

Rating Report

**Factory Mutual Insurance
Company**
And Subsidiaries

Ratings

Insurer Financial Strength..... AA

Rating Outlook

Stable

Subsidiary Ratings

Affiliated FM Insurance Co.

Appalachian Insurance Co.

FM Insurance Company, Ltd.

Insurer Financial Strength..... AA

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■ **Summary Rationale**

Fitch Ratings' very strong ratings on Factory Mutual Insurance Company (Factory Mutual) reflect the company's strong competitive position in the market for highly protected risks, engineering and underwriting expertise, and solid balance sheet.

Fitch's ratings on Factory Mutual's subsidiaries, Affiliated FM Insurance Company (Affiliated FM), Appalachian Insurance Company (Appalachian) and the U.K.-domiciled FM Insurance Company, Ltd. (FM Insurance), reflect explicit and implicit financial support from Factory Mutual. Affiliated FM and Appalachian participate in a reinsurance pooling agreement with Factory Mutual, and a policy-level guaranty exists between FM Insurance and Factory Mutual.

Fitch evaluates FM Global's underwriting results on a cumulative basis over three-to-five-year periods because of the year-to-year volatility inherent in insuring large-limit commercial property risks. The company's cumulative three- and five-year calendar-year combined ratios on a statutory basis through year-end 2006 were 75.2% and 72.8%, respectively, which Fitch considers to be very strong.

Further, Fitch believes FM Global has the ability to mitigate and absorb volatility inherent in its underwriting and investment strategy due to the collective effect of the company's recent strong underwriting performance and internal surplus formation along with its historically solid reinsurance protection. Fitch believes that these factors contributed to the overall favorable results of a stress-test it conducted on FM Global's surplus under which it assumed events such as a 20% decline in equity market values and catastrophe-related losses well in excess of that incurred by the company since its merger-related formation in 1999.

■ **Rating Expectations**

Fitch's Stable Rating Outlook reflects its belief that FM Global will continue to generate favorable underwriting results and continue to build surplus, albeit perhaps not at the very strong recent levels. While Fitch believes that the company's cumulative combined ratios may increase slightly in the next few years, its expectation is that they will continue to be better than the company's peers.

■ **Company Description**

Factory Mutual is a mutual insurance company that specializes in providing engineered loss-prevention services and high-limit commercial property coverage to its member clients. Fitch believes that the company has a strong and unique franchise largely derived from its engineering capabilities. The organization employs more than 1,600 engineers who are engaged in a wide variety of roles. Fitch considers FM Global the industry leader in incorporating engineering expertise into insurance products and underwriting processes.

