coverage of regulatory fines as part of their D&O insurance package in Brazil. They were expecting SUSEP to expressly authorize such practice in the proposed regulation.

A classic alternative that could be used to address SUSEP's concern would be to establish deductions from the amounts to be paid in case of a loss arising from a regulatory fine, thus making directors and officers share at least partially the burden of the fines. Such deductions, together with negative effects regulatory fines have on directors and officers' reputations, should minimize the moral hazard insurance coverage may cause. Furthermore, insurance companies have all the right incentives to set out contractual terms to deal with moral hazard, which makes a market solution to this issue feasible.

The market also had expectations that the proposed regulation would enable directors and officers to purchase D&O insurance for themselves. There is a demand for personal D&O insurance when the company refuses or is unable to provide its directors and officers with proper D&O insurance. According to the draft ordinance, though, only companies would be able to purchase D&O insurance. As concerns the private equity industry, this provision seems to prevent FIPs (Fundos de Investimentos em Participações) – which, under Brazilian law, are not considered companies – from purchasing D&O insurance for the individuals appointed by them to act as directors of the FIPs' invested companies. Under the draft ordinance the D&O insurance would have to be purchased by the invested company itself.

Some critics of the draft regulation also do not agree with the proposed exclusion of litigation costs from the basic coverage of D&O insurance, making it an optional item. SUSEP would have done better by keeping the litigation costs in the basic D&O insurance coverage package, argue such critics, considering that it is one of the main reasons for which anyone in Brazil buys such insurance.

SUSEP's initiative to regulate D&O insurance in an autonomous regulation is a sign of the growth of such type of insurance in Brazil and the refinement of Brazilian corporate practices. After having disclosed the proposed regulation last semester, SUSEP invited the market to provide comments and criticism. Since then, SUSEP has not yet issued the new regulation. It is therefore not possible to know if any of such criticisms will be taken into account. Hopefully, when eventually instituted the new regulation will help to reduce transaction costs and further enhance the D&O insurance market in Brazil.