



Annual Report **2016**

BUILDING YOUR COMPETITIVE ADVANTAGE



# FM Global Around the World

FM Global products and services are available around the world.

The countries listed below represent those where we regularly serve our clients.

## Americas

Antigua and Barbuda  
Argentina  
Aruba  
Bahamas  
Barbados  
Bolivia  
Bonaire, St. Eustatius, and Saba  
Brazil  
Canada  
Cayman Islands  
Chile  
Colombia  
Costa Rica  
Curaçao  
Dominica  
Dominican Republic  
Ecuador  
El Salvador  
Grenada  
Guatemala  
Honduras  
Jamaica  
Mexico  
Nicaragua  
Panama  
Paraguay  
Peru  
St. Kitts and Nevis  
St. Lucia  
St. Maarten  
St. Vincent and the Grenadines  
Suriname  
Trinidad and Tobago  
Turks and Caicos Islands  
United States  
Uruguay  
Venezuela

## Europe, Middle East and Africa

Albania  
Algeria  
Angola  
Armenia  
Austria  
Azerbaijan  
Bahrain  
Belgium  
Bosnia and Herzegovina  
Botswana  
Bulgaria  
Burkina Faso  
Cameroon  
Croatia  
Cyprus  
Czech Republic  
Denmark  
Egypt  
Estonia  
Finland  
France  
Gabon  
Georgia  
Germany  
Ghana  
Greece  
Hungary  
Iceland  
Ireland  
Israel  
Italy  
Jordan  
Kazakhstan  
Kenya  
Kuwait  
Kyrgyzstan  
Latvia  
Lebanon  
Liechtenstein  
Lithuania  
Luxembourg  
Macedonia  
Madagascar  
Malta  
Montenegro  
Morocco  
Mozambique  
Namibia  
Netherlands

## Asia/Pacific

Norway  
Oman  
Poland  
Portugal  
Qatar  
Romania  
Russia  
Saudi Arabia  
Senegal  
Serbia  
Slovakia  
Slovenia  
South Africa  
Spain  
Sweden  
Switzerland  
Tanzania  
Tunisia  
Turkey  
Ukraine  
United Arab Emirates  
United Kingdom  
Australia  
Bangladesh  
Brunei  
Cambodia  
China  
Hong Kong  
India  
Indonesia  
Japan  
Laos  
Macau  
Malaysia  
New Zealand  
Pakistan  
Philippines  
Singapore  
South Korea  
Sri Lanka  
Taiwan  
Thailand  
Vietnam

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FM Global is a leading commercial property insurance company that forms long-term partnerships with its clients to support risk management objectives through a unique combination of engineering, underwriting and claims services. We work to ensure our clients’ business continuity by safeguarding their properties with seamless, worldwide coverage and property loss prevention engineering solutions.

## Industry Ratings

<i>Rating Agency</i>	<i>Financial Strength</i>	<i>Rating Outlook</i>
A.M. Best	<b>A+</b> (Superior)	Stable
Fitch	<b>AA</b> (Very Strong)	Stable
S&P Global	<b>A+</b>	Stable

For additional ratings information, view “Industry Ratings” at [fmglobal.com](http://fmglobal.com).

# Executive Message

## COMBINED RATIO



We reported an exemplary combined ratio for the fourth consecutive year, and the combination of strong underwriting performance and investment results strengthened our surplus by 8 percent to US\$11.9 billion at year-end.

## SURPLUS INCREASE

**+8%**  
US\$11.9 billion

**T**hanks to the superb efforts of our clients and their client service teams, 2016 was another very successful year for FM Global. Despite a very competitive marketplace, we once again achieved our financial goals and accomplished our business objectives, while maintaining a strong client base and exceeding our new business targets.

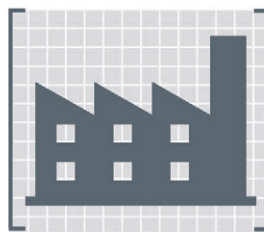
Our combined ratio of 83.2 percent was market-leading for the fourth consecutive year, and the combination of strong underwriting performance and investment results strengthened our surplus by 8 percent to US\$11.9 billion at year-end. In addition, we issued our ninth membership credit since the program began in 2001. By the end of 2017, we will have provided more than US\$3.3 billion in total membership credit to our mutual owners. This process of giving back underscores our mutual structure and supports our clients' loss prevention focus.