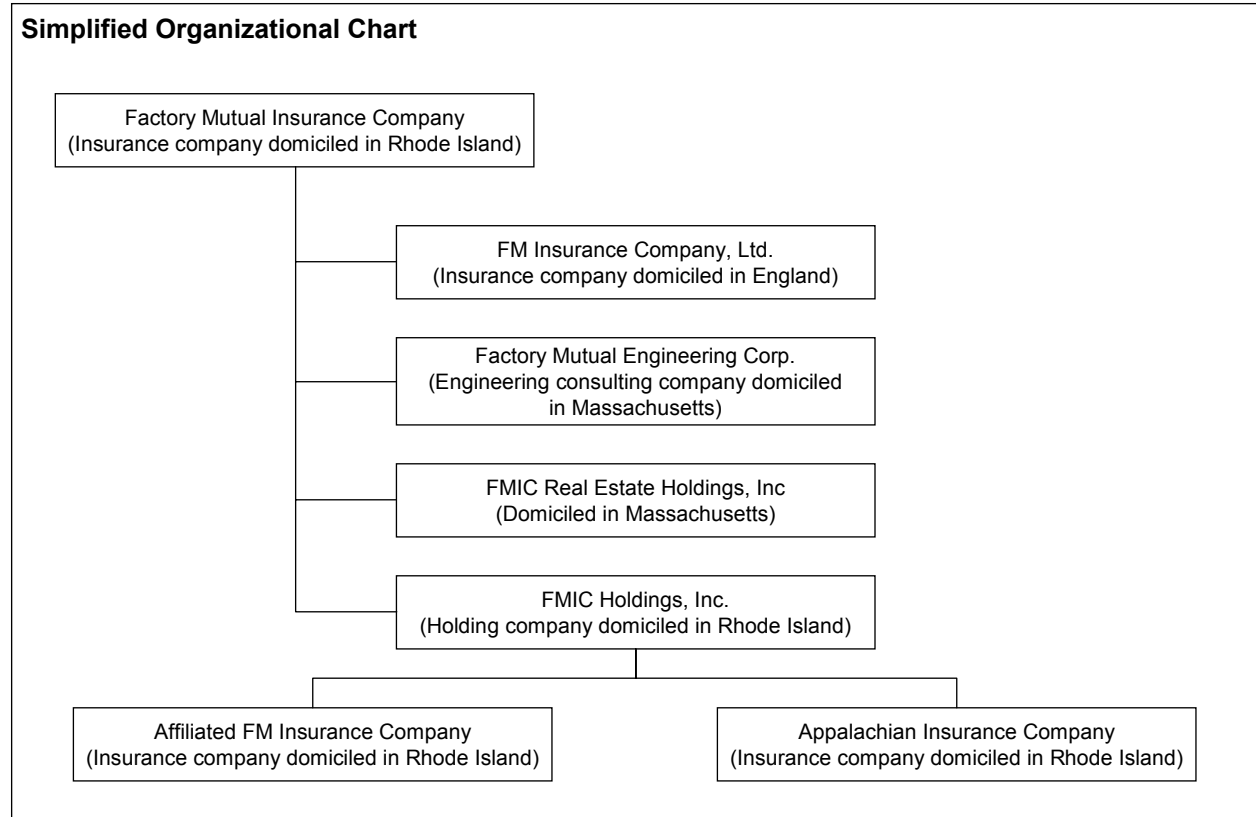
Additionally, Fitch believes that the company's mutual company status insulates it somewhat from concerns about volatility in short-term financial results. Fitch believes that these factors contribute to the company's ability and willingness to consistently provide large-limit capacity throughout changes in cyclical market conditions. Fitch views this ability and willingness as key competitive advantages.

The company's primary domestic insurance subsidiaries are Affiliated FM and Appalachian. The organization conducts operations internationally

through its U.K.-domiciled subsidiary, FM Insurance Company, Ltd. (FMI), which has branch offices worldwide.

In 2006, approximately 65% of the organization's premiums written was derived from insured property in the United States and 35% was derived from insured property outside the United States. The organization's market penetration is lower internationally than it is domestically and in 2005 revenue and earnings growth of the international business outpaced that of the domestic business. However, given the market disruptions caused by the 2005 hurricanes and weak international pricing, this trend reversed with better domestic opportunities for Factory Mutual in 2006 and will most likely continue into 2007.

Affiliated FM writes its own new and renewal business for smaller middle-market clients, while Appalachian assumes business under an intercompany reinsurance pooling agreement. Terms of the intercompany agreement call for premiums, losses, loss-adjustment expenses and underwriting expenses to be shared among the three companies based on their relative contribution to combined



Product Profile

	Products					
	Special Property	Special Liability	Commercial Multiperil	Reinsurance	Product Liability	Other Liability
Markets						
Large Commercial	X	X	X			
Fortune 500	X	X	X			
Fortune 1000	X	X	X			
Financial Data (\$ Mil.)						
NPW	2,174	436	37	0	0	0
— % of Total	82	16	1	0	0	0
Net Reserves	1,374	212	9	382	143	139
— % of Total	60	9	0	17	6	6
Distribution						
Direct	X	X	X			
Retail Brokerage	X	X	X			

NPW – Net premiums written.

surplus. Factory Mutual’s pooling percentage is 86%, Affiliated FM’s is 12% and Appalachian’s is 2%. Fitch has used a group rating approach to refer financial strength from Factory Mutual to Affiliated FM and Appalachian because of the pooling agreement.

FMI primarily writes property insurance and, like its U.S.-based parent, focuses on providing comprehensive commercial property coverage that requires significant engineering expertise.

