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DON'T BREATHE THE AIR: US Developments in Asbestos and Silica

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Notable Quotes

- “Asbestos is the energizer bunny of toxic torts; it keeps going and going and going...”
- “We are seeing operations claims from new defendants (contractors, distributors)”
- “I expect to see at least five more bankruptcies of asbestos defendants in the next 12 to 18 months.” (*This seemed to be a bold statement in September 2000; little did we know what was to come ...*)
- “... factories generating paper ... Here’s the form, fill in the blanks ... won’t end by when I die, even when my kids die ...”
- “It borders on fraud and in some cases is fraudulent.”
- “The elephantine mass of asbestos cases ... defies customary judicial administration and calls for national legislation.” (US Supreme Court)
- “Asbestos litigation is a profit-driven industry.”
- **“Don’t think of them as lawyers, think of them as venture capitalists.”**



Agenda

- Asbestos Litigation Overview
- Quantifying Asbestos Liabilities
- U.S. Legislative Update
- Silica: The Next Asbestos?



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Asbestos Litigation Overview



Why So Much Litigation?

- Large percentage of population exposed
- Signature diseases
- Potential for large jury awards
- Economies of scale for plaintiff attorneys
- Insurance recoverables



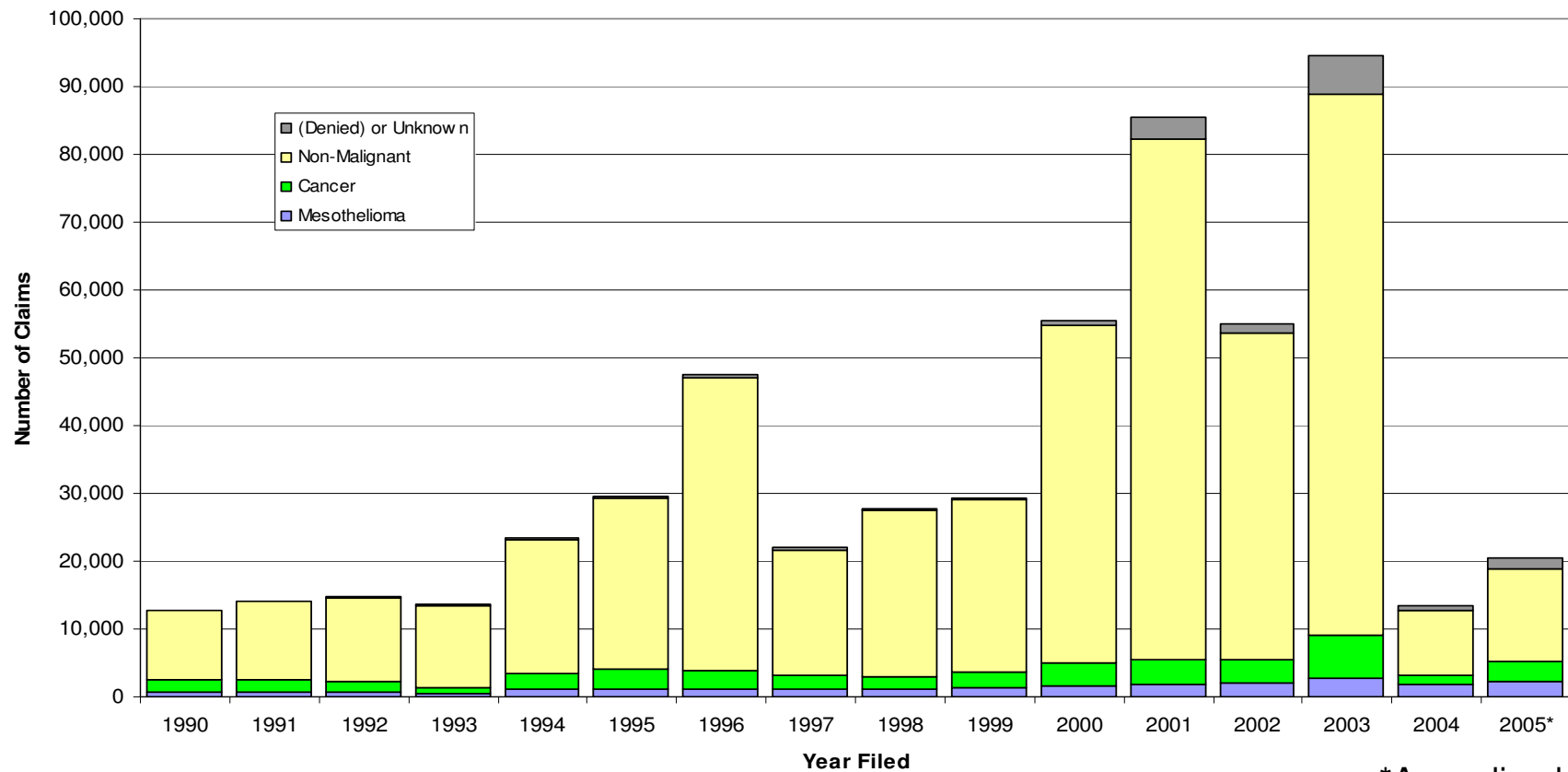
The Asbestos Litigation Environment Has Changed

- Increasing costs to defendants...
 - Surge in claim filings:
 - Per RAND: > 730,000 claims filed through 2002; estimates of ultimate claim filings range from 1-3 million
 - > 100,000 filed against Manville during 2003
 - Elevated settlement demands against individual defendants
 - Bankruptcies
- ...and increasing costs to insurers and reinsurers
 - Higher costs for existing defendants
 - Additional costs for new defendants
 - Additional coverage accessed