### Creating Advantages

These outstanding results validate the strength of our business model and enable us to focus on our working relationships with clients, brokers, reinsurers and WorldReach® partners. This network is supported by the fully engaged, knowledgeable workforce here at FM Global, whose sole focus is on delivering the highest quality insurance experience to our clients. We are committed to providing our employees with the training, development and resources they need to flourish. This global team helps to create the advantages our clients expect from us.

### CLIENT RETENTION AND AVERAGE TENURE



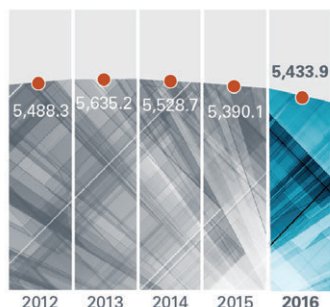
**96%** CLIENT RETENTION

**18.4** YEARS AVERAGE TENURE

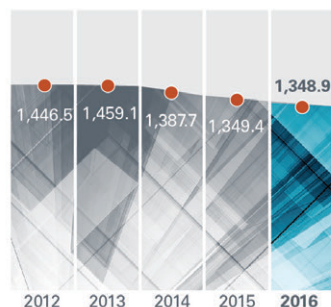
By the end of 2017, we will have provided more than US\$3.3 billion in total membership credit to our mutual owners.

# 2016 in Review

**TOTAL GROSS PREMIUM  
IN FORCE, US\$M**



**NON-NORTH AMERICA GROSS  
PREMIUM IN FORCE, US\$M**

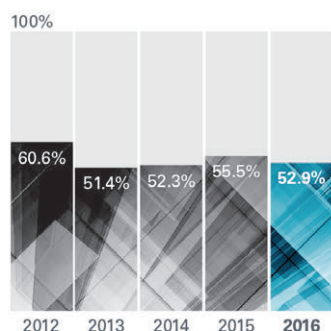


## 2016 Premium Trends

Against extremely competitive market conditions, we not only retained most of our clients but also exceeded our expectations for new business. As a result of this strong performance, our overall gross premium in force increased for both our FM Global and AFM lines.

On a consolidated basis, FM Global (large commercial property) and AFM (middle-market property) are the source of 95.8 percent of our overall premium in force, with Mutual Boiler Re and FM Global Cargo representing the balance. Consolidated net premium remained flat at US\$4 billion, excluding the impact of 12 months of the membership credit.

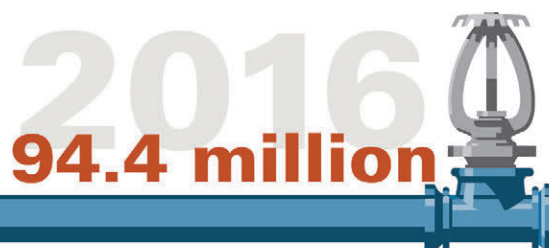
**LOSS RATIO**



## Loss Trends

Our consolidated loss ratio for 2016 was 52.9 percent. The natural disaster loss ratio of 19.8 percent was slightly higher than both prior year and our five-year average of 18 percent.

Our 2016 risk loss ratio of 30 percent was a marked improvement from the prior-year ratio of 32.3 percent and helped to lower our five-year average to 31.3 percent. Risk losses stem predominantly from fire and explosion. This ratio continues to improve as our clients prioritize risk improvement and reduce their losses. As an indicator of their commitment, our policyholders installed 94.4 million square feet (8.8 million square meters) of ceiling sprinklers worldwide in 2016.



square feet of ceiling sprinklers installed worldwide

## Expense Trends

Our 2016 expense ratio was 30.3 percent. Acting on our commitment to deliver high-quality services at low cost, we improved operating efficiency by implementing our new global policy delivery system. By one significant measure, 89 percent of policies were delivered on or before the effective date. We also appointed an innovation leader to accelerate our leverage of technology and improve time-to-market delivery of new products.

