

A Synthesis of Asbestos Disclosures

From Form 10-Ks

Insights

This article provides a comparative analysis of asbestos disclosures from hundreds of annual reports on Form 10-K submitted to the Securities and Exchange Commission (SEC) by public corporations domiciled in the United States that are known to have been named in asbestos personal injury litigation.

Background of Asbestos Litigation

Asbestos personal injury litigation has been a continuing concern among companies with asbestos exposure and their insurers for several decades. In the early 1980s, the companies named as defendants typically distributed asbestos or manufactured asbestos-containing products. Many of these companies have since filed for Chapter 11 bankruptcy protection. In response, plaintiffs began to target other companies with less significant ties to asbestos (peripheral defendants). These peripheral defendants often had asbestos encapsulated in their products or had asbestos present at their facilities. In RAND's 2005 study, it was estimated that by 2002 there were over 8,400 companies named as defendants in asbestos lawsuits.* Towers Watson maintains a corporate defendant list that currently contains more than 10,000 companies, including subsidiaries, named in asbestos litigation.

There have been substantial changes in the asbestos litigation environment in recent years. The 2000-2003 time period was characterized by recruitment of tens of thousands of unimpaired claimants through mass screenings, leading to a dramatic increase in claims, numerous defendant bankruptcies and federal legislative efforts at reform. Beginning in 2004, several states enacted legislative and judicial reforms, such as specifying medical criteria intended to prioritize resolution of cases for the sickest claimants as well as other measures relating to case consolidation and forum

requirements. By 2004, the number of bankruptcy filings declined; the mass screenings ended, and the number of new claims (especially nonmalignant claims) dropped significantly.

Despite the huge reduction in nonmalignant claims, many corporate defendants and their insurers continue to face substantial liabilities from the remaining claimants with malignant diseases, particularly mesothelioma. Towers Watson estimates that mesothelioma claims will continue for decades, with nearly 30,000 claims to be filed in 2010 and subsequent years.

Disclosure Guidance for Contingent Liabilities

Publicly traded corporations are required to disclose certain contingent liabilities in their financial statements. This article examines the asbestos personal injury litigation disclosures by corporate defendants in their annual SEC Form 10-Ks.

The Financial Accounting Standards Board (FASB) provides guidance to companies regarding accrual of contingent liabilities arising from asbestos litigation. An accrual for a contingent liability must be made if it is probable that the liability had been incurred at the date of the financial statement, and the loss can be reasonably estimated.

In practice, application of FASB guidance requires interpretation. For example, defendant companies and their advisors have considered the magnitude and volatility of the historical asbestos expenditures when determining whether to make an accrual. Many companies have significant insurance coverage that they believe will fully cover their asbestos losses (or the uninsured portion is not material). Some companies have a material uninsured asbestos loss potential leading to disclosure.

*Stephen J. Carroll, Deborah R. Hensler, et al., "Asbestos Litigation," RAND Institute for Civil Justice, May 10, 2005, www.rand.org/pubs/monographs/2005/RAND_MG162.pdf

“Only 51% of the Form 10-Ks of companies known to have been named in asbestos personal injury claims mention asbestos litigation exposure.”

Our review of numerous filing documents of defendant companies known to have asbestos litigation exposure reveals that disclosures are varied. Some companies report detailed data, such as numbers of pending and filed claims or estimates of contingent liabilities. Other companies provide a qualitative description of their historical exposure. Some include rationale for why the liability may not be quantified.

What Are Asbestos Defendant Companies Disclosing?

Our analysis focused on defendant companies expected to have the largest asbestos liabilities based on Towers Watson’s tier classification. While there are thousands of companies historically named as asbestos defendants, the vast majority do not have significant liabilities, or they do not currently file a Form 10-K because they are privately owned, are domiciled outside the U.S. or no longer exist (sometimes due to bankruptcy). Additionally, many of the corporate entities are related, either through mergers and acquisitions or as subsidiaries of one another.

