

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 89677 / August 26, 2020

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 4164 / August 26, 2020

ADMINISTRATIVE PROCEEDING
File No. 3-19932

In the Matter of

BorgWarner Inc.

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS, PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against BorgWarner Inc. (“BorgWarner,” “Respondent,” or “the Company”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. From 2012 until the fourth quarter of 2016, BorgWarner failed to estimate its "incurred but not reported" or "IBNR" liability for future asbestos claims. As a result, BorgWarner's financial statements were materially misstated. Although the Company recorded liabilities for filed asbestos-related claims and noted that future claims were probable, prior to 2016, BorgWarner concluded that it could not reasonably estimate its IBNR liability for future asbestos claims. BorgWarner came to this conclusion without conducting sufficient analysis, including any substantive quantitative inquiry, despite possessing nearly 40 years of historical raw claims data. Rather, the Company's assessment was based on untested qualitative assumptions not relevant to calculating an estimate. As reported in its 2017 Form 10-K/A, filed in 2018, BorgWarner could have estimated its IBNR asbestos liability as early as 2012.

2. In the fourth quarter of 2016, BorgWarner recorded a pre-tax \$703.6 million charge for the IBNR liability and identified the charge as being the result of a change in estimate. Thereafter, the Company concluded that the charge was the result of an error and filed a restatement in 2018 to reflect its IBNR liabilities in appropriate prior periods dating back to 2012. The restated numbers were material to the Company's financial statements and impacted, among other items, the amounts accrued for asbestos-related liabilities and pre-tax earnings. BorgWarner reported that its failure to record the IBNR estimate was due to a material weakness in the Company's internal controls over financial reporting.

3. As a result of the conduct described in this Order, BorgWarner violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder.

Respondent

4. BorgWarner Inc. is a Delaware corporation incorporated in 1987 that provides technology solutions for combustion, hybrid and electric vehicles. The Company manufactures and sells its products globally. The Company's stock currently trades on the New York Stock Exchange under the ticker symbol "BWA."

Facts

5. BorgWarner and its subsidiaries have been frequently named as defendants in personal injury lawsuits alleging exposure to asbestos-containing automotive parts – mainly clutch assemblies for use with manual transmissions – that the Company manufactured from 1928

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

through approximately 1986. In 2004, the Company's primary insurance policies were exhausted, and BorgWarner became responsible for managing its asbestos-related claims rather than relying on its insurance companies as it had done in the past. As part of that process, the Company built a database using the insurers' claims data to record and manage its claims.

6. Applicable accounting standards require companies to book a loss contingency charge whenever the estimated loss from a loss contingency is both probable and reasonably estimable. From 2004 through 2015, BorgWarner consistently disclosed that losses from future asbestos claims were probable, but asserted that the amount of those losses was not reasonably estimable. On that basis, BorgWarner did not book any IBNR charge during those years.

7. From at least 2011 until 2014, BorgWarner's conclusion that it could not reasonably estimate IBNR claims was memorialized in a two page memo-to-file (the "Memos") authored and updated by a Company employee.

8. The Memos consistently stated that BorgWarner could not reasonably estimate the amount of its IBNR asbestos liability due to a number of qualitative factors that created insurmountable uncertainty. Specifically, the Company concluded that there was no way to accurately estimate how many people had been exposed to BorgWarner products, the incidence of illness, or the life expectancies of exposed individuals. BorgWarner also concluded that because its asbestos-containing clutch pads were normally sealed inside a clutch housing, BorgWarner's position was unique among asbestos defendants, rendering industry benchmarks inapplicable for estimating BorgWarner's IBNR asbestos liability. These conclusions were based on high-level assumptions that were not subject to substantive quantitative analysis, actuarial assessment, or other testing.

9. In late 2014 and 2015, BorgWarner implemented a number of changes regarding its approach to asbestos litigation in an effort to reduce litigation costs. As part of that process, the Company hired a new employee who had asbestos litigation experience, as well as prior experience with evaluating IBNR asbestos liability. In the years leading up to 2014, no one at the Company reviewed the Memos memorializing the Company's analysis, which were updated on an annual basis. The process of creating and updating the Memos represented the Company's only internal control around whether it could estimate its asbestos-related IBNR.

