

Factory Mutual Insurance Co.

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Table Of Contents

Credit Highlights

Outlook

Macroeconomic Assumptions

Business Risk Profile

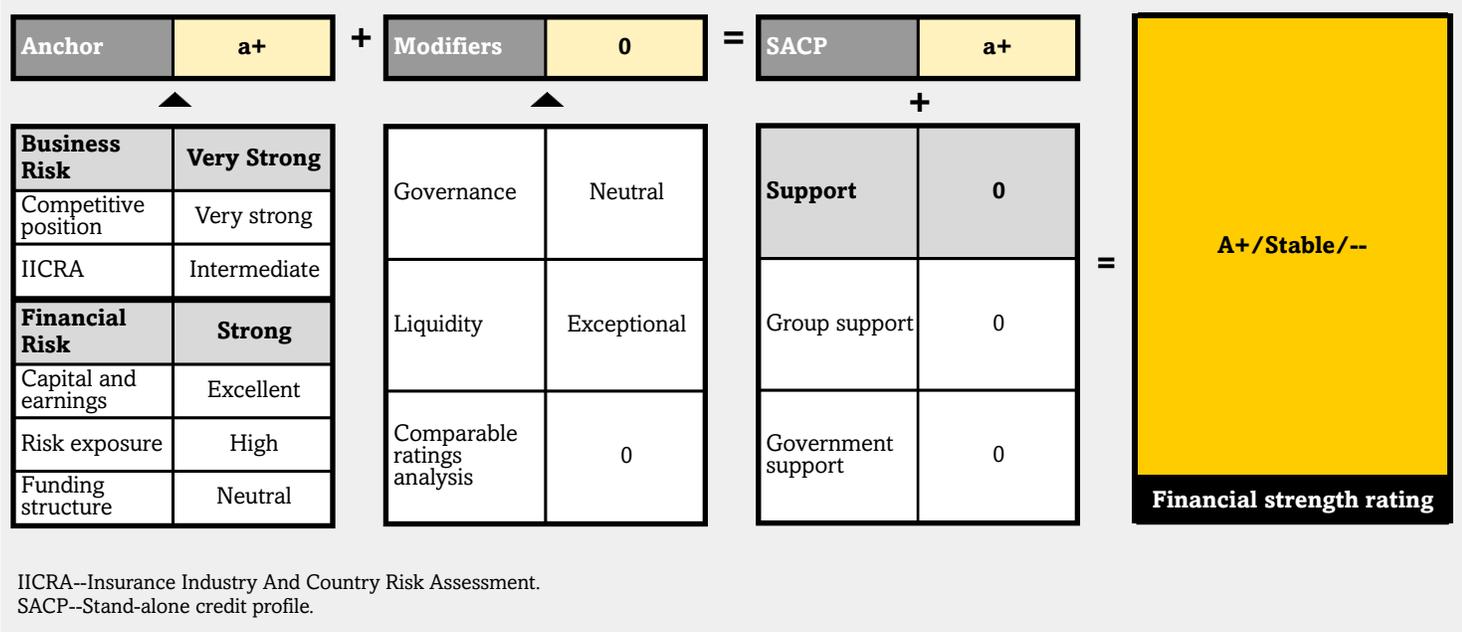
Financial Risk Profile

Other Key Credit Considerations

Related Criteria

Appendix

Factory Mutual Insurance Co.



Credit Highlights

Overview	
Strengths	Risks
Industry leader in engineering-based property underwriting and research	Susceptibility to significant capital and earnings volatility arising from high exposure to catastrophic events
Highly valued customized loss prevention services complementing large commercial property products	Large equity portfolio exposing capital to financial-market volatility
Strong long-term underwriting performance with recent outsized losses due to natural catastrophes	Growth prospects limited by relatively narrow focus on commercial property coverage

FM Global is the global leader in providing insurance coverage and risk management service for large commercial and industrial properties Factory Mutual Insurance Co. (FM Global) is a U.S.-based global commercial property insurer and risk management services provider. The company is willing to extend large limits on individual properties to clients that agree to implement the risk mitigation measures recommended by FM Global's extensive roster of risk management engineers, who perform onsite inspections of each commercial property.

Capitalization has been a strong pillar to the rating. FM Global's capitalization, as measured by S&P Global Ratings' capital adequacy model, shows a substantial redundancy at the 'AAA' level. The company has been able to maintain excellent capital levels through periods of heightened catastrophe activity due to this capital buffer, proper risk policies and judicious use of reinsurance.