We obtained 213 Form 10-Ks filed as of May 1, 2009. Due to corporate relationships, these filings correspond to 371 individual companies or subsidiaries.

Exhibit 1 shows various asbestos-related litigation statistics from the Form 10-Ks, with the companies grouped by Towers Watson tier. As one might expect, we found that Form 10-Ks for companies with greater known asbestos exposure (i.e., companies assigned by Towers Watson to its Tier 1, 2 or 3-High categories) were more likely to disclose information regarding asbestos claims, payments and estimated liability.

FAS 5

The 1975 “Statement of Financial Accounting Standards No. 5 Accounting for Contingencies” (FAS 5) provides guidance to companies with many types of contingent liabilities, including liabilities arising from asbestos litigation. Examples of loss contingencies resulting from asbestos litigation exposure include pending or anticipated asbestos claims against defendant companies.

When a loss contingency exists, FAS 5 guidelines specify treatment based on the likelihood of the future event(s), which can range from probable to remote. An accrual for a contingent liability must be provided if both of the following conditions are met:

1. Information available prior to issuance of the financial statements indicates that it is probable that a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
2. The amount of loss can be reasonably estimated.

FAS 5 provides the following definitions:

- **Probable** — The future event or events are likely to occur.
- **Reasonably Possible** — The chance of the future event or events occurring is more than remote, but less than likely.
- **Remote** — The chance of the future event or events occurring is slight.

Exhibit 01. Form 10-K Asbestos Disclosure Research Summary

Tier	Number With Form 10-K	Number Mentioning Asbestos Litigation Exposure	Percentage of Form 10-Ks Containing:			
			Mention of Asbestos Litigation	Asbestos Claim/Case Info	Asbestos Payment Info	Asbestos Liability Estimate
1 and 2	62	50	81%	68%	61%	58%
3-High	48	30	63%	46%	38%	46%
All Other	261	135	52%	27%	15%	15%
Total Companies	371	215	58%	36%	25%	26%
Total 10-Ks	213	109	51%	28%	16%	18%

Towers Watson Asbestos Tier List

In support of our analyses quantifying the asbestos liabilities of defendant companies and their insurers, Towers Watson maintains a list of corporate asbestos defendants that is divided into tiers. Tiers 1 and 2 are broadly defined as companies that were the original targets in the litigation and are expected to exhaust all or nearly all available insurance coverage. The Tier 3 companies manufactured, distributed or installed asbestos-containing products and were brought into the asbestos litigation arena in large part due to the bankruptcy of Tier 1 and Tier 2 companies. The Tier 3 companies are further subdivided into High, Medium and Low categories. Many Tier 3-High companies have asbestos liabilities that are expected to exceed \$100 million, gross of insurance.

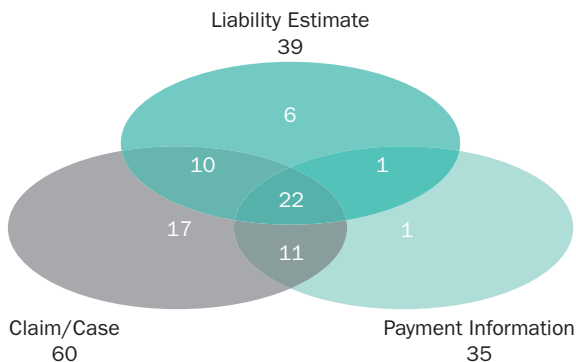
“Of the Form 10-Ks reviewed, 68 provided information regarding numbers of asbestos claims, payments and/or an estimate of their asbestos liability.”

All of the Form 10-Ks reviewed relate to companies that have been named in asbestos lawsuits. However, only 109 of the 213 filings reviewed (or 51%) disclose asbestos litigation exposure. The lack of disclosure in the remaining 104 filings may be because the loss potential is not material or is covered by insurance. As noted below, changes currently being considered to financial accounting standards may result in more detailed disclosures being required from some of these companies in the future.

