



EVOLVING D&O LANDSCAPE IN BRAZIL

October 2017

SUSEP REGULATION 553/2017

On 23 April 2017, SUSEP, the Brazilian insurance authority, issued its suspension of Regulation 541/2016--its most recent regulations on D&O insurance. In its stead, SUSEP issued Regulation 553/2017, which aims to re-establish minimum requirements that D&O wordings in Brazil must comply with, effectively replacing the requirements issued under 541/2016. We view this new regulation as SUSEP's much-needed response to the lack of appropriate and specific regulations on the topic.

Regulation 553/2017 expressly states, under Article 4, that individuals are now entitled to purchase D&O policies directly. Purchasing D&O policies used to be an exclusive right of legal entities who would purchase the policies as policyholders while their directors and officers were designated as the insured. How (re)insurers and D&O wordings will adapt to this new reality is yet to be answered. We also note that this new policy catered directly to individuals must have its wording approved by SUSEP.

Regulation 553/2017 also holds that insurers are able to offer a broader definition of Insured Person, to be taken out as additional coverage, so as to encompass service providers hired by the policyholder and/or the insured, e.g. lawyers, accountants, etc. There is also the possibility to broaden the definition of Insured Person to provide coverage for depositaries, liquidators, and other administrative intermediaries.

The regulation also establishes new rules related to Side B cover. D&O insurance is typically offered via three coverages—Side A, Side B, and Side C:

- **Side A** coverage reimburses individual D&Os (insureds) for any indemnifiable covered losses they have incurred personally.
- **Side B** is an additional coverage that is taken out to reimburse the entity (policyholder) for indemnifiable financial losses it has incurred on behalf of the insured.
- **Side C** coverage is an additional coverage that is taken out by the entity itself that reimburses the entity for any indemnifiable financial losses it has suffered as a result of a securities action brought against the entity.

This new regulation requires that a specific agreement between the policyholder and the insured individuals regarding indemnification exist before triggering Side B cover, an important development.

Moving to coverage for subsidiaries, Article 3, XXXIV, 2 states that the control status of a subsidiary (whether the policyholder owns the subsidiary directly or indirectly) must now be established prior to or on the inception date of the policy. However, the parties are allowed to include a new company that comes under the direct or indirect control of the policyholder during the policy period. The inclusion of new companies will depend upon the negotiations between (re)insurer and insured. Further complicating this problem, the regulation is silent with respect to the automatic inclusion of subsidiaries acquired during the policy period, which currently is an additional coverage commonly offered in the Brazilian market.

Finally, and perhaps most importantly, Regulation 553/2017 considerably broaches the topic of fines and penalties. SUSEP's position with respect to the possibility of an insurer indemnifying losses arising out of fines and penalties has been far from consistent. In fact, at one point, a previous SUSEP regulation stated that D&O insurance could not extend coverage to fines and penalties. Regulation 553/2017 has finally settled this endless discussion (at least for the time being!), stating that both civil and administrative fines are now insurable under D&O policies.

INTERIM MEASURE 784/17

Following Operation Car Wash and all of its ongoing sub-operations, the authorities in Brazil are decidedly more active in investigating and sanctioning the nation's largest companies. This is due, in part, to the fact that the authorities are being provided with more legal mechanisms to enforce both new and old regulations. This new

activity can be measured by the increase in leniency and settlement agreements signed between companies/individuals and the relevant authorities.

Regulation 553/2017's clarifications with respect to fines and penalties are extremely relevant, as Michel Temer, Brazil's president, through Interim Measure 784/17, has now legally expanded the regulatory power of the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários—CVM) and the Brazilian Central Bank (BACEN) to impose fines on both individuals and companies. BACEN can impose fines of up to BRL 2 billion (approx. USD 638 million), while the CVM is entitled to impose fines of up to BRL 500 million (approx. USD 160 million).

Interim measures in Brazil are issued under the President's authority and, although they can be immediately enforced, they need to be ratified by the Brazilian Congress in order for the measures to be definitively adopted into Brazilian law. The Brazilian Congress has 60 days to ratify the interim measure, but this period can be extended by a further 60 days. Interim measures that are not converted into law within this period will lose their enforceability. However, the effects established from the enforcement of the measure during its validity will be preserved. The deadline for this specific interim measure was extended until 19 October 2017.

Financial losses arising out of settlement agreements signed with the CVM have historically been covered under D&O policies, normally via additional coverage. Now that BACEN is also allowed to negotiate settlement agreements, these agreements will likely find their way into the covered provisions of future wordings. BACEN agreements can have a financial component to them and it is clearly stated under Interim Measure 784/17, and under Law 6385/76, that these settlement agreements do not carry an implication of guilt. As such, the policies' willful misconduct exclusion would not be triggered by these settlements. Both the CVM and the BACEN now have the power to enter into settlement agreements with the companies and/or individuals directly without having to file an administrative proceeding, as they were required to do previously.

Another mechanism available to both authorities is the leniency agreement. Leniency agreements are similar to settlement agreements, but the party entering into the leniency agreement must confess its liability. Prima facie, both leniency agreements

and the settlement agreements should be publically available, unless the authorities decide otherwise.

TAKEAWAYS

- The recent amendments to the existing Brazilian insurance legislation could result in higher exposure for (re)insurers that are offering D&O policies for financial institutions (under the regulatory scope of BACEN) and/or companies that are under the regulatory umbrella of the CVM. We also point out that both regulators have power over companies or individuals that are providing independent auditing services for those that are under their regulatory control.
- Concerning the new requirements for the triggering of Side B coverage, we believe this is a pro-insured effort from SUSEP. Before Regulation 553/2017, there were no requirements for the triggering of Side B coverage. Traditionally, insurers have opted to trigger a policy's Side B coverage as it usually requires the erosion of a deductible while Side A cover, indemnification directly to the D&O, did not. As a result, insurers would encourage policyholders to cover the insureds' costs and the insurers would subsequently reimburse the policyholder. In practice, we do not believe that the requirement that the policyholder have a specific indemnification agreement with the insured will be that much of a deterrent to the triggering of Side B. However, it will require underwriters to at least inquire as to whether these agreements exist.
- The CVM and the BACEN's new power to enter into settlement agreements directly without the need for a formal proceeding also presents a problem. Without a proceeding, (re)insurers will be left without a formal administrative decision that they could analyze to determine whether an exclusion under the D&O policy should be triggered or not.
- Finally, now that civil and administrative fines and penalties can once again be covered by D&O policies, it would benefit (re)insurers to establish sub-limits for these, especially when considering the extended powers given to the CVM and BACEN through Interim Measure 784/17.

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