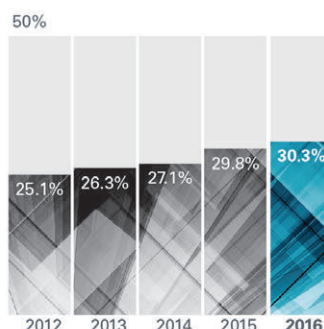
## Investments and Surplus

Our investment portfolio produced a 6.65 percent return. Discussion and detailed breakdown of the results are provided in the Investment Report section beginning on page 21. In summary, healthy returns from stocks during 2016, with the S&P 500 index return of 12 percent, benefited our portfolio. Our strong balance sheet and longer-term investment orientation allows us to participate in the returns of higher opportunity/volatility asset classes.

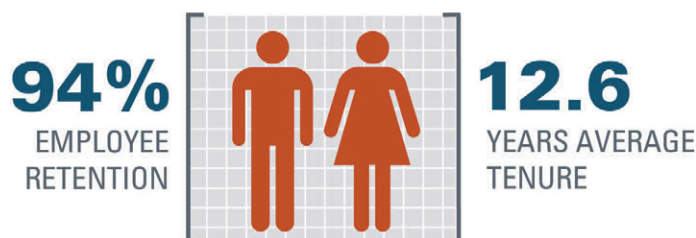
## Our Workforce

Our employee retention rate remained comparatively high at 94 percent, average employee tenure stood at 12.6 years, and we made progress on two top priorities. The first is to become a more diverse workforce. While we have not yet reached our goal, progress was evident in the class of new field engineers—more than 50 percent of whom were women. The other key priority is to sharpen our focus on leadership development and succession planning. Training is a major aspect of this objective. To provide our people with the best resources, we made substantial progress toward developing a new learning management system.

EXPENSE RATIO



## EMPLOYEE RETENTION AND AVERAGE TENURE



## CORPORATE GOVERNANCE

FM GLOBAL BOARD OF DIRECTORS				
ADVISORY BOARDS				
Atlanta/ Dallas	Canada	Chicago/ St. Louis	Cleveland	
Europe	New York	San Francisco	Washington, D.C./ Philadelphia	
RISK MANAGEMENT EXECUTIVE COUNCILS				
Canada	Central	Eastern	EMEA	Western

### Leadership and Governance

In 2016, we welcomed Michel Giannuzzi, chief executive officer, Tarkett, and Israel Ruiz, executive vice president and treasurer, Massachusetts Institute of Technology, to our board of directors. Two of our board members announced their retirement. We extend our thanks to David Pulman and James Thyen for all their contributions. We are grateful for the support and oversight provided by our board of directors, eight advisory boards and five risk management executive councils.

### Industry and Public Recognition

The quality and value of our products and services continue to be recognized by independent, third-party industry ratings agencies, analysts and media channels worldwide. In 2016, A.M. Best, Fitch and S&P Global affirmed our ratings at A+, AA and A+, respectively.

FM Global was named best carrier for property, business interruption, and boiler and machinery insurance by *National Underwriter*, and we received an Innovation Award from *Business Insurance* for MyRisk®, our client extranet. Outside our industry, we were honored that the White House Office of Management and Budget recognized FM Global for our on-site risk assessments and loss prevention recommendations for schools, hospitals and transportation facilities.

### 2017 Forecast and Landscape

We are in the midst of a complicated industry landscape. A combination of low interest rates and a benign state of natural catastrophes over the last several years continues to support significant capital in the insurance market and has strengthened balance sheets. This resulted in a competitive marketplace in 2016, which we expect to continue in 2017. While some competitors continue to try to replicate our business model, our mutuality and strong specialty focus remain unique to FM Global and differentiate us in the market.

The fact that we are a knowledge-based company

with a global presence is a distinct advantage for us and our clients.

The vote by the United Kingdom to exit the European Union (EU) will affect a number of insurance companies, including FM Global. We implemented our contingency plan and are in the process of forming a new company, FM Insurance Europe S. A., in Luxembourg, which will allow us to continue to deliver seamless coverage throughout the EU.

The fact that we are a knowledge-based company with a global presence is a distinct advantage for us and our clients. To ensure we are well-positioned in the future, we began construction on a new loss prevention training and operations center in Singapore and began the expansion of our SimZone hands-on training facility in Norwood, Mass., USA. The latter project will be completed midyear, 2017.