10. Beginning in 2015, the Company discussed whether to retain an actuary to evaluate BorgWarner's data for IBNR purposes. Repeating the untested assumptions set forth in the Memos, BorgWarner determined that an actuary was not necessary, citing, among other factors, gaps in its claims data, the uniqueness of the Company's product (which the company asserted rendered industry benchmarks inapplicable), and volatility in claims patterns.

11. Thereafter, BorgWarner began to populate missing data fields, evaluate claims patterns, and assess volatility using information from the Company's database, which included over 100,000 claims at the time and dated back to the 1980s; and also began evaluating other companies' public filings.

12. In conjunction with this work, in September 2016, the Company hired an actuarial firm with asbestos claims expertise (the “Actuary”) to perform an actuarial analysis for the purpose of determining whether the Company’s IBNR asbestos liability was reasonably estimable.

13. While BorgWarner had previously concluded that its data set was incomplete, the Actuary was generally able to obtain sufficient information from litigation files accessible to the Company. In addition, the Actuary determined that industry benchmarks could be applied to BorgWarner and that it did not need to adjust the benchmarks because BorgWarner’s claims data was volatile or inherently unique – a finding in contrast to the Company’s prior position that industry benchmarks were inapplicable. Moreover, the Actuary found that the multiple inhibiting factors listed in the Company’s Memos (such as product uniqueness and unknown exposure rates) were not barriers to its estimation of future liabilities.

14. In its 2016 Form 10-K, BorgWarner reported a change in estimate for the accounting of its asbestos-related IBNR liabilities and recorded a corresponding pre-tax, non-cash charge of \$703.6 million.²

15. Subsequently, on June 15, 2018, BorgWarner announced it would restate its consolidated financial statements due to a material weakness in its internal controls over financial reporting related to the Company’s historical assertion that IBNR asbestos liabilities could not be estimated. BorgWarner stated that it had determined that it could have estimated an IBNR prior to Q4 2016, and that it would therefore need to reflect the one-time \$703.6 million charge in appropriate prior periods.

16. BorgWarner’s material weakness in its internal controls over financial reporting around asbestos-related IBNR stemmed from its use of untested assumptions that, among other things, lacked substantive quantitative analysis and did not consider industry benchmarks to conclude that it could not reasonably estimate its IBNR liability. BorgWarner filed an amended 2017 Form 10-K on September 28, 2018 reflecting corrected financial statements dating back to year-end 2012.

17. The impact of the Company’s misstatement was material to several financial statement items, including a 6% reduction in pre-tax earnings in both 2014 and 2015 and a more than 200% increase in asbestos-related liabilities for each year.

Violations

18. As a result of the conduct described above, BorgWarner violated the reporting provisions of Sections 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder. Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder require issuers like BorgWarner to file annual, current, and quarterly reports with the Commission containing such

² In 2015, BorgWarner reported pre-tax earnings of \$926.8 million. In 2016, the Company reported pre-tax earnings of \$190.5 million.

information as the Commission's rules prescribe. As described above, BorgWarner's financial statements contained in annual, current, and quarterly reports were materially mistatted.

19. BorgWarner also violated Sections 13(b)(2)(A) and (B) of the Exchange Act. Section 13(b)(2)(A) requires an issuer like BorgWarner to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the company's transactions and dispositions of assets. Section 13(b)(2)(B) requires issuers like BorgWarner to devise and maintain a system of sufficient internal accounting controls. As detailed above, BorgWarner failed to make and keep books, records, and accounts which accurately and fairly reflected transactions related to its IBNR for asbestos liabilities. BorgWarner also failed to establish sufficient internal accounting controls relating to its IBNR for asbestos liabilities.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 13a-1, 13a-11 and 13a-13, thereunder.

B. Respondent shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of \$950,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying BorgWarner as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Carolyn Welshhans, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010A.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary