

# RatingsDirect®

---

## FM Global

**Primary Credit Analyst:**

Jeff Pusey, San Francisco (1) 415-371-5016; jeff.pusey@spglobal.com

**Secondary Contact:**

John Iten, Hightstown (1) 212-438-1757; john.iten@spglobal.com

### Table Of Contents

---

Rationale

Outlook

Base-Case Scenario

Company Description

Business Risk Profile

Financial Risk Profile

Other Assessments

Accounting Considerations

Related Criteria And Research

# FM Global

SACP* Assessments				SACP*		Support		Ratings		
Anchor	a+	+	Modifiers	0	=	a+	+	0	=	Financial Strength Rating
Business Risk			ERM and Management	0		Liquidity	0	Group Support	0	A+/Stable/--
Very Strong			Holistic Analysis	0		Sovereign Risk	0	Gov't Support	0	
Financial Risk										
Strong										

\*Stand-alone credit profile.  
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

## Rationale

### Business Risk Profile: Very Strong

- Industry leader in engineering-based underwriting and research
- Highly valued customized loss-prevention services complementing commercial property products
- Strong operating results due to underwriting granularity and loss prevention consulting
- Significant global presence within the large commercial property segment

### Financial Risk Profile: Strong

- Extremely strong capital adequacy supported by strong, though volatile, operating results
- Large property book exposed to man-made and natural disasters
- Greater equity exposure than peers

### Other Factors

- Adequate enterprise risk management (ERM) with sufficient processes in place to control risks
- Consistent strategy to provide commercial property insurance capacity coupled with best-in-class loss prevention services
- Flexibility arising from mutual ownership structure allowing for a long-term strategic view of risk
- Business and financial risk profile scores leading to an anchor rating of 'aa-/a+'; we assigned the latter because our view of the company's business profile is on the lower end of very strong due to its narrow focus on commercial property

**Outlook: Stable**

The stable outlook on FM Global reflects S&P Global Ratings' view that the company has a very strong competitive position supported by its highly regarded reputation for assessing risk to prevent and mitigate loss, as well as its notable market presence in the large commercial property segments. FM Global's extremely strong capital adequacy and strong operating results also allow the group to absorb catastrophe losses and financial market volatility--a key ratings factor.

**Downside scenario**

We may lower our ratings in the next two years if FM Global's capital adequacy or redundancy as measured by our proprietary capital model falls below the 'AAA' confidence level for a prolonged period, or if its competitive position weakens.

**Upside scenario**

It is unlikely that we will raise the ratings on FM Global in the next two years because of its exposure to capital and earnings volatility arising from its high equity concentration and narrow focus on commercial property business.

**Base-Case Scenario****Macroeconomic Assumptions**

- Real U.S. GDP growth of about 2.4% in 2017 and 2.3% in 2018
- Average 10-year Treasury note yield of 2.4% in 2017 and 2.8% in 2018
- U.S. core Consumer Price Index (CPI) of 2.2% in 2017 and 1.9% in 2018
- Neutral industry outlook for property/casualty (P/C) insurers

**Company-Specific Assumptions**

- Flat-to-low premium growth due to selective underwriting and competitive environment
- Long-term combined ratio of less than 90% (assuming 20%-25% points in catastrophe losses)
- Extremely strong capital adequacy in 2016 and 2017
- Potential realized gains/loss and reserve development excluded

## Key Metrics

(Mil. \$)	--Year ended Dec. 31--				
	2017*	2016*	2015	2014	2013
P/C: Gross premiums written	5,528	5,473	5,473	5,677	5,658
P/C: Net combined ratio (%)	<90	<90	85.8	79.8	78.1
Net investment yield (%)	1.7	1.7	1.7	1.8	2.0
S&P Global Ratings capital adequacy/redundancy	AAA	AAA	AAA	AAA	AAA

\*Forecast data reflect S&P Global Ratings' base-case assumptions. P/C--Property/casualty.

## Company Description

Founded in 1835, Johnston, R.I.-based FM Global provides commercial property insurance and risk management solutions via engineering-driven underwriting and property loss-prevention research. It employs nearly 2,000 engineers and has a world-class 1,600-acre campus for scientific research and product testing. FM Global comprises four insurance operating entities: Factory Mutual Insurance Co. (FMIC), Affiliated FM Insurance Co. (AFM), F.M. Insurance Co. Ltd. (FMI), and Appalachian Insurance Co.