Fitch’s rating on FMI reflects support provided by Factory Mutual in the form of a policy level guaranty and reinsurance contracts between the two companies. The rating also reflects Fitch’s view that FMI is a core component of the organization’s strategy of providing engineered loss-prevention services and insurance coverage on a global basis.

Throughout the remainder of this report, Fitch refers to Factory Mutual, Affiliated FM, Appalachian and FMI collectively as FM Global. Data shown throughout the report is taken from the combined Factory Mutual Insurance Company & Affiliates statutory annual statement unless otherwise noted.

FM Global was formed in mid-1999 through the merger of Allendale Mutual Insurance Company, Protection Mutual Insurance Company and Arkwright Mutual Insurance Company. Prior to the merger, these companies shared an engineering research facility and participated in various reinsurance agreements with one another.

The company has an 11-member board of directors that are elected by policyholders for three-year terms. Ten of the current directors are currently affiliated with FM Global policyholders. The chairman of the board also serves as FM Global’s chief executive officer.

Fitch believes that there is a high degree of operating risk associated with FM Global’s products because of the extensive engineering and loss-prevention services underlying the products and their underwriting. However, in comparison to other companies that write commodity-like products, Fitch believes that FM Global faces less transaction-oriented operating risk.

FM Global’s products provide large-limit property insurance to commercial entities. The company’s policies generally provide protection against property losses including losses caused by fires and plant explosions and natural catastrophes such as hurricanes and earthquakes. The company also writes specialized lines of coverage that protect against equipment and machinery failures and corresponding business interruption losses.

Fitch believes that FM Global’s target market generates comparatively little operating risk for the company. These markets typically require a high degree of loss-prevention services and consistent large-limit capacity. As a result, Fitch believes that FM Global’s target market provides the company with “stickier” business that is somewhat less price sensitive than more commodity-oriented commercial line markets.

Individual Company Data

(\$ Mil.)

Company	State or Country of Domicile	Country or States Licensed In	2006			NAIC RBC Ratio
			Net Premium Written	Surplus/ Shareholder Funds	Total Assets	
Factory Mutual Insurance Company	Rhode Island	50 United States, Canada	2,450	5,017	9,585	379
Affiliated FM Insurance Company	Rhode Island	50 United States, Canada	347	572	1,278	522
Appalachian Insurance Company	Rhode Island	Rhode Island. Operates on a surplus lines basis in other states.	54	100	199	343
FM Insurance Company, Ltd.	United Kingdom	European Union, Australia, Singapore	238	299	1,682	N.A.
Total			3,089	5,988	12,744	N.A.

NAIC – National Association of Insurance Commissioners. RBC – Risk-based capital. N.A. – Not applicable. Note: Statutory accounting principles except for FM Insurance Company, Ltd., which is based on U.K. accounting principles. FM Insurance Company, Ltd. data was translated from U.K. pounds into U.S. dollars based on an exchange rate of 1 pound = \$1.96. Source: Individual company statements.

FM Global's target markets include industrial properties such as pulp and paper plants, chemical plants, and other manufacturing and warehousing facilities. These properties typically have large loss exposures, and policies covering these properties often have high loss limits and high policy deductibles.

FM Global is the largest writer of insurance for boiler and machinery as well as fire and allied lines in the United States. The company has roughly 5,700 policyholders worldwide and insures approximately 35% and 20% of the Fortune 1000 and Global Fortune 500 companies, respectively.

Fitch believes that FM Global's distribution methods generate comparatively little operating risk. The company uses direct distribution to market its products, and Fitch believes that this provides the company with a high degree of cost-effective operational control over its distribution. FM Global also relies on brokers to source its business and this distribution channel presents more operating risk for

the company because of the relative lack of control. The operations staff is composed of engineers and underwriters, and its members complement the company's distribution channels and have a significant amount of client interaction.

■ **Financial Analysis**

Profitability

Unlike many of its competitors, FM Global's recent operating performance has been very strong despite catastrophe losses, reflecting the company's underwriting expertise, expense efficiencies and generally favorable market conditions. However, Fitch believes that there is a significant amount of inherent volatility in FM Global's year-to-year operating performance because of the company's large book of property insurance and its corresponding exposure to both natural and manmade catastrophe-related losses.