Surge in Claim Filings

Manville Trust - Injury by Year Filed

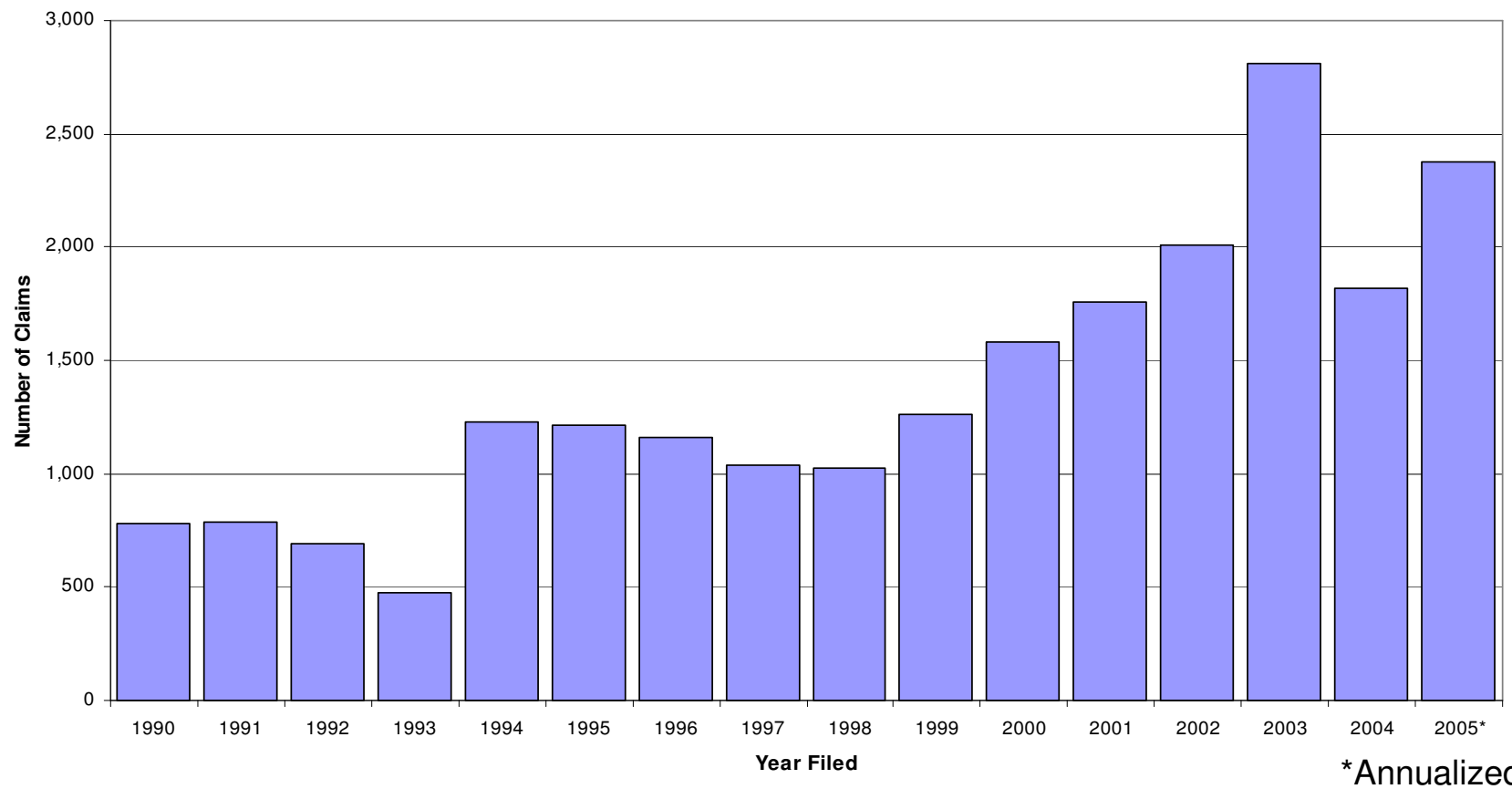


*Annualized



Claim Filings - Mesothelioma

Manville Trust - Injury by Year Filed
Mesothelioma



*Annualized



Increasing Numbers of Claimants Are Unimpaired

1982

**4% of claims showed no manifest asbestos-related injury
(RAND)**

1993

**Up to one-half of all asbestos claims have little or no physical
impairment (*Harvard Journal of Legislation*)**

1998

**No evidence of disease in 57% of asbestos claims
(Manville Trust)**

2001

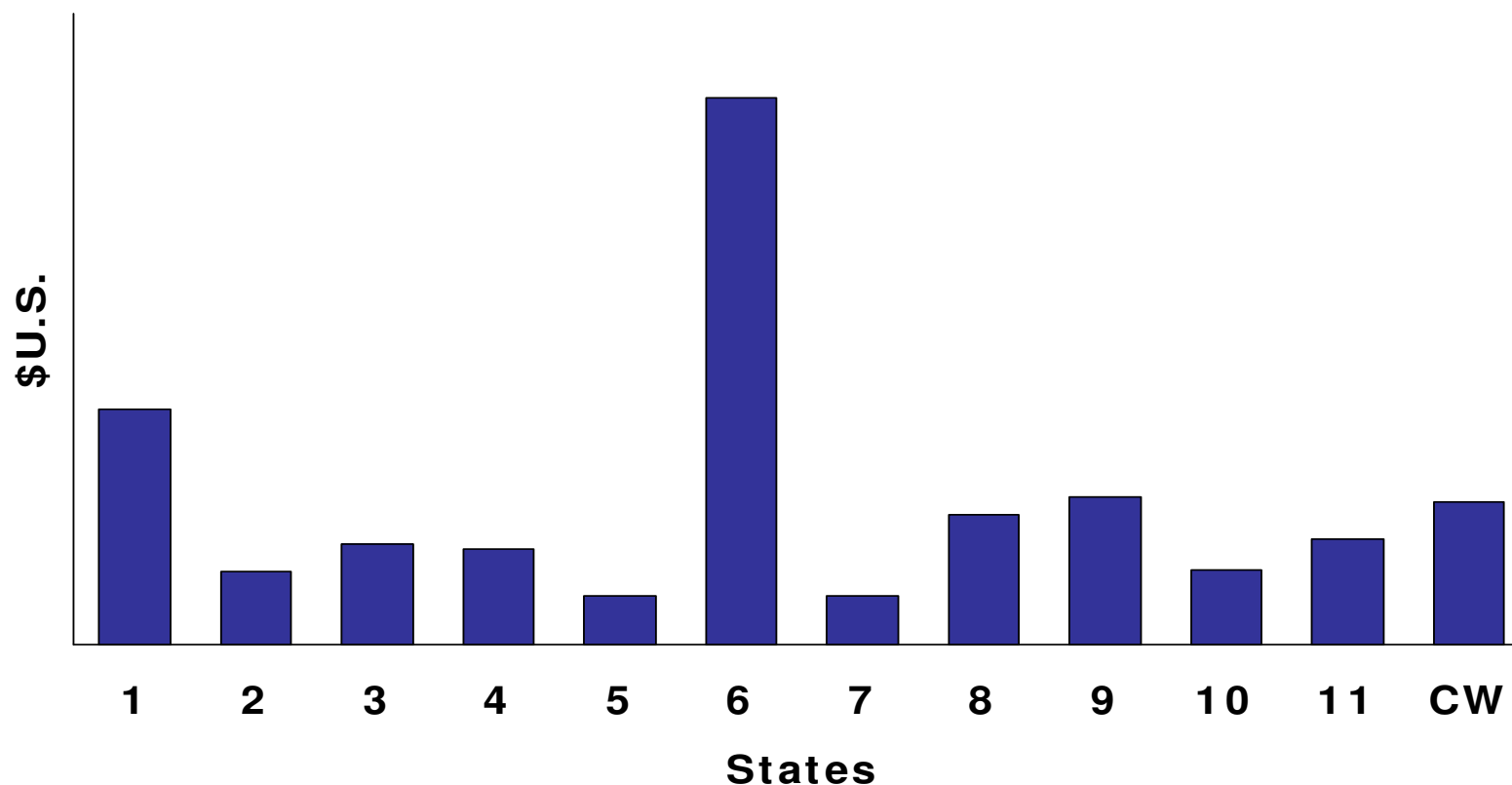
**74% of pending claims are unimpaired
(confidential report prepared for a defendant)**