References to asbestos litigation vary from a brief mention of asbestos exposure to several pages of details, including historical litigation statistics and possibly a projection of future liabilities. There were 41 Form 10-Ks that provided only narrative reference to asbestos exposure, while the remaining 68 companies also provided information regarding numbers of asbestos claims or cases either pending or filed, asbestos payments and/or an estimate of asbestos liability.

The majority (70) of the 109 Form 10-Ks that mention asbestos do not quantify liabilities related to asbestos litigation. Reasons stated include an inability to quantify the liability, immateriality of the estimated liability and existence of substantial or complete insurance coverage. As shown in *Exhibit 2*, the most common detail provided was the number of claims or cases.

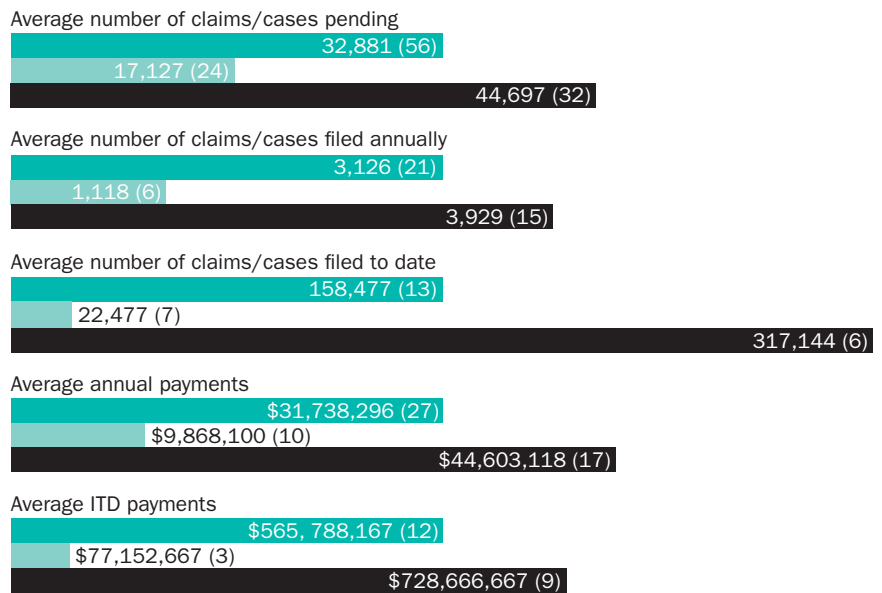
Exhibit 02. Form 10-K Asbestos Disclosure Research Summary



As shown in *Exhibit 3*, the average of the number of claims and size of asbestos payments, both annual and inception to date (ITD), are typically larger for companies that disclose a liability estimate than for those that do not. It is likely that the 39 companies disclosing a liability have larger liabilities, on average, than the 70 companies that mention asbestos but do not disclose a liability.

Further, those companies with potentially significant liabilities are more likely to retain an outside consultant to help estimate the accrual amount. Of the 39 Form 10-Ks disclosing a liability accrual, 15 reported use of an outside consultant, although we suspect that more consultants are actually used but not named. We note

Exhibit 03. Form 10-K Asbestos Litigation Disclosures – With vs. Without Asbestos Liability Estimates



■ Total
 ■ Without liability estimate
 ■ With liability estimate
 Various averages (number of Form 10-Ks)

that companies disclosing use of an outside consultant were also more likely to disclose other details supporting their estimates, such as asbestos claim and payment information, as shown in *Exhibit 4*.

FAS 5 requires disclosure only when the amount can be reasonably estimated. Asbestos claims are expected until the middle of this century, and companies have different views on how far into the future reasonable projections can be made.

The length of this time horizon (i.e., the number of years for projecting future claims or payments) used to establish a liability estimate varies greatly among the Form 10-Ks, ranging from estimates based solely on pending claims, to 51 years into the future.

“Some companies have recently lengthened the time horizon of their projection of future asbestos claims.”