Given this potential volatility, Fitch believes that FM Global's underwriting results are best viewed on a

Operating Performance

(\$ Mil.)

	2006*	2005	2004	2003	2002
Net Premium Written Excluding Membership Credit	2,851	2,648	2,285	2,678	2,242
% Change in Net Premium Written Excluding Membership Credit	7.7	15.9	(14.7)	19.4	93.6
Membership Credit	—	16	316	—	—
Net Premiums Earned Net of Membership Credit	2,719	2,601	2,334	2,549	1,823
Net Underwriting Gain	666	589	609	827	426
Net Investment Income	219	177	166	140	124
Operating Income	884	767	771	972	550
Realized Gains	99	74	57	22	(125)
Policyholders' Dividends	0	0	0	0	0
Income Taxes	299	236	273	318	190
Net Income	684	605	555	676	234

*Fitch's estimate based on individual company data. Note: Statutory accounting principles. Source: Factory Mutual Insurance Company & Affiliates.

Reported and Cumulative Combined Ratios

(%)

	2006*	2005	2004	2003	2002	2001	2000	1999
Reported	74.4	76.9	74.5	66.5	72.1	112.9	98.8	166.7
Cumulative 2000–2006	77.6	78.3	78.7	80.4	89.7	106.4	98.8	—
Cumulative 2002–2006	72.8	72.3	70.6	68.7	72.1	—	—	—
Cumulative 2004–2006	75.2	75.7	74.5	—	—	—	—	—

*Fitch's estimate based on individual company data. 2001 Reported Combined Ratio and 2001 and subsequent Cumulative Combined Ratios exclude 2001's \$237 million membership credit. 2004 Reported Combined Ratio and 2004 Cumulative Combined Ratios include 2004's \$316 million membership credit. Note: Statutory accounting principles. Source: Factory Mutual Insurance Company & Affiliates.

cumulative basis over a relatively long time horizon. The Reported and Cumulative Combined Ratios table above shows the company's reported annual combined ratios for the 1999–2006 period, as well as three-, five- and seven-year cumulative combined ratios.

Fitch views the cumulative combined ratios for the 2000–2006 period as the most representative of FM Global's underwriting performance primarily because the merger that formed FM Global did not close until mid-1999 and the company was not able to implement uniform underwriting standards and procedures until after the close.

FM Global's 2006 GAAP basis pretax operating income and net income were \$973 million and \$737 million, respectively. These results reflect benign catastrophe losses partially offset by an increase in other losses as a result of the company's decision to purchase less facultative reinsurance.

From 1999 through 2005, natural catastrophe losses and losses from the events of Sept. 11, 2001, contributed an average of 17 points annually to FM Global's combined ratio. In 2005 the company had \$613 million of net catastrophe losses, including \$509 million related to Hurricanes Katrina, Rita and Wilma. The company's 2004 results included \$256 million of net catastrophe losses, \$93 million of which resulted from the hurricanes that struck the Southeastern United States in the third quarter of 2004.

FM Global conducts on-site loss-prevention and engineering reviews on the majority of its policyholder sites, and Fitch believes that these reviews have a significant positive effect on the company's underwriting results. Additionally, Fitch believes that FM Global's strong underwriting results are due in part to the extensive engineering and loss-prevention studies the company conducts at its state-of-the-art engineering test facility. Fitch views FM Global's ability to conduct these studies and the insights they bring to the company's underwriting processes as key competitive advantages.

Commercial line premium rates began to come under pressure in the second half of 2004, and Fitch expects this pressure to have a modest negative effect on FM Global's premium revenues going forward. Fitch anticipates that this effect will be somewhat muted by the company's focus on accounts that require extensive engineering and loss-prevention services in addition to insurance coverage. Additionally, Fitch believes the company's use of membership credits have helped retention.