**Two-thirds of claims show no evidence of impairment
(Babcock & Wilcox)**

**Vast majority of claims provide no evidence of impairment
(W.R. Grace)**

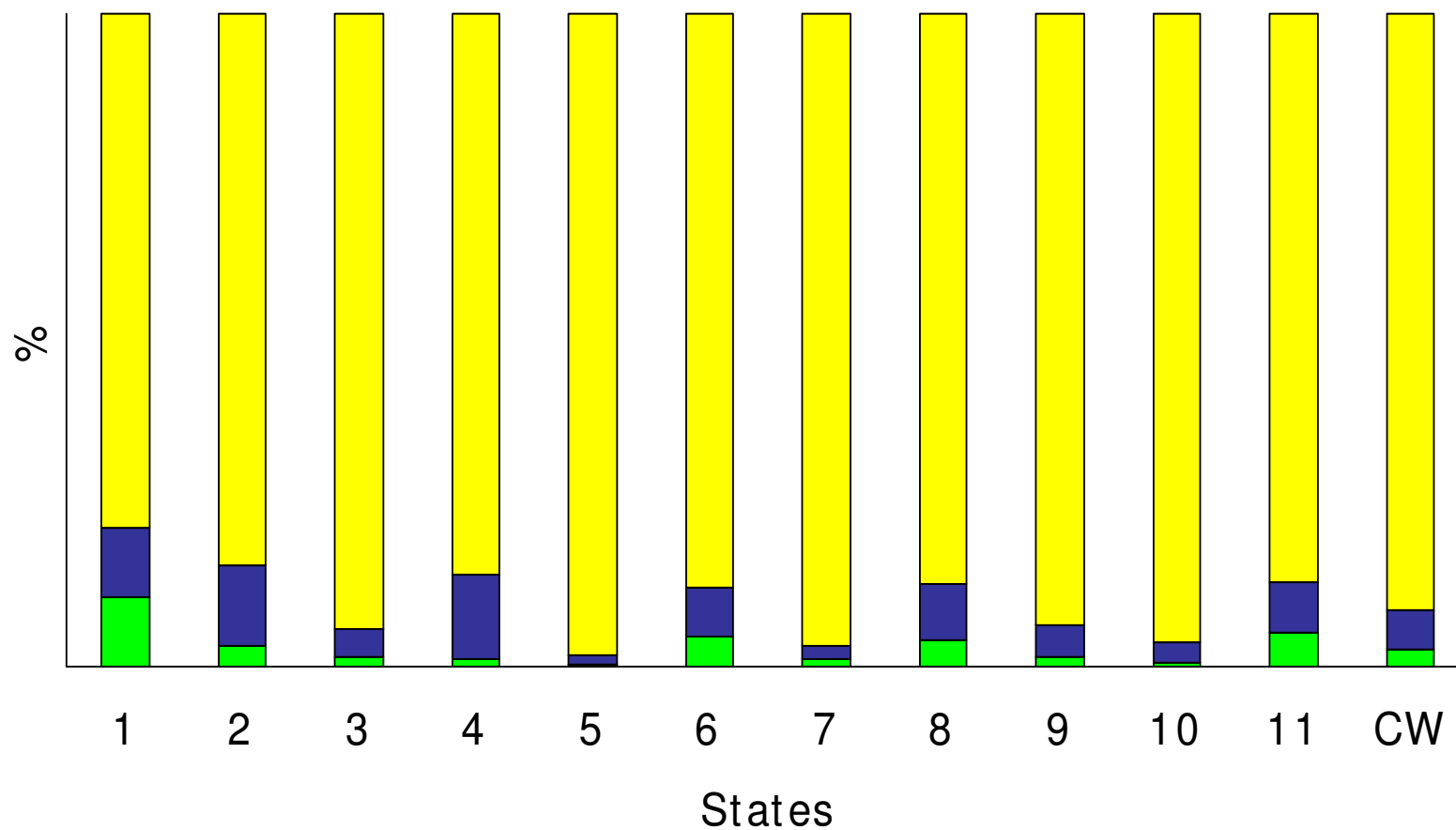


Observations – Average Settlements by State





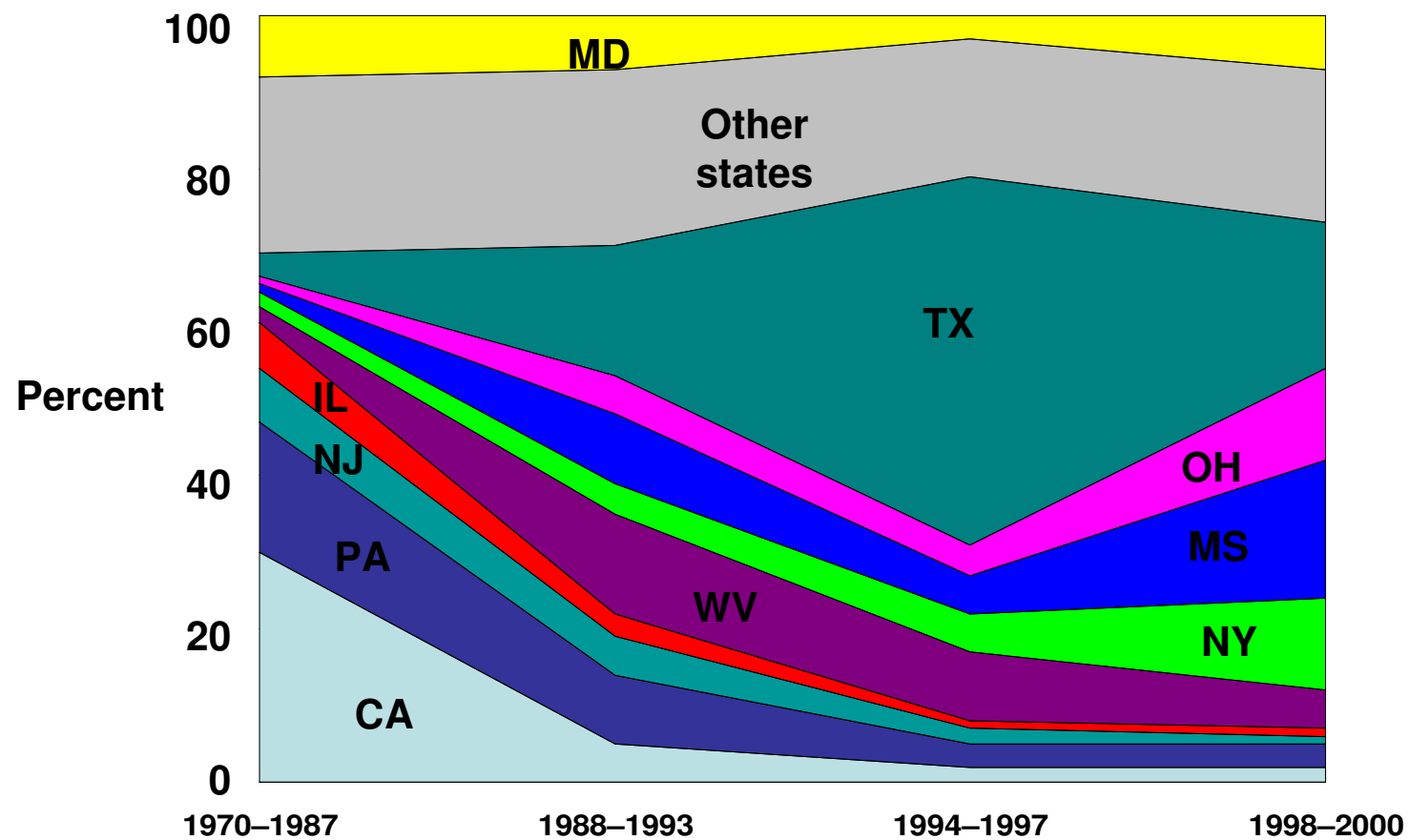
Observations – Disease Mix by State



■ Mesotheiloma ■ Cancer ■ Non-Malignant



Trends in Claim Filing Activities



Source: RAND, January 2003



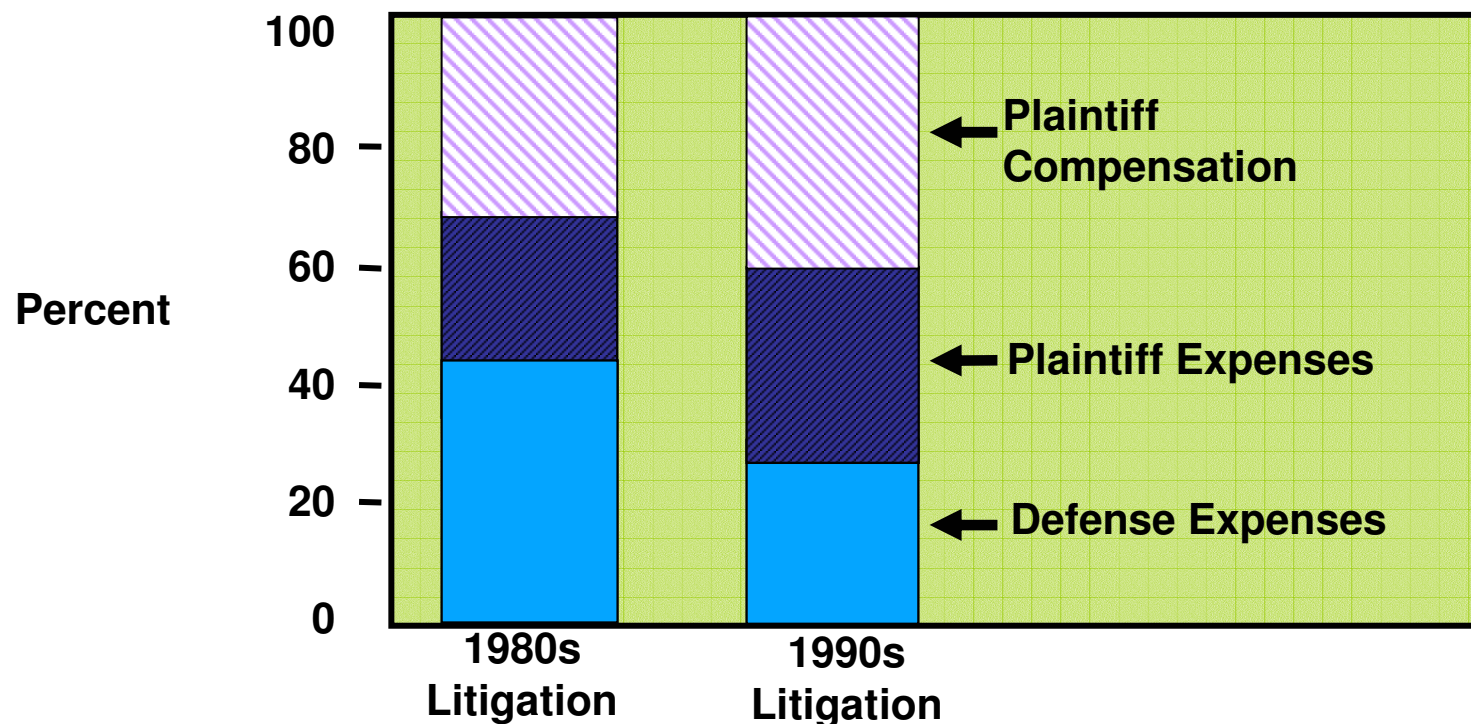
Individual Claim Costs Also Increased

- Mean verdicts to plaintiffs increased dramatically from 1998 to 2001 (RAND)
 - Mesothelioma: ~\$2M to ~\$6.5M
 - Other cancer: ~\$1M to ~ \$2.5M
 - Asbestosis: ~\$2.5M to ~\$5M
- Damages paid by many individual defendants also increased dramatically, reflecting
 - increase in plaintiff awards
 - higher shares for remaining defendants
- RAND estimates \$70 billion was paid through 2002



Frictional Costs in the System are High

- According to RAND, transaction costs have consumed more than half of total spending



- And they are likely to go back up in next decade

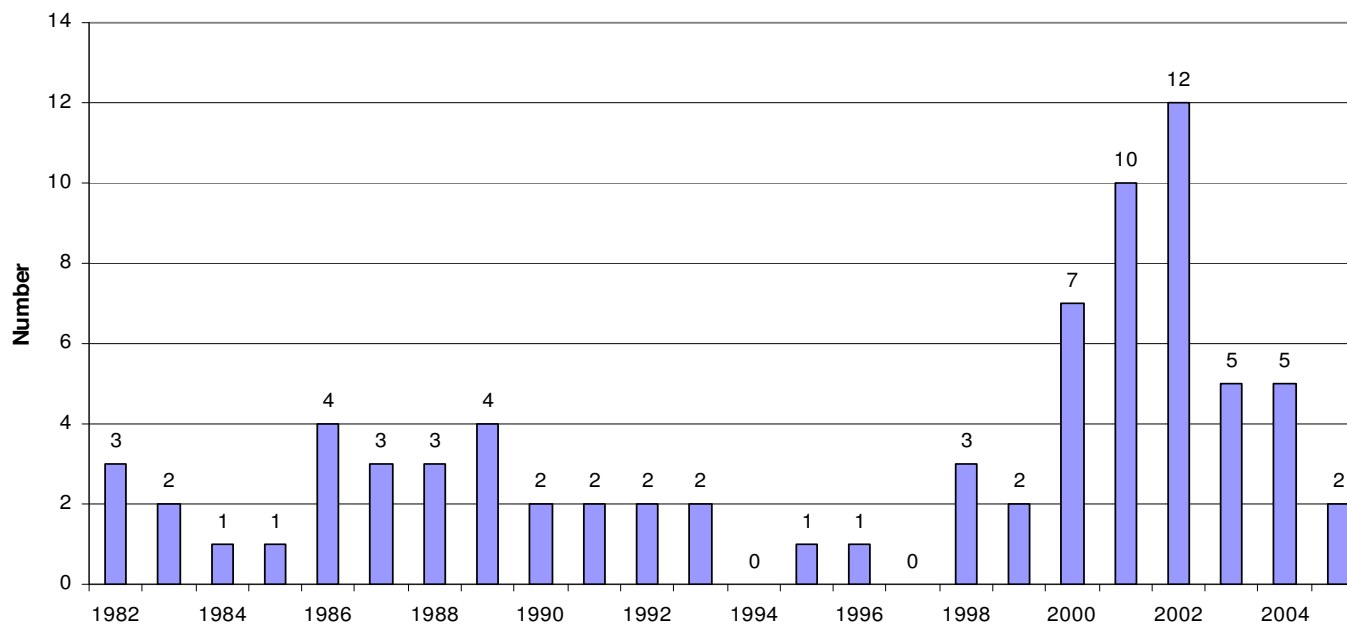


Bankruptcy of Defendants

- Currently approximately 78 bankruptcies of companies with asbestos-related problems (American Academy of Actuaries)
- Bankruptcy cited as “legislative solution” by Babcock & Wilcox
- New bankruptcies may:
