

ANNUAL REVIEW

D&O risk & liability

REPRINTED FROM
ONLINE CONTENT
FEBRUARY 2019

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Spain ■

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Belén Vílchez Morales is a financial lines specialist and product leader for management liability at Aon in Spain. Her previous experience focuses on the analysis and placement of diverse products, such as directors and officers (D&O), public offering of securities insurance (POSI), employment practices liability (EPL), and crime, cyber and professional indemnity policies. Since early 2014, she has been responsible for the placement of D&O, POSI and EPL policies for large commercial clients, as well as developing newsletters and speaking at conferences.

■ Q. To what extent have personal risks facing board members increased in today's challenging business environment?

VÍLCHEZ: The issue here is that there is no precise definition of D&O liabilities as such, resulting in new exposures arising continuously. Brexit is a hot topic, where directors may face increased liabilities if they fail in their performance, if results dip or as a result of a business interruption. Another source of increased risk is unregulated business, where matters mainly associated with technology, such as cryptocurrencies, artificial intelligence (AI) and cyber crime, are giving rise to exposures which had not previously been considered. Cyber risk is a feared subject and managers are becoming aware of their exposure as some public cases have led to D&O claims, due to alleged breaches of fiduciary duties. In the case of Yahoo, there was a compensation arrangement of \$29m to settle charges, while in the Marriott data breach-related securities lawsuit, estimated losses ranged from \$200m to \$600m where the chief executive, chief financial officer and chief accounting officer were all on the defendant's bench.

■ **Q. Could you highlight some of the major themes you have seen in recent D&O litigation in Spain? Has there been an increase in the number of such cases over the last 12-18 months?**

VÍLCHEZ: The number of claims skyrocketed in 2016 and has been significant over subsequent years. Although there are occasional circumstances that have a specific impact, such as political elections in public sector companies, it is worth mentioning that litigation is no longer concentrated in a specific sector. Listed companies have been subject to a rise in securities actions, especially financial institutions or Spanish entities with US exposure. It should be noted that as a result of increased M&A activity in Spain, we have also seen claims based on shareholder conflicts of interest. Although the actions of regulatory bodies are not new, during 2018, the Spanish Anti-Trust Commission (CNMC) doubled the personal fines imposed on D&Os for antitrust violations, mainly affecting financial institutions, energy, parcel, media and electricity companies, while the Spanish Stock Exchange Commission (CNMV) imposed 30 penalties, of which 10 were directly imposed on individuals for a total of €1.9m.

■ **Q. What types of claims are being brought against D&Os, considering issues arising from business decisions, financial performance and bankruptcy, through to alleged fraud and corruption?**

VÍLCHEZ: The risks associated with health and safety, climate change and employee practices liability are moving up board agendas, mainly for energy and construction companies with a presence in the US, Australia or Latin America. The increased awareness of potential suits abroad, together with the risk of directors being extradited, are the main reasons for reviewing and adapting corporate programmes to local needs. For the time being, pollution and cyber claims against individual directors are recurring matters, and although personal liability is currently difficult to determine, there is a clear impact on D&Os' reputation, which is much more difficult to recover than personal assets.



■ **Q. To what extent is the litigation landscape changing? For example, are you seeing more securities class action lawsuits against D&Os in Spain?**

VÍLCHEZ: Securities class actions are growing in Europe. Although they still take hold in the Spanish litigation landscape, some cases related to financial institutions have also been echoed in the media in recent years. We perceive that Spain has experienced different stages in the D&O litigation environment. Up until 2014, the main losses derived from the Spanish crisis and the insolvency or bankruptcy of many companies. Following that period, during 2015, 2016 and 2017, criminal actions based on fraud, corruption and bribery brought additional complexity, as they were raised in criminal courts. Since 2018, we have witnessed a shift in litigation, with a decline in fraud judicial cases and an increasing return to the original purpose of D&O insurance, with commercial and company law breaches the main source of claims.

■ **Q. What affect are increased regulation, penalties, damages and settlement figures having on the costs associated with defending D&O claims?**

VÍLCHEZ: Two key factors have an impact on the rising costs associated with D&O claims. First, claimants are more prepared. There is broader knowledge of the existence of D&O insurance, other similar claims, and a greater number of specialised law firms which boost the number of claims. Consequently, some directors and companies prefer to settle rather than continue with the legal process and risk

reputational damage. Second, there are higher expenses associated with cross-border and multijurisdictional claims. As the insured usually needs advice both in Spain and in some other country, at least two law firms are involved to provide legal assistance. This is extremely expensive when US law firms are appointed. The increased D&O loss ratio is triggering a global impact, affecting all portfolio renewals. First, changes have already taken place in the US and the UK, mainly in listed companies, and in Spain leading D&O insurers increased the premium rate in Q4 primary policy renewals – mainly for large risks, together with limitations on coverage and capacity restrictions.

■ **Q. In your opinion, how important is D&O liability insurance as a tool to mitigate the personal risks to board members? Do you believe enough attention is paid to this issue currently?**

VÍLCHEZ: Our regulation does not oblige a company to indemnify or defend its D&Os; quite the opposite – Spanish law establishes they are liable, first, before the company itself. Therefore, D&O insurance is crucial to mitigate personal liability. The tightening of the regulatory framework and the increase in litigation has raised awareness of the need to purchase appropriate insurance cover. These factors have also driven demand for insurance among Spanish companies that are subsidiaries of a foreign group, especially if the corporate programme does not meet local needs and regulations. Also, there is growing concern about the need to protect the reputation of both businesses and individual directors in the face of intense scrutiny.



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■ **Q. What is your advice to companies and their D&Os when assessing the terms, coverage and pricing of a D&O insurance policy?**

VÍLCHEZ: D&Os should know and understand in depth the coverage and limit of indemnity provided by their insurance policy, and whether both are relevant to their activity, sector, litigation and business environment. Furthermore, their policy limit is shared among all past, present and future D&Os, as well as the company and other parties, such as internal lawyers and employees, and has the potential to improve their independent protection through Side A policies which are the last, but sometimes

the first, line of defence. D&O policies are hard to understand for people not used to dealing with insurance language, and the help of an experienced broker may be essential to provide clarity to insureds, together with legal advice, to obtain a tailored policy that is fit for purpose. We still see many organisations purchase a D&O policy through their procurement department, like any other product or service. The board must entrust the negotiation of renewal policies to the legal department or the secretary of the board of directors, or at least ask for their active involvement in the process. Price is important, but when protecting people, it should be the lowest priority, especially given that the market is hardening. ■

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