FM Global has paid three membership credits to policyholders since 2001, including \$237 million in 2001 and \$316 million in 2004 as well as \$355 million to be paid in 2007. Fitch's expectation is that the company will continue to pay membership credits in the future depending on a variety of factors including the company's underwriting trends, surplus levels and market conditions. Fitch viewed the 2001

Operating and Underwriting Ratios

(%)

	2006*	2005	2004	2003	2002
Return on Assets	9.6	9.6	10.9	16.2	11.2
Return on Surplus	14.8	15.6	17.4	28.4	12.6
Loss Ratio	51.3	53.4	48.5	44.3	52.4
Expense Ratio	23.1	23.6	25.9	22.2	19.7
Combined Ratio	74.4	76.9	74.5	66.5	72.1

*Fitch's estimate based on individual company data. Note: Statutory accounting principles. Source: Factory Mutual Insurance Company & Affiliates.

Asset Portfolio

(%)

	2006*	2005	2004	2003	2002
Bonds	38.1	38.5	39.4	40.6	43.7
Preferred Stock	0.0	0.0	0.0	0.0	0.0
Common Stock	48.0	45.9	44.2	38.0	30.2
Mortgages	0.0	0.0	0.0	0.0	0.0
Real Estate	0.0	0.0	0.0	0.0	0.0
Cash and Short-Term	6.0	8.0	8.6	13.7	19.3
Affiliated	5.9	6.2	6.3	5.6	5.5
Other	1.9	7.5	1.5	2.2	1.3
Total Investments (\$ Mil.)	8,908	7,723	6,747	5,790	4,577

*Fitch's estimate based on individual company data. Note: Statutory accounting principles. Source: Factory Mutual Insurance Company & Affiliates.

membership credit as more “one-time” in nature because it was intended to compensate policyholders for expense savings the company recognized after completing its 1999 merger. Fitch views the 2004 and 2007 membership credits as akin to a policyholder dividend to compensate insureds for lower than expected losses.

Investments/Liquidity

Fitch believes that FM Global has a high-quality investment portfolio and that the company has adequate liquidity. The company's investment portfolio is managed on a total-return basis with a long-term investment horizon.

FM Global invests in fixed-income securities to support the relatively short-duration liabilities generated by its property insurance reserves. The company invests in equity securities primarily to support its surplus. As a result, FM Global is significantly overweighted in equity investments relative to the industry. At Dec. 31, 2006, Fitch estimates FM Global's surplus exposure to unaffiliated equities was approximately 85% compared to the industry average of 34%. Fitch's expectation is that the company will remain overweighted in equities relative to the industry.

Fitch believes that FM Global's higher than industry average allocation to equities is reasonable, since the company's strong surplus position and relatively predictable reserves enable it to adopt a long-term investment horizon and since it takes very little credit risk in its bond portfolio. However, Fitch also recognizes that the equity portfolio, which has a high correlation to the S&P 500 Index, adds to FM Global's surplus volatility. The company did not have any significant hedges in place at year-end 2006 to protect the value of its equity portfolio, although in the past it has used futures and options contracts to hedge this risk, and Fitch anticipates that FM Global may implement hedging strategies in the future depending on its market expectations.

FM Global has a high-quality and liquid fixed-income portfolio. At Dec. 31, 2006, approximately 98% of the portfolio consisted of publicly traded investment-grade bonds, which translates into statutory surplus exposure to below-investment-grade bonds of 2%.

Fitch believes that FM Global has an adequate liquidity profile that is supported by the company's investment portfolio. Due to the nature of the

Liquidity

(%)

	2006*	2005	2004	2003	2002
Public Bonds/Total Bonds	97.6	97.6	98.6	98.0	99.0
Total Investment-Grade Public Bonds/Total Public Bonds	97.9	96.5	97.0	96.3	96.8
Below-Investment-Grade Public Bonds/Total Public Bonds	2.1	3.5	3.0	3.7	3.2
Liquid Assets to Liabilities	170.8	169.2	164.5	149.4	135.6
Cash Inflows (\$Mil.)	3,095	2,743	2,476	2,637	2,426
Cash Outflows (\$ Mil)	2,323	1,954	1,757	1,807	1,219
Cash Flow Ratio	133.2	140.4	141.0	146.0	199.0

*Fitch's estimate based on individual company data. Notes: Statutory accounting principles. 2003 figures for cash flows are not directly comparable to 2002 and prior figures due to changes in the NAIC annual statement. Source: Factory Mutual Insurance Company & Affiliates.