FM Global is acknowledged globally as the leading provider of property loss prevention engineering services and insurance capacity to large corporations. In recent years, AFM has also achieved a leadership position in North America, with significant opportunity for profitable expansion in other global markets. With the progress we continue to make in all our market segments, the future success of our business model, with its emphasis on keeping our clients resilient, appears to be very secure.

In this Annual Report, you will see how FM Global continues to build on who we are, while remaining true to our promise to protect the value our clients' businesses create. We feel strongly that an alliance with FM Global helps build its own unique set of competitive advantages in any industry. It was a productive year—in which we enhanced our FM Global Advantage® policy, introduced our global flood map, and redoubled our commitment to cyber risk reduction, all driven by what we heard from our clients. As we move into 2017 and beyond, we're certain our clients will indeed enjoy those benefits and take major strides right along with us.



Thomas A. Lawson  
President and Chief Executive Officer



Shivan S. Subramaniam  
Chairman of the Board

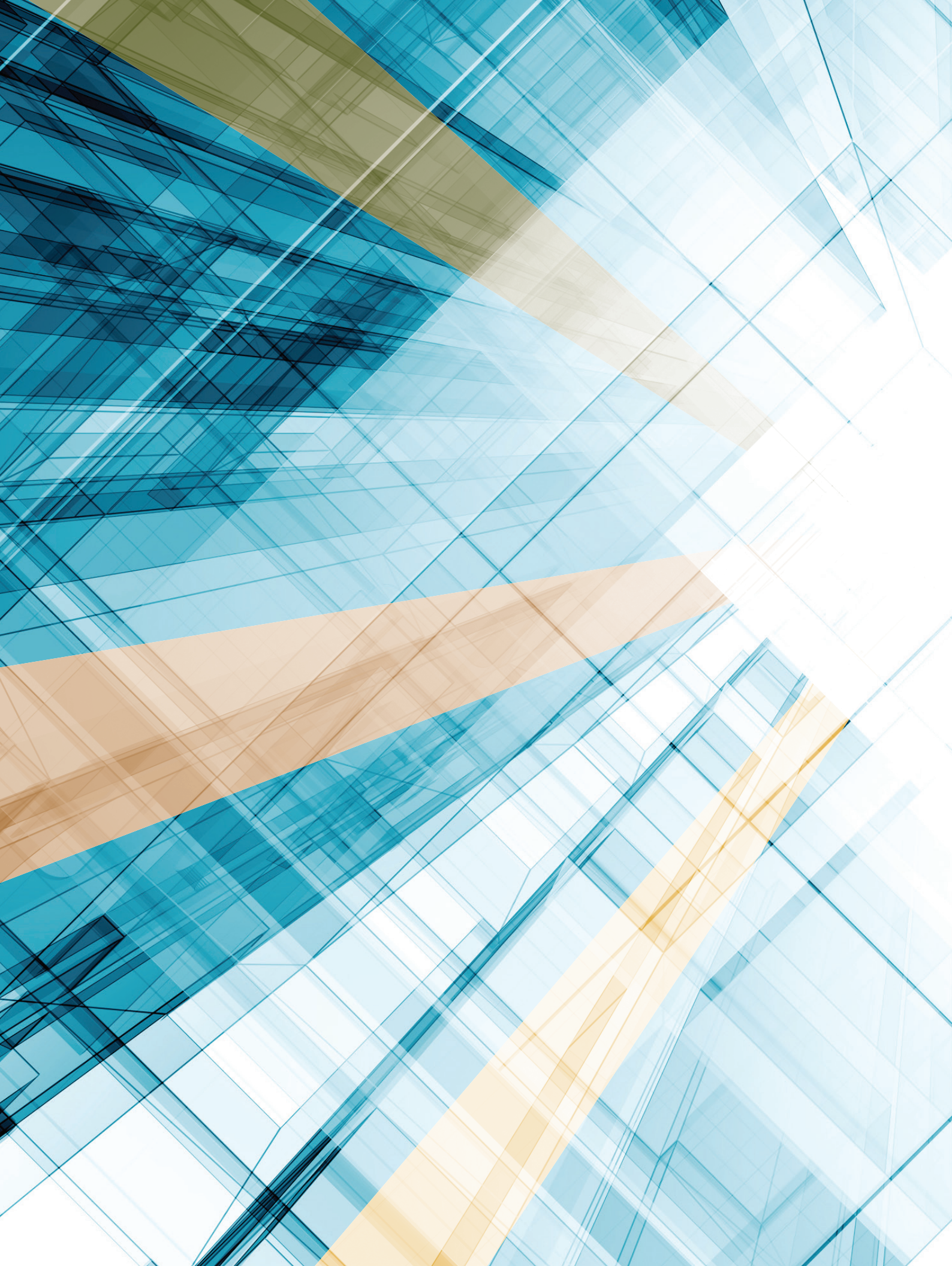
## BREAKING NEW GROUND

Singapore loss prevention training and operations center



Construction starts on SimZone expansion





# Building Your Competitive Advantage

Regulations, market volatility, economic conditions, cyber threats—the list of risks all companies face is real and growing. Our business is to keep your property off that list. FM Global aims to alleviate any insurance anxiety and provide strategic partnerships that move our clients forward. The clients spotlighted in the following pages—Campofrio Food Group and Eastman—have experienced this benefit firsthand, gaining tangible competitive advantages in a spectrum of ways through their FM Global partnership.



**EASTMAN**



## Rebounding from adversity

Many good things can come from a genuine partnership: trust, confidence, courage, insight, intelligence, even profit. At FM Global, we pride ourselves on solid partnerships. We see the benefits every day. The relationships we build with our clients include the best aspects of collaboration. Take, for example, one specific way our partners benefit from doing business with us: that is, building a strategic advantage.

Virtually all of our clients are competitors. They do battle every day, seeking to gain an edge, seize greater market share, lead the pack, muscle out the competition. What our policyholders know is that FM Global can advance, and in the best cases, bolster their ability to reach those goals. Rather than worry about fluctuating rates, timely claims response and complex clauses and contracts, our clients have more time to concentrate on sales and revenue targets and company performance, knowing their primary revenue sources are protected. Just ask Campofrio Food Group (CFG).