Presumably, the time horizon reflects the length of time that the companies believe their asbestos litigation liability is reasonably estimable. Typical projections based on epidemiologic studies assume that mesothelioma claims arising from occupational exposure to asbestos will continue for the next 35 to 50 years.

In total, approximately 69% of the 39 Form 10-Ks with liability estimates include a provision for at least some claims expected to be filed in the future. Three of the companies based their accruals just on pending claims. *Exhibit 5* shows the disclosed liabilities by future time horizon for asbestos indemnity and expense cost when available, reflecting insurance recoveries when provided.

The liability projections of companies in the “35+ years” group appear to be an attempt to quantify the liability for all future asbestos claims. We note that some companies have recently increased the time horizon of their future claim projections.

Exhibit 04. Percentage of Form 10-Ks Disclosing Asbestos Litigation Details

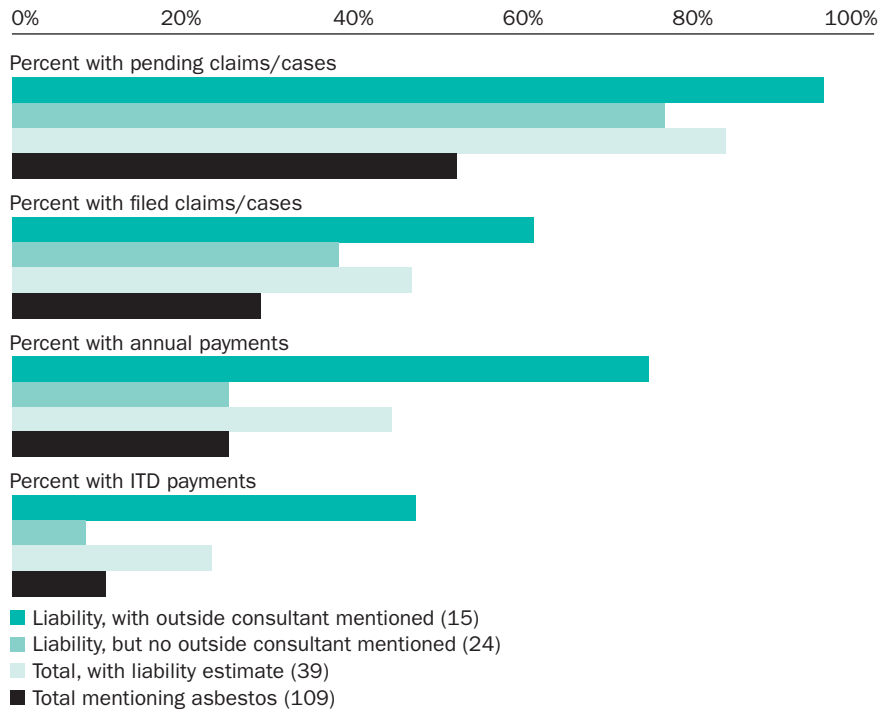


Exhibit 05. Future Time Horizon of Asbestos Liability Projections

Future Time Horizon	Number With Consultant	Number of 10-Ks	Average Liability Estimate
Unspecified	0	10	\$220,270,800
0 (pending only)	1	3	5,325,000
4-10 years*	7	11	272,098,364
15-30 years	4	8	212,993,125
35+ years	3	6	292,700,000
Total	15	38	\$228,208,158

*Average excludes one company that mentions an accrual, but does not separately disclose the amount.

“There does not appear to be a significant difference in the level of asbestos litigation disclosures by audit firm.”

Common reasons stated by the companies for lengthening the time horizon include:

- Recent legislation reducing filings by unimpaired claimants
- Current focus on claimants alleging malignancies (mainly mesothelioma), resulting in:
 - More stable filing levels from year to year compared to unimpaired claims
 - More predictable disease manifestation for malignant claims based on epidemiological studies

Companies vary in accruing liability on a nominal or discounted basis (*Exhibit 6*). Four companies disclosed that their accruals are on a discounted basis, while 10 specifically noted that their accruals are on a nominal basis and do not factor in a discount for the time value of money. It is likely that companies that do not state the basis for their accruals present their liability estimates on a nominal basis, because disclosure of discounting is typical.