Reserves

(\$ Mil.)

	2006*	2005	2004	2003	2002
Loss Reserves	2,188	2,116	1,817	1,684	1,336
Loss Adjustment Expense Reserves	186	167	154	122	109
Asbestos and Discontinued Lines Reserves Adverse Development	150	—	190	175	120
Other Adverse (Favorable) Reserve Development	(93)	(209)	(45)	15	170
Adverse (Favorable) Reserve Development/Premiums Earned (%)	2.1	(8.0)	6.2	7.5	15.9
Adverse (Favorable) Reserve Development/Policyholder Surplus (%)	1.1	(5.9)	5.1	9.8	16.3

*Fitch's estimate based on individual company data. Note: Statutory accounting principles. Source: Factory Mutual Insurance Company & Affiliates.

company's insureds and the high-limit policies the company writes, FM Global's operating cash flow can be volatile, although recent operating cash flow has been strong due to the company's favorable underwriting results.

Reserves

Fitch believes that FM Global's loss reserves are adequate and that the company follows a disciplined approach when establishing reserves. Fitch also believes that the relatively short duration of FM Global's reserves reduces reserve uncertainty. The vast majority of the company's loss reserves tend to develop into paid losses within three years.

Fitch uses a reserve adequacy model and reported paid loss and incurred loss data from Schedule P data to estimate ultimate accident-year losses and required accident-year reserves. Fitch views its model as a tool to project directional indicators of possible outcomes rather than precise predictions and believes that the model provides a reasonable basis for assessing reserve adequacy. Using FM Global's year-end 2005 data, Fitch's model estimates an immaterial deficiency using paid loss data and an immaterial redundancy using the case-incurred data.

Fitch notes that FM Global experienced adverse reserve development in four of the last five years but was still able to produce strong calendar-year underwriting results. As seen in the Reserves table above, development on asbestos-related reserves and reserves for discontinued business lines generated the majority of this adverse development. Since 2004 the company has posted favorable development relating to its continuing operations.

Fitch believes that FM Global's reserves for asbestos-related claims are among the strongest in the industry and that unlike many of its peers, FM Global has been able to bolster its asbestos reserves while still generating strong calendar-year profitability. The

company's gross and net survival ratios based on three-year average paid asbestos losses were 11.7 times (x) and 20.0x, respectively, at year-end 2006. Fitch believes that FM Global is solidly reserved for environmental claims. At year-end 2006, the company's gross and net survival ratios based on three-year paid losses were 13.3x and 32.1x, respectively.

Reinsurance

Fitch believes that FM Global's reinsurance programs provide adequate protection against the large losses the company can face and that the credit quality of the company's reinsurers is good.

FM Global has a significant amount of exposure to natural and manmade catastrophic losses from its large book of property insurance. As a result, Fitch believes that reinsurance is a very important component of FM Global's risk management process.

FM Global evaluates its reinsurance needs on an individual-location basis and purchases facultative reinsurance on specific lines of business and when policyholders request coverage limits that generate concentration risks that it is unwilling to accept. The company uses modeling software commonly used in the insurance industry to estimate its losses from potential catastrophes and to manage its aggregate exposures.

FM Global uses vendor-produced models to simulate natural catastrophes and their affect on the company's insured exposures and to estimate potential losses. Fitch believes that the quality and resolution of exposure data used in these simulations is a key factor in the models' effectiveness. Fitch also believes that the quality of the data FM Global uses in these processes is enhanced by the engineering inspections it does at its insured properties.

Reinsurance Recoverables

(\$ Mil.)