## Business Risk Profile: Very Strong

FM Global's business risk profile reflects its strong operating results and significant market position in the large commercial property segment, partially offset by a relatively narrow focus.

### Insurance industry and country risk: Intermediate

Overall, FM Global's insurance industry and country risk is intermediate, reflecting low country risk and moderate industry risk for its globally diverse insurance operations--mostly in developed markets that typically have low risks as a result of a stable political environment, financial system, payment culture, and rule of law. We believe FM Global's P/C operations are exposed to intermediate industry risks because of the sector's inherent product risk and consequent susceptibility to reserve volatility. But the stability of the U.S. and Western European insurance markets' profitability, growth prospects, and overall institutional framework mitigates this weakness.

### Competitive position: Very strong

FM Global's competitive position is very strong based on its positive reputation, significant market presence, and overall positive operating results. It is highly regarded for using its engineering expertise in assessing client risks to help prevent and mitigate losses, fostering a significant commercial advantage over competitors. The company utilizes a state-of-the-art research campus to replicate potential property hazards and develop risk mitigation strategies. According to some industry surveys, FM Global is the world's leading provider of large commercial property coverage. FM Global reported relatively strong five-year (2011-2015) operating results based on an average combined ratio of 90.2%, which its moderate use of reinsurance partly supported. But its relatively narrow focus on commercial property products partially offsets our view of the company's competitive position.

**Table 1**

<b>FM Global -- Competitive Position</b>					
	<b>--Year ended Dec. 31--</b>				
<b>(Mil. \$)</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Gross premiums written	5,473	5,677	5,658	5,406	5,164
Change in gross premiums written (%)	(3.6)	0.3	4.7	4.7	10.6
Net premiums earned	3,579	3,617	3,545	3,621	3,234
P/C: Reinsurance utilization - premiums written (%)	26.6	25.8	32.6	31.8	31.3

P/C--Property/casualty.

## Financial Risk Profile: Strong

FM Global's financial risk profile is supported by extremely strong capital, but the company is highly exposed to market risks and catastrophic losses.

### Capital and earnings: Extremely strong

We view FM Global's capital adequacy as extremely strong and a ratings strength. In our base-case forecast, we expect its capital adequacy to remain extremely strong despite the highly competitive pricing environment in the commercial property market because its competitive advantage supports high retention of current policyholders and moderate growth of new business.

FM Global's strong earnings support its capital redundancy at the 'AAA' level. The company generated a five-year average return on revenue (ROR) of 17.3% and a loss ratio of 63.1% from 2011-2015. For the first nine months of 2016, FMIC's statutory combined ratio totaled 87.2%, while its ROR was 23.2%. Although the company has generated strong long-term earnings, it is susceptible to earnings volatility, as reflected by its 120% combined ratio in 2011, which stemmed from underwriting losses mostly from tornadoes in the U.S., floods in Thailand, and earthquakes in New Zealand and Japan. Assuming 20%-25% of catastrophe losses, we expect the company to generate a long-term combined ratio of less than 90%, which will offset continued low investment yields and support extremely strong capital adequacy.

**Table 2**

<b>FM Global -- Capitalization</b>					
	<b>--Year ended Dec. 31--</b>				
<b>(Mil. \$)</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Common shareholders' equity	11,037	10,637	9,716	7,907	6,883
Change in common shareholders' equity (%)	3.8	9.5	22.9	14.9	(5.5)
Total reported capital	11,037	10,637	9,716	7,907	6,883
Change in total capital (reported) (%)	3.8	9.5	22.9	14.9	(5.5)

**Table 3**

<b>FM Global -- Earnings</b>					
	<b>--Year ended Dec. 31--</b>				
<b>(Mil. \$)</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Total revenue	3,899	3,944	3,857	3,914	3,512
EBIT adjusted	838	1,068	1,100	807	(397)
EBITDA adjusted	900	1,123	1,221	912	(312)
Net income (attributable to all shareholders)	738	956	1,021	774	(42)
Return on revenue (%)	21.5	27.1	28.5	20.6	(11.3)
Return on shareholders' equity (reported) (%)	6.8	9.4	11.6	10.5	(0.6)
P/C: Net expense ratio (%)	30.4	27.5	26.6	25.5	25.4
P/C: Net loss ratio (%)	55.5	52.3	51.5	60.6	95.8
P/C: Net combined ratio (%)	85.8	79.8	78.1	86.1	121.2

P/C--Property/casualty.