 - Increase costs for remaining defendants
 - Several defendants cited higher settlement demands as a cause of bankruptcy
 - Cause need for additional defendants
 - Approximately 300 asbestos defendants in early 1980s
 - Estimates of ~2,000 published a few years ago
 - RAND estimates over 8,400 today
 - Firms in current list of defendants span 75 of 83 possible 2-digit SIC industry codes
 - Show more use of “pre-packaged” bankruptcies



Number of Asbestos Related Bankruptcies per Year



While only five bankruptcy petitions were filed during each of 2003 and 2004, the reduced level should not be misinterpreted as a sign of improvement in the asbestos litigation crisis. Rather, the number of 2003-2004 petitions was likely lower as defendants delayed decisions as they awaited the outcome of federal reform efforts and challenges to newer “pre-pack” bankruptcy plans.

Note: Graph excludes a bankruptcy in 1976.



Differences Between Traditional and Pre-Packaged Bankruptcies

Traditional

- Can take years to complete¹
 - File petition
 - Negotiate with creditors
 - File reorganization plan
 - File disclosure statement
 - Solicit votes
 - Confirmation hearing
- Insurance coverage generally exhausted or settled, or insurers included in negotiations
- Court appoints claimant representatives
 - Future's Rep involved in negotiation for >50% equity