	2005	2004	2003	2002	2001
Paid Losses	134	187	191	162	222
Unpaid Losses	1,064	456	574	1,088	1,440
Incurred But Not Reported Losses	521	642	437	299	188
Unearned Premium	287	297	318	363	221
Total Recoverable	2,006	1,582	1,520	1,912	2,071
Affiliates	10	8	10	20	28
Pools and Associations	422	474	388	234	208
Net Recoverables	1,574	1,099	1,122	1,658	1,834
Total Recoverables/Policyholder Surplus (%)	47.7	44.8	53.6	98.9	116.2
Net Recoverables/Policyholder Surplus (%)	37.4	31.1	39.6	85.8	102.9
Provision for Reinsurance	25	25	26	29	34
Total Recoverables/(PHS + Provision for Re) (%)	47.4	44.4	53.1	97.4	114.1
Net Recoverables/(PHS + Provision for Re) (%)	37.2	30.9	39.2	84.5	101.0

PHS – Policyholder surplus. Note: Statutory accounting principles. Source: Factory Mutual Insurance Company & Affiliates.

FM Global's excess-of-loss reinsurance program consists of a per-risk program and a catastrophe program. The per-risk program provides the company with coverage on losses in excess of \$100 million and the company's catastrophe reinsurance program provides coverage on losses in excess of \$175 million. Additionally, the company purchased a second event cover in 2006.

FM Global uses a diverse mix of financially sound reinsurers, and thus Fitch believes that the overall credit quality of the company's reinsurance recoverable is strong. FM Global's largest reinsurance recoverable is from Mutual Marine Insurance, Inc. (MMI). This recoverable is derived from a discontinued book of marine business where MMI acted as the underwriting manager for a group

of companies. FM Global effectively wrote the business on a direct basis and then ceded the portion in excess of its pool participation to these pool participants.

At year-end 2006, approximately 86% of the company's reinsurance recoverable on paid losses was current. In addition, approximately 5% of the amounts past due were less than 90 days past due.

In addition to the company's traditional reinsurance program, FM Global accessed the capital markets in June 2005 and again in August 2006 by sponsoring two \$300 million catastrophe bonds, Cascadia Limited (Cascadia) and Cascadia Limited II (Cascadia II). Both contracts provide that FM Global will receive specified payments if earthquakes of

15 Largest Reinsurance Recoverables at Year-End 2005

(\$000)

Reinsurer Group Name	Recoverable	Collateral	Net Recoverable
Mutual Marine Office Inc.	363,304	199,658	163,646
Lloyd's of London	294,899	11	294,888
XL Capital Group	92,659	32,901	63,177
Endurance Group	80,454	26,295	54,163
Aspen Insurance Ltd.	79,708	35,275	48,949
Berkshire Hathaway Group	77,911	297	77,614
Everest Re Group	69,276	0	69,276
GE Global Insurance Group	59,249	4,236	55,166
Hannover Group	54,510	4,373	50,819
ECRA Pool	46,940	0	46,940
ACE Ltd. Group	38,087	1,713	36,387
Munich Re/American Re Group	36,426	1,116	35,763
The Hartford	34,923	0	34,923
Montpelier Re Holdings Ltd	34,208	38,578	0
Allstate Group	33,456	0	33,456
Total Largest 15 Recoverables	1,396,010	344,453	1,065,167

Source: Schedule F.com.

various magnitudes occur in the Pacific Northwest portion of the United States or in portions of British Columbia. Cascadia matures in 2008 and Cascadia II matures in 2009.

Fitch views positively FM Global's use of catastrophe bonds. Catastrophe bonds provide sponsors with multi-year protection as well as minimal credit risk and increased liquidity should the covered peril occur.

Statutory Capitalization

FM Global has a solid capital position characterized by good risk-based capitalization and an appropriate amount of operating leverage partially offset by higher than industry average surplus exposure to equities. Due to the high-severity events the company insures and its corresponding inherently volatile operating results, Fitch considers FM Global's strong capitalization a key factor supporting its rating.

Fitch believes that the company's loss reserves are adequate and that its reinsurers' credit quality is strong. As a result, they pose comparatively little risk to FM Global's capitalization. In contrast, Fitch believes that the company's surplus has significant exposure to equity market volatility due to the company's higher than industry average allocation to equity investments.

The results of a stress-test scenario on FM Global's year-end 2006 surplus are shown in the Stress-Tested

Stress-Tested Capital

(\$ Mil.)

