

Excerpt: **Executive Message**



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## EXECUTIVE MESSAGE ▾

The year 2008 was extraordinary by any measure. Politically and economically, we saw unprecedented events that included dramatic financial market upheaval, more frequent natural disasters, and increased severity in risk losses.

Amid these extreme and volatile influences, we continued to offer stable capacity and services worldwide, followed through on our fourth (and first consecutive) membership credit to our mutual policyholders (US\$360 million in 2008, for a total of US\$1.3 billion since 2001), and finished the year in a strong liquidity position. Net income from operations was US\$308 million before realized investment losses and income taxes. However, despite an investment strategy that avoids securities generally categorized as “toxic,” our investment portfolio was not impervious to the financial market downturn, incurring approximately US\$1.8 billion of pretax unrealized losses. Of this amount, due to accounting requirements (Statement of Financial Accounting Standards [SFAS] No. 115) for other-than-temporarily impaired assets (OTTI), US\$800 million will be reflected in our consolidated statements of operations as a realized loss, resulting in a net loss of US\$318 million in 2008. Our surplus also declined by US\$1.6 billion to US\$4.6 billion, due to financial market impact on our investment portfolio and pension plan assets, and due to the strength of the U.S. dollar.

### Review of 2008

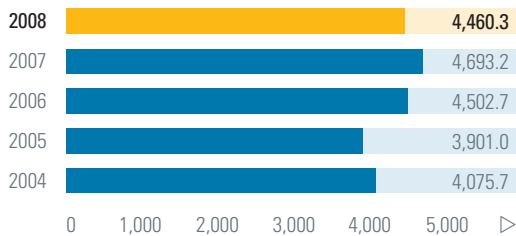
In 2008, as anticipated, we faced a competitive market driven by extremely profitable industry underwriting results in 2006 and 2007, coupled with strong investment returns.

Price levels dipped, and we expanded our underwriting coverage and capacity worldwide. At the same time, frequency and severity of natural disaster losses increased to levels not seen since 2005, and risk losses reached an all-time high—a combination that led to higher loss ratios overall. Our approach has been to stay competitive, improve and enhance products and services, and collaborate with our policyholders to understand the hazards that threaten their facilities. Together, we’ve taken measurable steps to improve their risk profiles to ensure business continuity.

As our clients continue to expand their operations globally and look for efficiencies in their production and distribution channels, supply chains are becoming increasingly complex, creating interdependencies that are as daunting as they are vast. Reliance on these supply chains has become a vital business strategy, significantly increasing our clients’ exposure to business

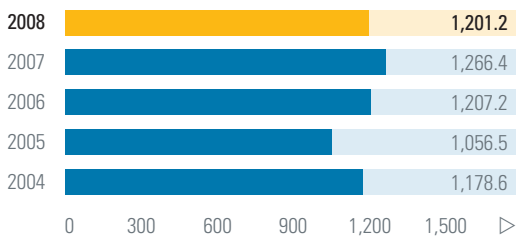
### TOTAL GROSS PREMIUM in force

in US\$ millions

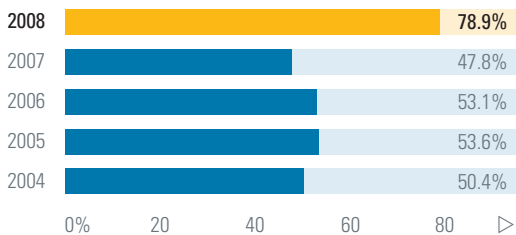


### NON-NORTH AMERICA GROSS PREMIUM in force

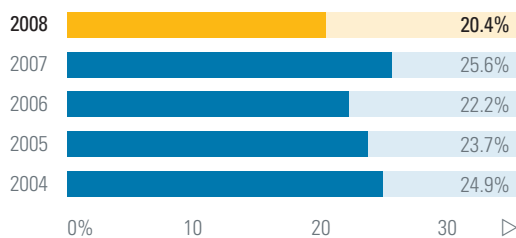
in US\$ millions



### LOSS RATIO



### EXPENSE RATIO



interruption. In response, we enhanced our risk-transfer products (including supply chain coverage) and risk-assessment services to match their evolving needs.

We also improved our performance in the delivery of insurance products. Some 93 percent of our policies were delivered within 30 days of inception. And, more than 54 percent of all policies were delivered before the policy's inception date.

To better facilitate our policyholder interaction, we strengthened the capabilities of *MyRisk*<sup>®</sup>, our secure client extranet. Originally, *MyRisk* was developed as a way for our clients to access their location-specific engineering data and reports. Over the next several years, we are expanding its scope to encompass all facets of policyholder services. Features and functionality added in 2008 include the ability to view policies and claims history, download facility sketches, and access more detailed location-specific engineering data and risk management information to support risk improvement decision-making.

Our policyholders continued to expand beyond their domestic markets, and, as part of their international growth activities, have often acquired properties with inferior or substandard protection. This growth has led to greater demand for our products and services globally, and to corresponding increases in the frequency and severity of losses outside North America.

We are following two paths simultaneously to meet this critical challenge. First, we continue to hire and train engineering staff outside North America, acquire licenses to broaden our international scope of activities, and invest in developing a single global service platform.

The second path is to accelerate our understanding of the evolving hazards facing our policyholders, and to develop engineering solutions to mitigate those hazards. To that end, we are in the process of dramatically increasing the capabilities of our Research Campus by doubling the testing capacity of our large-burn laboratory, and building a dedicated laboratory to examine the effects of natural hazards (wind, hail, flood and

earthquake). These actions will enable us to better assess risk and work with manufacturers of products that help prevent and/or control property loss on a global basis. Meanwhile, to help advance the science and practice of loss prevention worldwide, we are openly sharing more of our research and knowledge in the public arena.