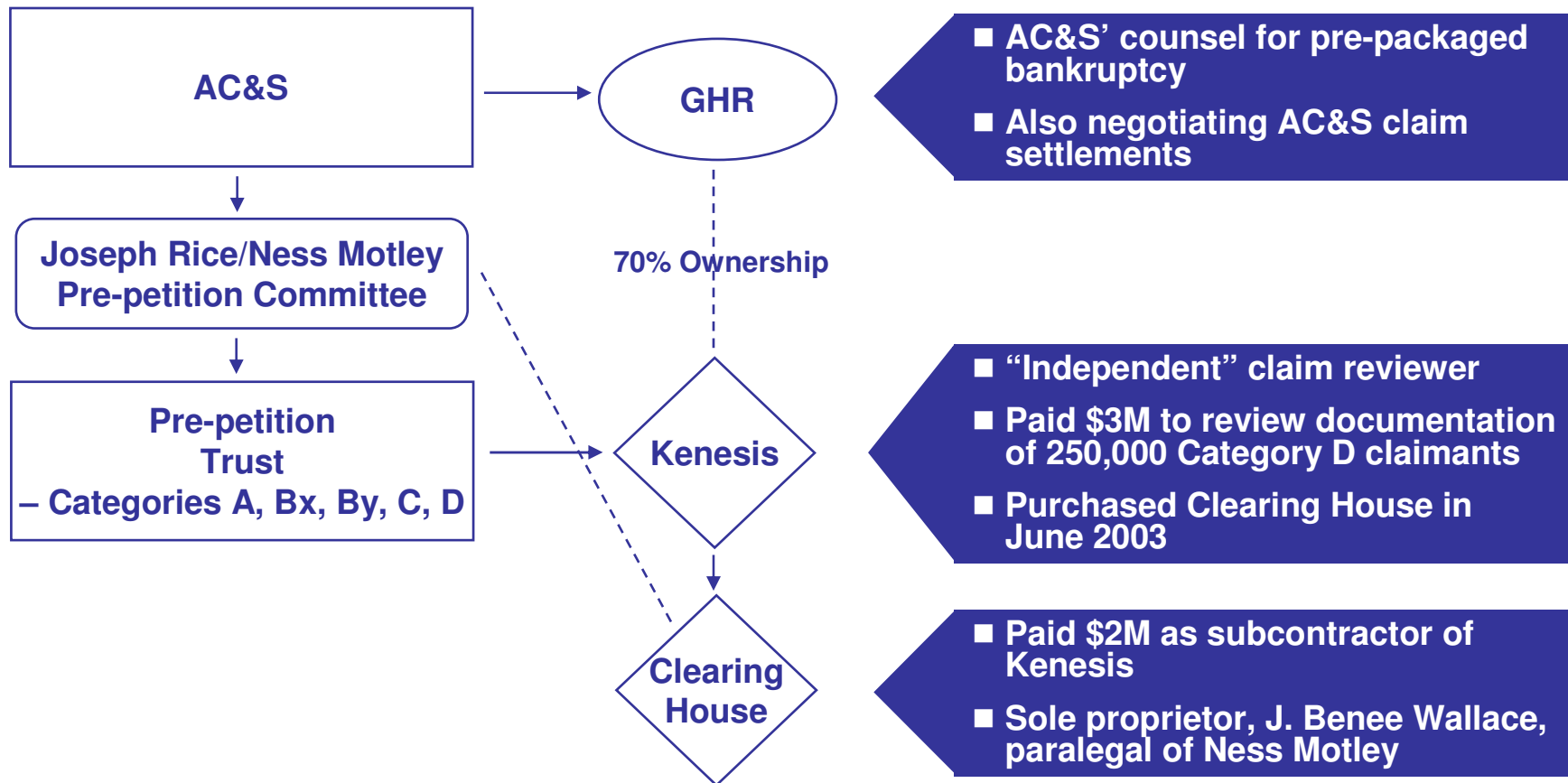
¹ Johns Manville filed bankruptcy in 1982 and its plan was not confirmed until 1988; Babcock & Wilcox filed bankruptcy in 2000 and its plan has not yet been confirmed.

Pre-Packaged

- Intended to be completed within a few months of filing
 - Negotiated and voted on before filing
 - Combined hearing to confirm plan and disclosure
- Insurers interests are not represented in pre-petition negotiations
- Commonly include a pre-petition trust to pay near full value on current claims
 - Plaintiff attorneys with large inventories negotiate matrix agreements that benefit their own clients, but do not owe a duty to all claimants
 - Disease criteria broadly defined
 - Claimants not fully compensated, so remain eligible to vote on the bankruptcy plan
 - Generous awards to lower disease severity classes
 - Significant portion of equity can be secured (therefore not available to bankruptcy trust)



Independence vs. Conflicts of Interest?



- From appointment of Kenesis (5/2002) until pre-package bankruptcy filed (9/16/2003), AC&S settled more than \$2 billion of claims
 - Settlements over prior 20 years totaled \$600 million
- Pre-packaged plan stipulated that these settlements could not be challenged by the asbestos trust or AC&S



AC&S Plan Denied Confirmation

- On 1/23/04 Judge Newsome (Delaware federal bankruptcy court) denied confirmation of the AC&S pre-packaged bankruptcy plan, finding that the plan
 - Was not proposed in good faith
 - Unjustly prejudiced by plaintiff attorneys
 - Largely drafted by and for the benefit of the pre-petition committee through various pre-petition settlements
 - Unfairly favors one plaintiff over another
 - Fundamentally unfair that one claimant with non-symptomatic pleural plaques will be paid in full, while someone with mesothelioma runs the substantial risk of receiving nothing
 - Both should be compensated based on the nature of their injuries, not based on the influence and cunning of their lawyers

“The court is informed that other judges have confirmed plans with such discriminatory classifications. This judge cannot do so in good conscience.”



Problems with Pre-Packaged Bankruptcies

- Negotiated in secret by a select group of lawyers, whose clients receive preferential treatment relative to other claimants with similar disease
- Future's Representative bound by pre-petition settlements
- Debtor is negotiating with insurers' money
- Conflicts of interest are abundant



Costs Extend Beyond Claims Paid by Defendants and Insurers

- “The Impact of Asbestos Liabilities on Workers in Bankrupt Firms” by Joseph E. Stiglitz, Jonathan M. Orszag, Peter R. Orszag – December 2002
 - Bankruptcies across the nation
 - headquarters in 19 states
 - facilities in 47 states
 - Pre-bankruptcy, 200,000 workers employed by bankrupt firms
 - Loss of 52,000 – 60,000 jobs with each displaced worker losing an average of \$25,000 – \$50,000 in wages
 - Average 25% reduction to their 401(K) account (approx. \$8,300 each)
 - Direct cost of bankruptcy: \$850M – \$1.7B



The Costs Extend to the Overall Economy

- “The Secondary Impacts of Asbestos Liabilities,” NERA, 2002
 - \$2 billion of secondary impacts on the economy
 - For every 10 jobs lost due to an asbestos bankruptcy, the surrounding community will lose an additional 8 jobs
- “Reducing the Asbestos Litigation Penalty: An Economic Benefit of Asbestos Reform Legislation,” Navigant Consulting Group, 2003
 - Asbestos defendants pay an “asbestos litigation penalty,” increasing their borrowing costs and making it difficult/impossible for some firms to raise capital
 - Failure to enact legislation could reduce economic growth by \$2.4 billion per year, costing 30,770 jobs annually
 - Extended over the 27 year timeframe contemplated by S1125 could mean 830,000 jobs will not be created and \$64.8 billion in economic growth will be lost



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Quantifying Asbestos Liabilities



How to Quantify Asbestos Liabilities?

- Actuaries typically use past experience to predict the future
- However, for asbestos we can't use traditional actuarial methods (e.g., accident year loss development projections)
 - Long latency from exposure to disease manifestation
 - Potential involvement of multiple policy periods for individual claims



How to Quantify Asbestos Liabilities?

- Many use benchmarks or rules of thumb
 - Market share techniques
 - For example, 5% of GL premium volume for affected years translates to 5% share of ultimate liabilities
 - Survival ratio techniques
 - equals ratio of total reserves divided by average annual payments
 - U.S. net asbestos survival ratio at year-ends 2001, 2002, 2003 and 2004 = 8.8, 11.4, 10.6, and 8.5, respectively (ex Fibreboard)
 - A.M. Best using an undiscounted survival ratio of 18 - 20.
 - Aggregate development
 - multiples of paid losses, case reserves, or reported losses
 - Comparisons to peer companies (e.g., significant reserve additions)



How to Quantify Asbestos Liabilities?