**Risk position: High risk**

FM Global's risk position is high because of its exposure to man-made and natural disasters, its material equity portfolio, and legacy asbestos and environmental exposure. It has relatively high exposure to catastrophic events due to its commercial property business concentration. As of year-end 2015, its investment portfolio comprised about 51.1% equity investments, exposing the company to additional capital and earnings volatility. But the investment portfolio is adequately diversified by sector and obligor, partially offsetting this risk.

**Table 4**

<b>FM Global -- Risk Position</b>					
	<b>--Year ended Dec. 31--</b>				
<b>(Mil. \$)</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Total invested assets	15,456	15,230	13,836	12,261	11,042
Net investment income	256	264	256	240	230
Net investment yield (%)	1.7	1.8	2.0	2.1	2.1
Net investment yield including realized capital gains/(losses) (%)	3.4	4.2	5.0	4.9	4.8
<b>Portfolio composition (% of general account invested assets)</b>					
Cash and short-term investments	8.4	8.8	5.6	6.8	5.5
Bonds	36.7	35.8	39.7	43.8	46.2
Equity investments	51.0	51.8	51.6	45.7	44.8
Real estate	3.8	3.6	3.1	3.7	3.4

**Financial flexibility: Adequate**

We regard FM Global's financial flexibility as adequate because it has no debt, but does have adequate sources of capital and liquidity. It doesn't have a credit facility, but maintains material levels of cash and short-term investments and utilizes large highly rated reinsurers in reinsurance program cessions.

## Other Assessments

### Enterprise risk management: Adequate

We regard FM Global's ERM framework as adequate because it can identify, measure, and manage most key risk exposures and losses. The cornerstone of its ERM program is the company's positive risk management culture. FM Global employees are mostly engineers with substantial technical expertise who work as loss-prevention consultants, underwriters, and claims adjusters, supporting a deep-rooted risk-reward culture. FM Global believes all losses are preventable and works diligently with its insureds to help foster best-in-class loss prevention plans.

### Management and Governance: Satisfactory

FM Global's senior management has maintained its strategy of providing extensive competitive property insurance. The company offers best-in-class products and services that keep pace with the needs of its policyholders and owners. The management team has significant depth and breadth as a result of its tendency to make promotions within the company. For example, Thomas Lawson was appointed as president and CEO after chairman Shivan Subramaniam retired at the end of 2014.

### Liquidity: Strong

We do not expect FM Global to face any liquidity constraints in meeting its obligations in the next two years because of its strong operating cash flows.

## Accounting Considerations

As an alternative to dividends, FM Global routinely provides a membership credit to policyholders. When afforded, the credit is contingent upon renewal or anniversary of an existing policy and is recorded as a reduction in net premiums earned. FMIC is the flagship insurance company and parent of AFM, FMI, and Appalachian. FMIC, AFM, and Appalachian each file U.S. statutory financial statements. FMIC and FMI, a U.K. subsidiary, generate U.S. and U.K. generally accepted accounting principles statements, respectively. We believe all of FM Global's accounting is consistent with industry standards.

## Related Criteria And Research

- Group Rating Methodology, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

### Ratings Detail (As Of February 1, 2017)

#### Operating Companies Covered By This Report

## Ratings Detail (As Of February 1, 2017) (cont.)

**Factory Mutual Insurance Co.**

Financial Strength Rating

*Local Currency*

A+/Stable/--

Counterparty Credit Rating

*Local Currency*

A+/Stable/--

**Affiliated FM Insurance Co.**

Financial Strength Rating

*Local Currency*

A+/Stable/--

Issuer Credit Rating

*Local Currency*

A+/Stable/--

**F.M. Insurance Co. Ltd.**

Financial Strength Rating

*Local Currency*

A+/Stable/--

Issuer Credit Rating

*Local Currency*

A+/Stable/--

**Domicile**

Rhode Island

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Copyright © 2016 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.