Dec. 31, 2006 Surplus	5,018
Year-End 2006 Authorized Control Level Surplus	662
Risk-Based Capital Ratio (%)	379
	Net
Projected After-Tax Underwriting Gain (based on 35% tax rate; includes \$300 million of after-tax catastrophe losses)	407
Projected After-Tax Investment Income from Fixed Income Portfolio	157
After-Tax Equity Portfolio Losses from 20% Decline in Global Stock Markets	553
Net After-Tax Losses from Two 250-Year Events	368
After-Tax Terrorism Losses Under TRIA Retention	331
Stress-Tested Surplus	4,330
Year-End 2006 Authorized Control Level Surplus	662
Stress-Tested Risk-Based Capital Ratio (%)	327

TRIA – Terrorism Risk Insurance Extension Act of 2005. Sources: Factory Mutual Insurance Company & Affiliates, Fitch Ratings.

Capital table below. Fitch considers this to be a very severe stress test and views its effect on the company's surplus as significant but not outside Fitch's tolerance for an 'AA'-rated company. The after-tax effect of the following issues on FM Global's year-end 2006 surplus are included in the stress test:

- A year's worth of run-rate underwriting income and investment income.
- A 20% decline in worldwide equity markets.
- Losses from two catastrophic events, each with a 0.4% probability of occurring.
- Full retention terrorism losses under the Terrorism Risk Insurance Extension Act of 2005 (TRIA).

FM Global manages its capital by examining catastrophe exposure using a deterministic approach relative to capital and by evaluating growth in total insured values (TIV) relative to growth in surplus.

The company uses location-based insured data to determine its exposure in catastrophe-prone areas. As such, the company performs a ground-up analysis and does not rely on catastrophe model simulations to determine its potential shock losses.

FM Global continues to use a reasonable amount of operating leverage. Fitch notes that the company's operating leverage ratios have steadily declined over the past five years as growth in surplus has outpaced growth in premiums. At Dec. 31, 2006, the company's ratio of net premiums written to statutory surplus was 0.57x.

FM Global's year-end 2006 NAIC risk-based capital (RBC) ratio was 379%. Fitch views the company's RBC ratio as being higher than many comparably rated peers but believes that the ratio generally fails to adequately capture the underwriting volatility inherent in the company's core insurance products.

Downstream subsidiaries of Factory Mutual had \$63 million of mortgage-related debt on their balance sheet at year-end 2006. Fitch's expectation is that the subsidiaries will retire this debt in 2007 and that Factory Mutual will ultimately provide funding for the retirement.

Capitalization

(%)

	2006*	2005	2004	2003	2002
Beginning-of-Period Surplus	4,205	3,534	2,833	1,933	1,781
Net Income	684	605	555	676	234
Unrealized Gains	133	90	135	329	(117)
Paid-in Capital/Surplus	0	0	0	0	0
Dividends to Stockholders	0	(0)	(0)	(0)	0
Other Changes	(4)	(24)	11	(105)	34
Total Changes	813	671	700	900	151
End-of-Period Surplus	5,018	4,205	3,534	2,833	1,933
Dividend Payout (%)	0.0	0.1	0.1	0.0	0.0
Net Premiums Written/Policyholder Surplus (x)	0.57	0.63	0.65	0.95	1.16
Net Leverage (x)	1.53	1.66	1.77	2.28	2.93
Gross Leverage (x)	N.A.	2.28	2.39	3.04	4.35
NAIC Risk-Based Capital Ratio (%)	379	355	341	295	228
Non-Investment-Grade Bonds/Policyholder Surplus (%)	N.A.	3.9	3.2	3.9	4.2
Unaffiliated Common Stock/Policyholder Surplus (%)	85.2	84.3	84.5	77.6	71.4
Investment in Affiliates/Policyholder Surplus (%)	0.0	0.0	0.0	0.0	0.0

*Fitch's estimate based on individual company data. N.A. – Not available. NPW – Net premiums written. NAIC – National Association of Insurance Commissioners. Note: Statutory accounting principles. Source: Factory Mutual Insurance Company & Affiliates.

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