- Exposure-based modeling will improve understanding of ultimate A&E liabilities
- For an insurer or reinsurer, it considers
 - Mix of insureds
 - Types of coverage
 - Policy wording
 - Attachment points and limits
 - Years of coverage
 - Claims handling and settlement activities
- Greater understanding equips the defendant, insurer, or reinsurer to deal strategically with its exposure



Asbestos Exposure-Based Analysis

Steps:

- 1) Identification of exposure to asbestos defendants
- 2) Projection of ground-up ultimate loss and expense for asbestos defendants
- 3) Allocation of defendant losses across coverage block
- 4) Comparison of losses in a given year to insurer / reinsurer coverage terms



Potential Coverage Expansion

- Roll-forward of coverage blocks
- Reclassification of products claims as non-products claims by traditional products defendants with installation activities with exhausted (or nearly exhausted) products coverages
 - reinstates previously exhausted products coverages
 - opens up previously “untapped” non-products coverages
 - non-products coverages may not have aggregate limits



U.S. Rating Agency View

	A.M. Best	Standard & Poors	Fitch
Estimate of U.S. P/C Ultimate Asbestos Liabilities	\$65B	Standard & Poors believes the insurance industry's incremental reserve needs are at the lower end of the range (on a PV basis)	Range: \$49B – \$62B – \$74B
Methods to Evaluate Individual Insurer Potential Liabilities	Formula Approach <ul style="list-style-type: none"> • A.M. Best Indications • Exposure Based Reviews 	One-on-One Approach <ul style="list-style-type: none"> • Review methodology • Review historical data 	Step 1: <ul style="list-style-type: none"> • SR Target based on a risk-adjusted rate (3%) <ul style="list-style-type: none"> • 16 x industry aggregate • Unique targets at company level Step 2: <ul style="list-style-type: none"> • Interpretation/discuss internal methodology
Discounting	20 years for BCAR <ul style="list-style-type: none"> • longer than other LOB 		Use risk-adjusted rate for highly uncertain payments
Prognosis	<ul style="list-style-type: none"> • Generally not a solvency issue • Downward pressure on ratings 	<ul style="list-style-type: none"> • Expects modest number of downgrades • Asbestos not a catastrophic-loss event for the industry, but another example of why tort reform is needed • Credibility issue; how do CEOs/CFOs sign off? 	<ul style="list-style-type: none"> • Moderately negative impact on ratings • Downgrades for shock losses weakening capital or unchecked growing deficiencies/earnings drag • Increasingly prospective view



Increases in US Insurers' Asbestos Liabilities (top 10 A&E insurers¹)

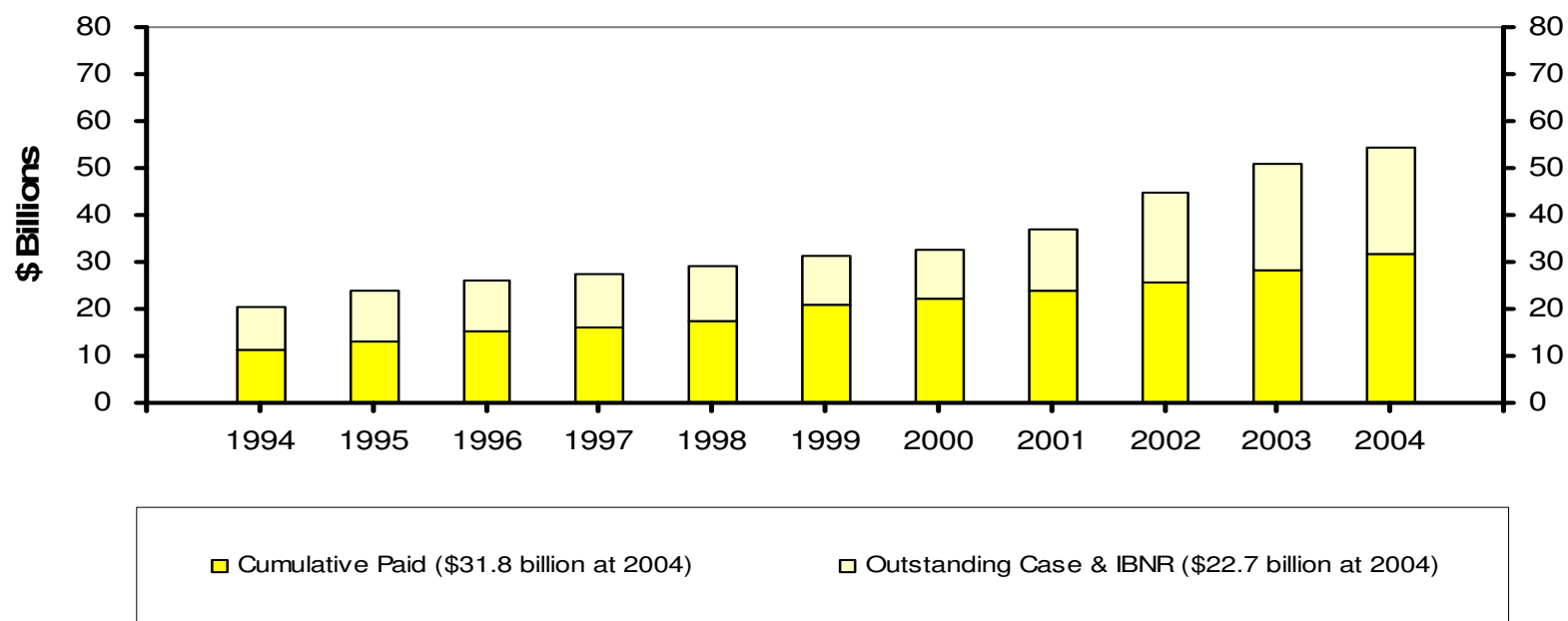
	St Paul/ Travelers	Hartford	ACE	CNA	Nationwide	Allstate
Net Asbestos Reserve 12/31/2000	1,102	428	631	636	737	640
Paid 2001-2004	2,131	985	464	464	496	376
Net Asbestos Reserve 12/31/2004	3,858	2,188	1,754	1,686	1,218	1,461
Increase since 12/31/2000	4,887	2,745	1,588	1,514	977	1,197
% Increase Relative to 12/31/2000	444%	641%	252%	238%	133%	187%

	Berkshire Hathaway	Liberty Mutual	Chubb	White Mountains	All Other	Total
Net Asbestos Reserve 12/31/2000	628	796	205	200	4,151	10,154
Paid 2001-2004	175	623	343	195	2,764	9,016
Net Asbestos Reserve 12/31/2004	1,023	1,083	902	669	6,785	22,627
Increase since 12/31/2000	570	911	1,039	664	5,397	21,489
% Increase Relative to 12/31/2000	91%	114%	506%	332%	130%	212%

¹Ranked by 2004 Net A&E Reserves



US Insurers' Paid and Reported Loss and Expense





Recent Increases Abroad

- Equitas (amounts in Sterling)
 - £1.5B gross undiscounted (Q1 2000)
 - £1.7B gross undiscounted (Q1 2001)
 - No change as of Q1 2002
 - £0.4B gross discounted (Q1 2003)
 - £0.3B gross discounted (Q1 2004)
 - £0.167B gross discounted (Q2 2005)
- Royal & Sun Alliance (amounts in Sterling)
 - £371M for U.S. and U.K. (Feb. 2002)
 - *£150M for U.S. and U.K. (Sept. 2003)*
 - *£500M for U.S. and U.K. (March 2004)*



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U.S. Legislative Update



Earlier Asbestos-Related Bills Introduced in Congress

- 7 relating to asbestos reform
 - HR1114 – Kirk (R-IL) – office of Asb. Comp./court
 - HR1586 – Cannon (R-UT) – court
 - HR1737 – Dooley (D-CA) – court
 - S413 – Nickels (R-OK) – court
 - S1125 / S2290 – Hatch (R-UT) – trust
- 2 to ban the use of asbestos
 - HR2277 – Waxman (D-CA)
 - S1115 – Murray (D-WA)
- 1 to change the tax code, such that asbestos-related settlement funds would be exempt from tax
 - HR2503 – Collins (R-GA)