Marta García Alba, general counsel for CFG, has firsthand experience with "the bad times." In November 2014—smack in the middle of their holiday selling season—a devastating fire hit CFG's La Bureba plant, its principal manufacturing facility, in Burgos, Spain, burning a hole through the heart of the company.

"It was a great loss for CFG and the people of Spain who have supported the brand for decades," says Mario Paez, the company's chief financial officer. "A very tough time to go through."

As soon as the situation was known, CFG notified FM Global, but with some hesitation. "To be honest, none of us here knew what to expect from FM Global. We had only started working with them a few months before the fire."



"To be honest, none of us here knew what to expect from FM Global. We had only started working with them a few months before the fire."

– Marta García Alba, general counsel, Campofrío

## LA BUREBA PLANT BUSINESS IMPACT





Benito Tapiador (second from left), CFG engineering director, and three of the company's engineers discuss plans for CFG's new plant in Burgos, Spain.

With its main facility down, the company's sales and market share plummeted. CFG mobilized quickly, working together with FM Global's claims team to do its part. "They made themselves available to us in the very first days," says García Alba, still a little incredulous, "and it didn't take long for us to realize they were on our side! It was amazing how strong a relationship we built in a very short time."

Every day the Burgos facility sat idle was another day that CFG's capacity to produce and deliver was impaired. Thanks to quick thinking from senior management, deep commitment and the support of FM Global, CFG had a new production and distribution plan in place—and product in the supermarkets—just over a month after the fire. "It was 10 days after the fire happened," García Alba explains, "while we were still assessing the extent of the damage, that FM Global presented us with an advance payment of 50 million euros."

"It meant so much to us," says Paez, of the advance. "It meant that we could put our trust in FM Global. It meant that we were in this situation together with a real partner, and it meant that partnership brought real value to CFG. The biggest takeaway for me in this whole thing is that you must have the right partner, especially in the bad times."

## AVERAGE DAMAGE OF FIRE LOSSES in Food Factories

Inadequate  
sprinklers  
**US\$9.3 million**

Fully functional  
sprinklers  
**US\$638,000**



"The biggest takeaway for me in this whole thing is that you must have the right partner, especially in the bad times."