Potential earnings and capital volatility are high due to the nature of the insurance coverage FM Global provides and the company's investment strategy. Because the company writes almost exclusively primary commercial property coverage, it is exposed to large individual losses from fires and accidents, as well as more widespread losses from natural catastrophe events. Therefore, underwriting results each year can fluctuate dramatically depending on the level of large loss or natural catastrophe activity. At the same time, the company's investment strategy is heavily weighted

toward equities, which exposes capital to significant market risk. These risks are mitigated to a large degree by the company's substantial capital buffer and the generally uncorrelated nature of these risks.

Outlook: Stable

The stable outlook reflects S&P Global Ratings' view that the group has a very strong competitive position supported by its highly regarded reputation for assessing risk to prevent and mitigate loss and leading market presence in the large commercial property market. FM Global's extremely strong capital adequacy and generally strong operating results also allow it to absorb significant catastrophe losses and financial market volatility. Given FM Global's monoline focus on large commercial property, the potential for several large single losses or an elevated level of catastrophe losses is always present, making underwriting performance inherently volatile, and such losses have resulted in material underperformance in two of the past five years. But we expect a longer term average combined ratio of 93%-96%, assuming the more recent level of catastrophe losses does not represent a new normal.

Downside scenario

We could lower the ratings in the next 24 months if FM Global's operating performance comes in substantially below our expectations and we believe that a systemic change has occurred that's weakened its competitive position. We may also lower our ratings if, during the next two years, FM Global's capital redundancy per our proprietary risk-adjusted capital model falls and remains below the 'AAA' confidence level due to significant underwriting losses or equity markets volatility.

Upside scenario

It is unlikely that we will raise the ratings in the next two years because of FM Global's high exposure to capital and earnings volatility and strong but narrow focus on the commercial property business.

Macroeconomic Assumptions

- A decline in real GDP of about 4.0% in 2020 and 3.9% growth in 2021
- 10-year Treasury rate remains low at around 0.9% in 2020 and 1.2% in 2021
- Consumer Price Index inflation at 1.4% in 2020 and 1.9% in 2021
- Unemployment rate at 8.4% in 2020 and 6.7% in 2021.

Source: "Economic Research: The U.S. Economy Reboots, With Obstacles Ahead," published on Sept. 24, 2020.

Key Metrics

	2021F	2020F	2019	2018	2017	2016	2015
Net premiums earned (mil. \$)	~4,700	~4,500	4,211	3,892	3,910	3,601	3,579

Key Metrics (cont.)

	2021F	2020F	2019	2018	2017	2016	2015
Net income (mil. \$)*	400-500	500-600	2,479	161	254	797	738
Return on shareholders' equity (%)	<5	<5	18.8	1.3	2.0	6.9	6.8
S&P Global Ratings capital adequacy	AAA	AAA	AAA	AAA	AAA	AAA	AAA
P/C: Net combined ratio (%)	94-96	98-100	79.7	128.6	129.9	84.7	85.3
Return on revenue (excluding investment gains/losses) (%)	9-11	5-7	26.6	(17.2)	(19.3)	23.6	21.5

f--S&P Global Ratings forecast. *No estimate of realized investment gains/losses included for 2021.

Business Risk Profile: Very Strong

FM Global is a global commercial property insurer and risk management services provider focused on the large commercial property market. Its operations are globally diversified and mostly in developed markets that we typically view as having intermediate industry risk due to the property/casualty (P/C) sector's inherent product risk in these markets.

We base our very strong assessment of FM Global's competitive position on its strong reputation and major presence in the large commercial property market. Its highly regarded reputation for engineering expertise in assessing client risks to prevent and mitigate losses gives it a significant commercial advantage over competitors, as shown by its high client retention and generally favorable underwriting performance. FM Global employees are predominantly engineers with substantial technical expertise who work as underwriters and claims adjusters, fostering a deep-rooted risk-reward culture. Client retention is enhanced by the membership credits given to policyholders in years when FM Global's operating performance and capital position are strong. These credits are based in part on their tenure as policyholders with the company.

FM Global's underwriting results have historically been favorable, as demonstrated by a 10-year (2010-2019) average combined ratio of about 94%. But more-recent performance has been significantly affected by catastrophe events in 2017 and 2018, which pushed the combined ratio close to 130% in both years before falling to about 80% in 2019, a year of low losses. Its most recent five year (2015-2019) average combined ratio is 101%, highlighting the volatility inherent in its business concentration. We expect that another year of above average losses will lead the group to report a full-year combined ratio below 100% in 2020. Projecting FM Global's underwriting performance is inherently difficult given the volatility of large losses and catastrophe-related losses, but we would expect the combined ratio in an average year to be 93%-96% (assuming about 20 percentage points in annual catastrophe losses).