Efforts in the 2005-2006 Congress

- President Bush campaigns for asbestos reform
 - Trips/speeches in Detroit and Madison County
 - State of the Union
- Specter holds Judiciary Committee Hearing January 11, 2005
 - Discussion draft released January 7, 2005 with “blanks”
 - Exxon Mobil, DuPont, Federal Mogul and others say they would fare better under existing system
 - AIA says draft bill “designed to fail”
 - Group of insurers / defendants say draft “raises serious concerns”



Efforts in the 2005-2006 Congress

- February 2, 2005 hearing regarding mixed-dust claims and “double-dipping”
 - Medical experts agreed asbestos v. silica disease can be distinguished
 - Unlikely an individual would suffer diseases carried by both substances
- Early-February Specter delays introduction of bill to garner GOP support, at request of Frist
 - March 1, Washington Times “If everyone insists on the last bit of advantage, there will be no bill... Prompt compromises will have to be forthcoming if this critical legislation is to become law or relegated to the deep freeze.”
 - Frist has reserved time in early April (after 3/18 – 4/4 recess) for Senate consideration
- S. Res 43 (H. Reid/Democrat/Nevada) designates April 1, 2005, as “National Asbestos Awareness Day” (Note: Apr 1 is April Fools’ Day in the US)
- S852 (FAIR Act)[Fairness in Asbestos Injury Resolution]
 - Introduced on April 19, 2005 by Specter (R-PA) & Leahy (D-VT)
 - Reported out of the Judiciary Committee on June 30, 2005



Senate Bill 852

- No-fault system with medical criteria
- Funding of \$140 billion over 30 years comprised of:
 - Insurers - \$46.025 billion
 - Defendant companies - \$90 billion
 - Current bankruptcy - \$4 billion
- Funding contribution
 - Insurers to be determined
 - Defendants grouped into tiers based on status (bankrupt vs. solvent vs. FELA/Jones Act) and payment status (amount of indemnity + expense paid at Dec 2002, gross of insurance recoveries)



Earlier Potential Insurer Allocation

- Insurers include U.S. and non-U.S. companies
- Insurer funding is net of third party reinsurance
 - Gross of financial cover
- Initial discussions based on a blended approach
 - Market share – premium and paid losses
 - Future exposure – carried reserves
- Later discussions focused on an industry-wide ground-up study
- Insurer funding is concentrated
 - 12 insurers likely to contribute 75%
 - 20 insurers likely to contribute 90%



S852 Major Issues

- Size of trust – is \$140 billion enough?
- Transition – how to start it?
- Sunset – how to end it?
- Workers compensation “subrogation”
- Silica “re-tread” claims
- Special treatment for Libby, Montana, vermiculite exposures (covered by Michael Bowker in Fatal Deception)



Is \$140 Billion Enough? – Estimates

- Congressional Budget Office
 - \$120 -- \$132 -- \$150 billion
- Bates White
 - \$301 -- \$695 billion
 - Sponsored by the American Legislative Exchange Council (ALEC)



Will \$140 Billion Be Enough? – Comparison of Future Filings

U.S. Claims	CBO	Manville *	Bates White
Malignant	78,000	107,000	467,000
Nonmalignant	1,184,000	743,000	94,000
Total Estimate	1,585,000	850,000	561,000

* Reflects Manville's 2002 TDP; does not represent entire universe of claimants in the tort system

- CBO estimate and Tillinghast forecast of Manville claims are similar for malignant claims:
 - If Manville excludes 28,403 Level 6 Lung Cancer (One) claims without SOE or asbestos disease that are not likely to be compensable under S.852, then the total reduces to 79,000
 - Bates White non-malignant estimate does not include Tier 1 medical monitoring



Where Does the Bill Stand?

- Senate
 - Frist commitment to bring to the floor (Oct? Nov?)
 - Delay due to Hurricane Katrina
- House
 - House does not want to take up bill that does not have chance in Senate
 - Pressure to move right, balanced against will to preserve a bill that can succeed in conference
 - Medical criteria a non-starter



State Reform Efforts

- Efforts at federal reform have drawn attention to abuses in the current system (e.g., claims by the unimpaired)
- Several states aren't waiting for a federal solution and recently have enacted various reforms
- States that have enacted asbestos reforms
 - Mississippi
 - New York
 - Ohio
 - Texas
 - West Virginia
 - Florida
 - Georgia



State Reform Efforts

- Focus on medical criteria / statute of limitations
 - Medical criteria established in Ohio, Florida, Georgia, Ohio and Texas
 - Inactive dockets being considered / created in several jurisdictions (e.g., Boston, NYC, Syracuse, Seattle, Madison County, IL)
 - Penalties for frivolous lawsuits (e.g., Mississippi, Texas)
- Focus on forum shopping / consolidations (e.g., Mississippi, Texas, West Virginia)
- Focus on joint and several liability (e.g., NY)
- Other issues: innocent sellers, successor liability, caps on non-economic and punitive damages



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Silica: The Next Asbestos?



More Notable Quotes

- “... [diagnoses were] manufactured for money ...”
(Judge Janis Graham Jack, presiding over *In Re Silica Products Liability Litigation, MDL No. 1553*)
- “Wow, that’s not good.” (plaintiffs’ expert, after being accused by defendants of making up his diagnoses, just before asking for his own lawyer)
- “... lunar dust resembles the silica dust on Earth that causes silicosis, a serious disease.” (Russell Kerschmann, NASA pathologist)