– Mario Paez, chief financial officer, Campofrío

In its own way, FM Global ensured CFG recovered quickly and could salvage as much of its market share as possible. "During our recovery," says García Alba, "we initially had shortages of product and we were losing shelf space every day. When FM Global entered the picture, it gave us confidence to plan more effectively and boldly because we knew we had their support."

While CFG was developing new distribution processing channels to serve its consumers, FM Global was collaborating with the CFG

engineering team on plans for a new facility, a facility that opened in late 2016. "Because we were building a plant from scratch, FM Global's information, technical specifications and engineering expertise were invaluable," says Benito Tapiador, CFG engineering director. "Their technical knowledge of fire protection measures was of strategic importance to us as we went through the design process. What FM Global did for us can be expressed in a single word: phenomenal, and with no problems!"

## CAMPOFRÍO FOOD GROUP

One of the world's most admired and successful food companies, the Madrid, Spain-based Campofrío Food Group (CFG), a subsidiary of Sigma Alimentos (part of the Mexico-based ALFA group), represents the industry standard in the processed meats sector. Boasting a significant presence in Europe and America and a strong brand portfolio, CFG leads the way in product performance, quality, growth, customer satisfaction and profitability. They are also tireless innovators, using discovery as a driver of growth, and they stand by a commitment to the highest ethical and sustainable standards. After a 2014 crippling fire at their principal manufacturing facility, La Bureba, in Burgos, Spain, CFG unveiled a state-of-the-art facility with unparalleled commitment to health, quality and safety. Thanks to an agile management team and a committed employee base, CFG has recovered from the disaster, recouped its market share and focused its effort on a renewed, invigorated future.

## SUPPLY CHAIN



Mario Paez, chief financial officer, and Marta García Alba, general counsel, Campofrío



### Alignment as an advantage

When business is interrupted, the pursuit of profitability becomes a little steeper. Eastman pledged years ago to stay clear of uphill battles. The specialty chemical company, with more than 50 global locations around the world, has always hoped to learn those lessons from others rather than firsthand. "As we consider what FM Global is about in terms of risk reduction, protecting people, protecting the environment, protecting property, it is beautifully aligned with our top priorities," says Mark Cox, Eastman senior vice president, chief manufacturing, supply chain, and engineering officer.

That bond represents quantifiable competitive advantages for Eastman. "Our relationship with FM Global produces value in a variety of ways," says Cox. "Most importantly, it has reduced the frequency and intensity of undesirable business interruption events and, therefore, improved our bottom line."

### IN 2016, FM GLOBAL ENGINEERS SPENT

540,000 HOURS VISITING  
64,000 CLIENT LOCATIONS AND  
26,000 HOURS IN CLASSROOM TRAINING



"Our confidence in our ability to innovate is increased by virtue of this relationship."

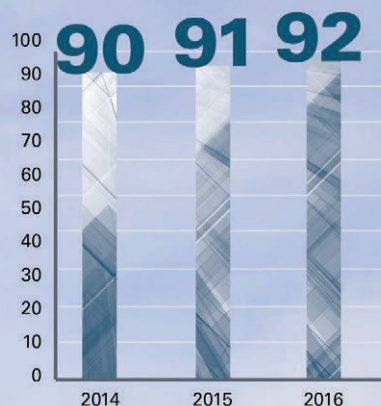
– Mark Cox, senior vice president, chief manufacturing, supply chain, and engineering officer, Eastman

Eastman's reliability is indeed impressive and it has helped the company stay ahead of its competitors. "I say this humbly," adds Cox, "because it's hard-earned and easily lost. There are systems and cultural elements we've had in place for a long time that allow us to remain reliable, and they happen to be consistent with FM Global's objectives as well."

Peter Roueche is Eastman's director of enterprise risk and insurance. "When you think about a chemical plant, one of the first things to look at is housekeeping, the reliability record," he says. "Those are highly correlated with safety and environmental stewardship. It's a matter of running a tight ship. The mindset that goes with protecting property well is consistent with doing the right things the right way."