### *Premium Trends*

As 2008 progressed, the marketplace became increasingly competitive across all our major product lines—FM Global, Affiliated FM and Mutual Boiler Re—and across all our territories. In addition, as in 2007, market opportunities in Europe continued to prove challenging.

Overall, gross premium in force fell by 5 percent to US\$4.5 billion, with most of the reduction attributed to the stronger U.S. dollar in the second half of 2008. Specifically, FM Global lines of business dropped by 6 percent, and Affiliated FM by 2.1 percent. Premium on existing business fell by 10.1 percent, due to reduced price levels and the strong U.S. dollar. Client retention remained at historically high levels. Again, the resiliency of our business model, stable capacity and value-added services on a global basis, together with our mutual structure, has resonated with our policyholders. The 2008 membership credit of US\$360 million—11 percent of our premium—reaffirmed the benefits of being an FM Global client on a long-term basis.

### *Loss Ratio Trends*

The 2008 loss ratio jumped to 78.9 percent from 47.8 percent in 2007. The 2008 loss ratio was adversely affected by increased frequency and severity of both natural hazard and risk losses over 2007 levels. The year 2008 can best be described as a period with many medium-size natural disasters. Our loss ratio from natural disasters was 20.3 percent compared with 8.6 percent in 2007. In 2008, we witnessed damaging snowstorms in eastern Canada; destructive tornadoes, floods and Hurricane Ike (the third most costly hurricane on record) in the United States; and

a devastating earthquake in China. Over the last five years, the loss ratio from natural disasters has averaged 13.1 percent, ranging from a low of 4.2 percent to a high of 22.2 percent. As in the past, with each of these events, our policyholders benefited from our risk assessment expertise, risk improvement strategies and pre-event planning services, which reduced the physical and financial impact of their losses.

Risk losses rose to 54.1 percent from 34.5 percent in 2007. This was our highest risk loss ratio in the last five years. Again, as in the past, the frequency and severity of losses from poorly protected facilities, especially those lacking sprinkler protection, was the principal driver, combined with an increase in machinery and equipment breakdown. Our major challenge continues to be achieving risk improvement at substandard, unprotected locations at a faster and more effective rate than our policyholders' acquisition of these facilities.

### *Expense Ratio*

Our expense ratio was 20.4 percent versus 25.6 percent in 2007, benefiting from the strong U.S. dollar. Adjusting for currency strengthening, our expense ratio was slightly higher than in 2007.

### *Employee Trends*

As with any service organization, our expenses are driven by the need to maintain a well-trained and productive group of employees. Our insurance-based staffing increased by approximately 3 percent. This growth was driven predominantly by our expanding global reach, in support of our policyholders as they expanded their global operations. A key organizational strength is our specialized knowledge, and, to ensure effective knowledge-transfer, our staffing strategy focuses on developing and retaining long-term employees. Today, our average employee tenure is 14 years, and the current turnover rate is 7.4 percent compared with 8.8 percent in 2007. We view these results as a strong employee commitment to FM Global and our business model.

### *Investments and Surplus*

Like any institution or organization that held financial assets, we were affected dramatically by the worldwide meltdown in financial markets. At the start of 2008, we held approximately 50 percent of our invested assets in equities, which dropped to 39 percent at the end of 2008, principally because of the reduction in market values. The S&P 500 lost 38.5 percent of its value, and our results were similar. Our investments are very marketable securities and are marked to market. We remain very liquid, with our short-term portfolio valued in excess of US\$900 million—almost twice our historical levels. In addition, we have no outstanding debt, thereby eliminating any additional exposures to an illiquid marketplace.

As referenced earlier, our surplus declined by US\$1.6 billion. Despite this reduction, our surplus can comfortably support all the insurance exposures we underwrite and accept. We are very pleased that A.M. Best has reaffirmed our A+ (Superior) rating with a stable outlook.

### *Mutual Company Governance and Senior Management Changes*

Our board of directors, eight regional advisory boards and five risk management executive councils are a very important part of our mutual company governance. We are deeply grateful for their guidance and involvement.

*William A. Roper Jr.* resigned from our board, and we thank him for his participation and support.

*Brian J. Hurley*, executive vice president of FM Global, retired after 37 years of dedicated and loyal service. His leadership and counsel will be missed.

*Ruud H. Bosman* was elected a director and vice chairman of FM Global. In addition, *Jonathan W. Hall* and *Thomas A. Lawson* were elected executive vice presidents.

### *Looking Ahead to 2009*

We believe 2009 will be a challenging year for our clients and for FM Global. The reduction in insurance and reinsurance industry capital will impact pricing and availability of underwriting capacity. Additionally, the increase in risk and natural catastrophe losses reinforces our commitment to working with our clients on their risk improvement priorities in a shared effort to reduce the impact of loss events on their facilities. We believe the business continuity preserved by these actions is especially important in these difficult economic times.

On a final note, our mutual structure allows us to maintain a confident and optimistic outlook. We can responsibly and patiently work with our policyholders to successfully navigate through these difficult times. We have all the right tools, a very committed and professional workforce, a proven long-term working relationship with our clients, a unique product that creates value, and a very solid balance sheet.



**Shivan S. Subramaniam**

Chairman and Chief Executive Officer

**Ruud H. Bosman**

Vice Chairman