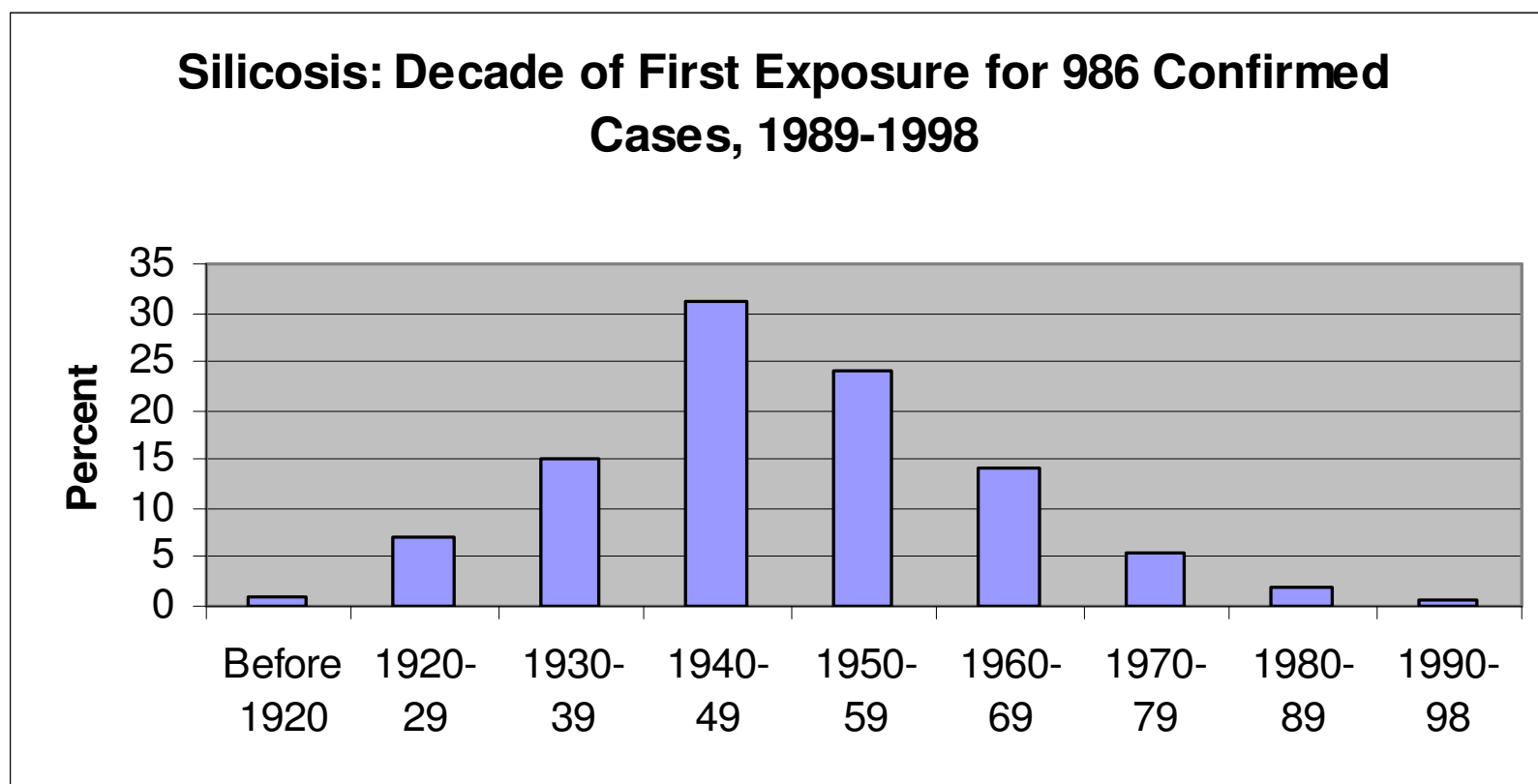


Silicosis: Background

- Inhalation of respirable silica has been linked with silicosis, lung cancer, COPD, and rheumatoid arthritis
- Silicosis occurs in three forms:
 - Chronic, which usually occurs after 10 or more years of exposure at relatively low concentrations
 - Accelerated, which develops 5 to 10 years after exposure; and
 - Acute, which develops after exposure to high concentrations and results in symptoms (sometimes fatal) as early as a few weeks after exposure
 - In the “Hawk’s Nest disaster” in 1935, hundreds of workers died drilling a tunnel in West Virginia



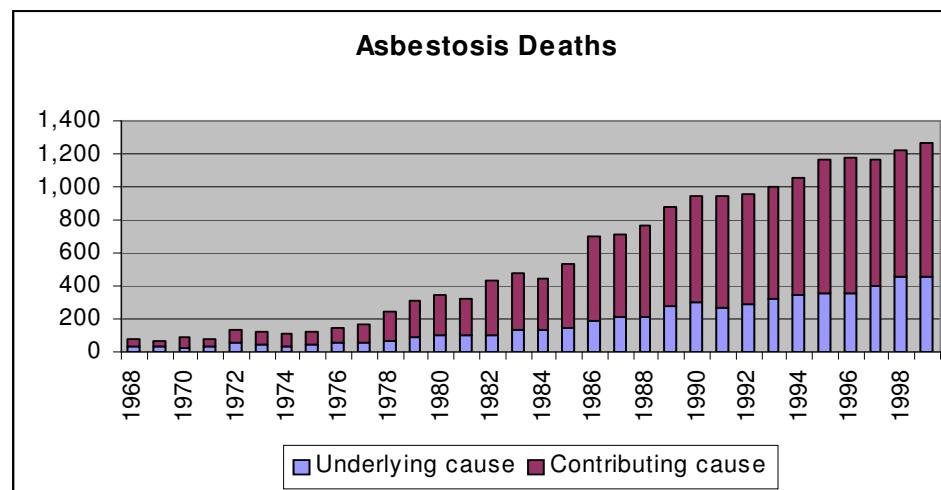
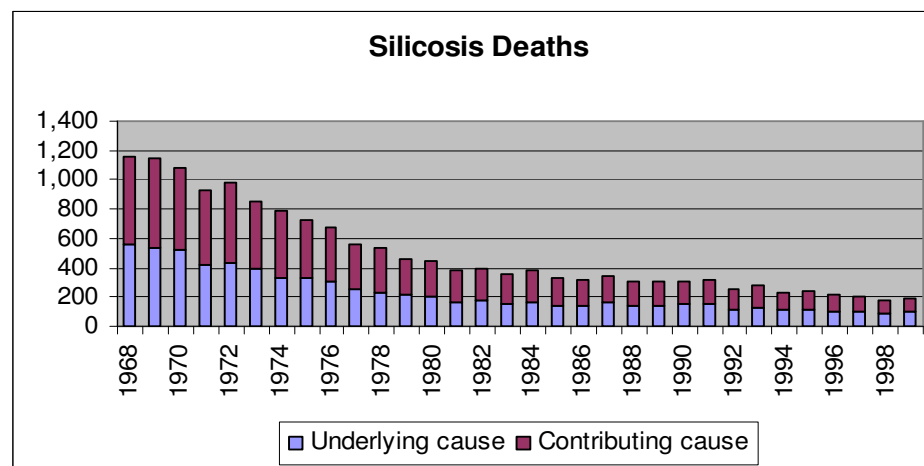
Silicosis Latency



Source: NIOSH WoRLD 2002, Section 3, Figure 3-5



Silicosis and Asbestosis Deaths



Source: NIOSH NSSPM 2002



Silica and the US Insurance Industry

- Silica claims have been filed since the 1930s, but have increased substantially recently
- Claims have been generally filed against approx. 160 defendants, especially silica producers, businesses using silica in their manufacturing processes (e.g., foundries and sandblasters), and respirator manufacturers
- Some defendants are presenting both asbestos and silica claims to insurers, notably Halliburton and 3M
- The industry has not adopted uniform silica exclusions



Fraudulent Claims

- National Tire Workers Litigation Project – 1986
 - Group 1: 64% positive; Group 2: 95% positive
 - Re-evaluated 439 cases: only 3.6% positive
- Johns Hopkins
 - Re-evaluated 551 films used as legal basis for claims
 - Originally >90% positive drops to <5% positive
- 2/16-18/2005 Silica MDL Daubert Hearings – Judge Jack/Corpus Christi, TX
 - >50% of 10K MDL claimants previously filed asbestos claims
 - Doctors testified they weren't qualified to make diagnoses; didn't authorize silica diagnoses
 - Defense attorneys have requested \$1.1M sanctions against plaintiff attorneys; subject of 3/14/2005 hearing



Fraudulent Claims (2)

- As a result of Judge Jack's findings:
 - US attorney in NYC is investigating
 - A Congressional investigation is underway
 - US Chamber of Commerce study has begun (should be released this fall)
 - Reviewing 1000 claims
 - Building a database showing links between screening companies, doctors, and plaintiff law firms



“The Next Asbestos” Requires:

- Massive underlying social “costs” that clearly result from that cause
 - Long-term exposure, many people exposed
 - Latency increases both the length of individual exposures and the number of people exposed
 - Signature disease
 - Inclination to sue
- Large amounts of exposed insurance limits
- Favorable judicial treatment of both underlying suits and coverage disputes



“The Next Asbestos”? (1)

- Estimates of the US population exposed to silica are generally smaller than for asbestos (3 million vs. >27 million)
- Silica-related mortality is much less (1.21 per million vs. 5.41)
- There is no known fatal “signature disease” similar to mesothelioma to “bundle” other cases with



“The Next Asbestos”? (2)

- If claims are based on “failure to warn,” aggregate limits would not normally exist prior to 1986
 - However, policy exposure would stop when usage ceases
 - Policy / coverage / allocation issues still open
- Claims have not yet been “priced”
- Would pleural dockets also apply to silica claims?
- HOWEVER ...
 - Plaintiffs’ lawyers already know the drill and have plenty of money to invest



“The Next Asbestos”? (3)

- At this point, silica appears to be a smaller problem (probably much smaller) than asbestos for insurers
- The fate of silica as an insurance problem may be linked to asbestos reform
 - Asbestos claims are easier to file, so in the absence of meaningful reform, may continue to be the path of least resistance
 - If there is effective asbestos reform (federal or most states), silica may become an attractive investment for the plaintiffs’ bar



Remember:

“[Asbestos litigation is an] endless search for a solvent bystander.”