The materiality of the asbestos liability disclosure varied among the filings. *Exhibit 7* shows the percentage of the company’s equity represented by the disclosed liability amount.

For the most part, there does not appear to be a significant difference in the level of asbestos litigation disclosures by audit firm (*Exhibit 8*). Of the 213 Form 10-Ks, approximately 51% mentioned asbestos, ranging from a low of 35% to a high of 58%, by audit firm. When asbestos litigation exposure was mentioned, a liability estimate was also provided approximately one-third of the time, again with some variation by audit firm. Differences in the level of asbestos disclosures by audit firm may be due to specifics regarding the individual defendant companies, rather than differences in interpretation of FASB standards by audit firm.

We compared Form 10-K disclosures by industry group based on the Standard Industry Classification (SIC) code of the filing company. The 213 Form 10-Ks were associated with 20 distinct industry groups. The SIC codes for more than half related to Aircraft, Chemical, Electrical, Machinery, Motor Vehicles, Railroad or Ship industries.

Exhibit 06. Nominal vs. Present Value Asbestos Liability Estimates

Liability Basis	Number of Filings	Average Liability Estimate
No reference*	24	\$174,946,250
Nominal	10	310,280,000
Present value	4	365,100,000
Total	38	\$228,208,158

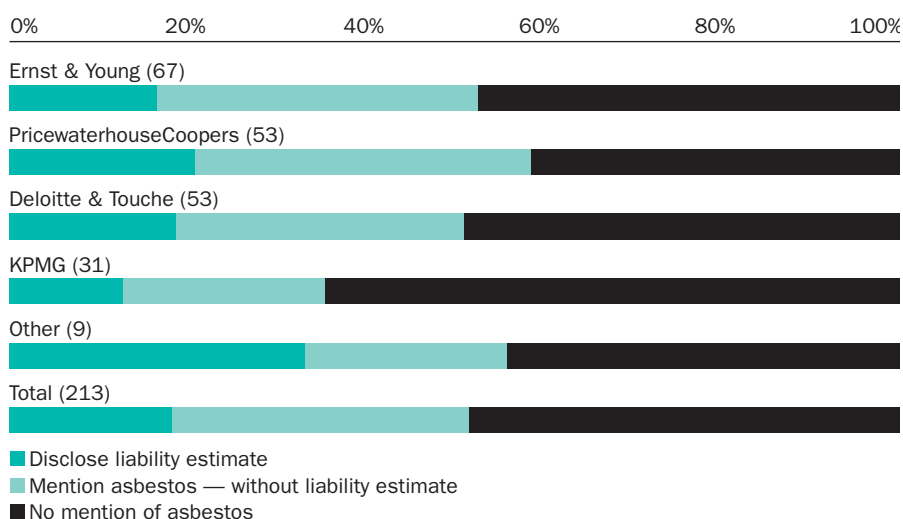
*Average excludes one company that mentions an accrual, but does not separately disclose the amount.

Exhibit 07. Accrued Asbestos Liabilities as a Percentage of Equity

Future Time Horizon	Liability as Percentage of Equity			Negative Equity	Total
	0%-20%	20%-100%	100%+		
0-30 years*	13	6	1	2	22
35+ years	5	1	0	0	6
Unspecified	9	0	0	1	10
Total	27	7	1	3	38

*Range excludes one company that mentions an accrual, but does not separately disclose the amount.

Exhibit 08. Comparison of Asbestos Disclosures by Audit Firm



However, Form 10-Ks for companies in these industries were no more likely to disclose asbestos exposure or to provide a liability estimate than companies in other industries within the overall group of 213 Form 10-Ks that we reviewed. We note that it is difficult to draw conclusions by industry group because the SIC code in the Form 10-K might not relate to the specific subsidiary with asbestos exposure.