Financial Risk Profile: Strong

We view FM Global's capital adequacy as extremely strong, supported by strong earnings generation and its mutual structure. We assess its capital redundancy as well into the 'AAA' range per our proprietary capital adequacy model. In our view, this mitigates the risk of substantial losses due to catastrophe events or a sharp decline in equity markets causing a significant decline in capital. While 2017 and 2018 underwriting and investment losses did not modify our capital assessment, we view the group's earnings volatility as partially offsetting its generally strong underwriting

performance.

We regard FM Global's risk exposure as high, due to its large concentration in equity investments (45% of its investment portfolio as of year-end 2019, including private equity and equity-oriented hedge funds), significant exposure to catastrophic events, and some legacy asbestos and environmental exposure. Its high catastrophe exposure is a direct result of its large commercial property business concentration. While the group does have a high risk tolerance toward equities, the risk is partially offset by its diversification by issuer and sector.

As a mutual insurer it lacks access to the public equities markets, but FM Global has no debt in its capital structure, consistently maintains sufficient levels of cash and short-term investments to avoid having to sell securities at an inopportune time to pay claims, and has access to large, highly rated reinsurers for capital support.

Other Key Credit Considerations

Governance

FM Global's senior management has maintained its longstanding strategy of providing extensive and competitive property insurance capacity to commercial, industrial, and institutional policyholders who share its commitment to proactive risk mitigation. FM Global believes the majority of losses are preventable, and it works diligently with its insureds to help foster best-in-class loss-prevention plans. Management has significant depth and breadth in the business, reflecting its tendency to promote from within the company.

Liquidity

FM Global's liquidity is exceptional, and we don't expect liquidity constraints to keep it from meeting its policyholder obligations in the next two years due to its strong operating cash flows. As an alternative to dividends, FM Global provides a membership credit to policyholders when these are justified by strong underwriting results. Receipt of the credit is contingent upon renewal or anniversary of an existing policy and is paid to the policyholder as a reduction of their renewal premium for the coming year.

Environmental, social, and governance

Similar to other P/C insurers, FM Global has moderate exposure to environmental and social risks, and we view them to be broadly in line with its peers. Our view of the company's environmental risk takes into consideration its meaningful property catastrophe exposure, which could be a source of capital and earnings volatility. However, we think that it is unlikely to experience losses greater than its risk tolerance given its robust capital base, risk modelling capabilities, and the judicious use of reinsurance utilization. The company's exposure to social risk is similar to that of other P/C insurers.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Guarantee Criteria, Oct. 21, 2016

- Principles Of Credit Ratings, Feb. 16, 2011
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Appendix

Credit Metrics History

(Mil. \$)	2019	2018
S&P Global Ratings capital adequacy	AAA	AAA
Total invested assets	19,577	17,747
Total shareholder equity	14,583	11,827
Gross premiums written	6,438	5,789
Net premiums written	4,479	4,097
Net premiums earned	4,211	3,892
EBIT	3,109	189
Net income (attributable to all shareholders)	2,479	161
Return on revenue (%)	26.6	(17.2)
Return on shareholders' equity (reported) (%)	18.8	1.3
P/C net combined ratio (%)	79.7	128.6
P/C net expense ratio (%)	27.3	28.5
Net investment yield (%)	1.8	1.7
Net investment yield including investment gains/(losses) (%)	13.3	(2.0)

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bbb	bb-/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bbb	bb+/bb	bb-/b+
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bbb	bbb-/bbb	bb+/bb	bb-/b+
Weak	bbb+/bbb	bbb/bbb-	bbb-/bbb	bbb+/bbb	bbb/bbb-	bbb-/bbb	bb+/bb	bb-/b+
Vulnerable	bbb-/bbb	bbb/bbb-	bbb-/bbb	bbb+/bbb	bbb/bbb-	bbb-/bbb	bb+/bb	bb-/b+

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of November 9, 2020)*

Operating Companies Covered By This Report

Ratings Detail (As Of November 9, 2020)*(cont.)

Factory Mutual Insurance Co.

Financial Strength Rating

Local Currency

A+/Stable/--

Issuer 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/--

FM Insurance Europe S A

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.

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