Disclosures in the Future

The level of detail in asbestos disclosures in the Form 10-Ks we reviewed varied greatly. While companies that appear to have the most significant asbestos liabilities (based on their disclosures of claims and payments) were more likely to record a liability accrual, many companies known to have been named as defendants did not mention asbestos at all. Given that more than 80 companies have filed for bankruptcy because of their asbestos litigation exposure, some believe that there is a need for the remaining solvent defendants to provide more transparency regarding their asbestos exposure.

In response to concerns from investors and other users of financial information, namely, “that disclosures about loss contingencies under the existing guidance in FASB Statement No. 5, Accounting for Contingencies, do not provide adequate information to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies,”* FASB proposed to amend its guidance on disclosure of contingent liabilities. The proposed enhancements to the disclosures, issued in 2008, were to include more detailed quantitative and qualitative disclosures of all contingencies related to a “probable” or “reasonably possible” loss, both gross and net of potential insurance recoveries. Additionally, the disclosures would include a tabular reconciliation of recognized loss contingencies to enhance financial transparency.

“FASB proposed to amend its guidance on disclosure of contingent liabilities, but the 2008 proposal was met with significant concern.”

The 2008 FASB proposal was met with significant concern, with more than 200 comment letters; 201 of 242 respondents did not support the proposal,** citing the following concerns:

- The enhanced disclosures in the Exposure Draft would be too difficult to implement.
- Disclosures would force reporting entities to waive attorney-client privilege and hinder their ability to defend themselves in litigation proceedings.

In August 2009, FASB met to reconsider disclosure requirements for certain loss contingencies with the following objective in mind: “An entity shall disclose qualitative and quantitative information about the loss contingency to enable a financial statement user to understand the nature of the contingency and its potential timing and magnitude.”

FASB’s final decisions may significantly alter future disclosures.

Insurer Disclosures

Our research reveals that most defendant companies with known asbestos exposure do not disclose detailed information regarding asbestos claim payment activity and unpaid liability estimates in their Form 10-K filings. In contrast, the U.S. insurers who provide coverage to the underlying defendants have been required to disclose details regarding their asbestos payments and unpaid liability reserves, both gross and net of reinsurance, in their statutory annual statements in a uniform format since 1996. As of year-end 2008, U.S. property & casualty insurers had paid asbestos loss and expenses of approximately \$42.7 billion and carried liability reserves of \$23.6 billion net of reinsurance recoveries.*

While most insurers initially considered their asbestos liabilities too uncertain to quantify, the magnitude and persistence of the claims, combined with pressure from insurance regulators, rating agencies and investors, led to the development of today’s state-of-the-art exposure-based modeling techniques. Additionally, as individual insurers quantified their liabilities and made detailed disclosures regarding their analyses, this peer pressure caused other insurers to follow suit. The lack of well-defined corporate defendant peer groups with regard to potential asbestos liabilities likely results in less pressure to enhance disclosures despite other defendant companies doing so.

**Best’s Special Report: U.S. Asbestos & Environmental Liabilities — 2008 Market Review,” A.M. Best Company, Special Report, December 7, 2009

*Exposure Draft, “Disclosure of Certain Loss Contingencies,” FASB, June 5, 2008, www.fasb.org/jsp/FASB/draft/ed_contingencies.pdf

**Final Comment Letter Summary, FASB, August 6, 2009, www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156421386

Towers Watson's Asbestos Practice

Towers Watson's asbestos practice routinely estimates asbestos personal injury liabilities on behalf of (re)insurers as well as individual corporations named as defendants in the underlying litigation. We also perform methodology studies. Asbestos liabilities can

be a major consideration in both insurance-related and other corporate transactions; we have assisted both buyers and sellers of the liabilities. We have provided expert testimony in bankruptcy cases and other matters. Additionally, we have authored various papers and given numerous speeches regarding asbestos.

About the Authors



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About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.