## CLIENT SATISFACTION PERCENTAGES

FM Global Field Engineering



Percentage of clients extremely/very satisfied with FM Global field engineering service, based on more than 27,000 responses following field engineering visits

Source: Clients surveyed by ORC International



In 2016, Eastman and FM Global celebrated 50 years of partnership. The relationship has had the luxury of incorporating a variety of worthwhile practices over the years—including policy workshops, customized research and testing, and product innovation. “Our confidence in our ability to innovate is increased by virtue of this relationship,” says Cox. “We know we will have a strong partner in risk management during the innovation phases of new product development.”

Also worth mentioning is that Eastman maintains arguably the largest, vertically integrated, single-owner chemical facility in the United States (in Kingsport, Tennessee). Not surprisingly, the location requires substantial insurance protection, and places intense demand on FM Global’s engineering capabilities.

“Another value that FM Global’s engineers bring to the table is boiler and machinery expertise,” says Roueche. “When we have a boiler down, we have regulatory and permit requirements. We rely on FM Global to help us get back online quickly. So if there’s a plant outage or a boiler needs upgrading or an inspection, FM Global’s engineer is there to see to it immediately, so we don’t have to wait days to get back up and running. This kind of service provides us with another strategic advantage.”

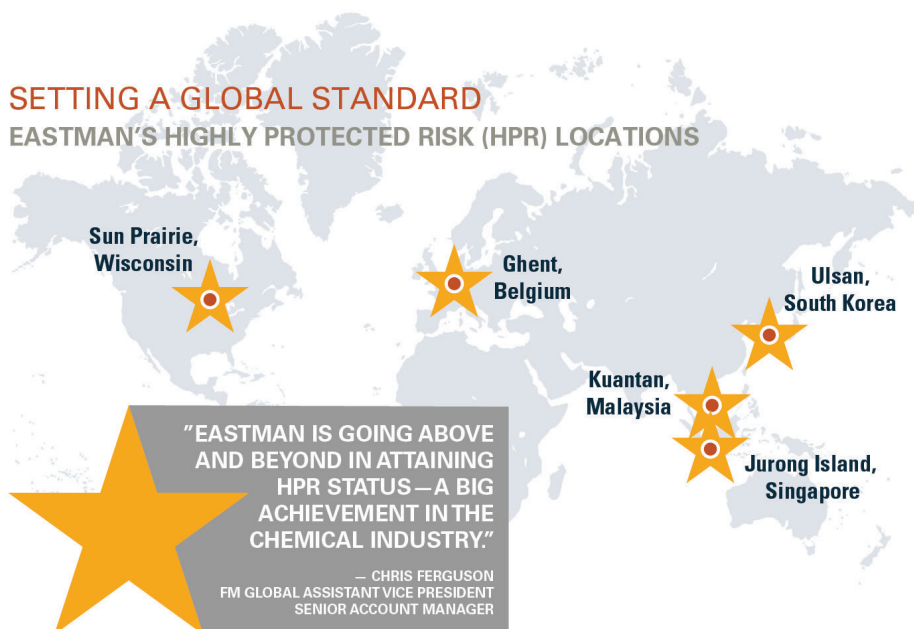
Eastman is also keen on taking advantage of FM Global’s mutuality, by aggregating the risk insight and wisdom of companies in that mutual group and using that knowledge as a competitive advantage. “Over time,” says Cox, “we should certainly improve in terms of how we manage our risk, and hopefully see a membership credit or premium benefit.”

Overall, the risk management team at Eastman agrees that it’s the partnership, the alliance, which brings all of these pluses together—and unlocks an array of competitive advantages. The mutual relationship and unparalleled attention to detail help elite companies move forward with confidence, innovate with determination and stay at the top of their respective markets.



## SETTING A GLOBAL STANDARD

### EASTMAN’S HIGHLY PROTECTED RISK (HPR) LOCATIONS



# 50 years of partnership

“When we have a boiler down, we have regulatory and permit requirements.  
We rely on FM Global to help us get back online quickly.”

– Peter Roueche, director, enterprise risk and insurance, Eastman



## EASTMAN CHEMICAL

Featuring a portfolio of specialty business, Eastman is a global chemical company that produces a wide range of products—and ingredients in products—found in items people use every day. The company, headquartered in Kingsport, Tennessee, USA, employs 14,000 people worldwide. In 2016, Eastman and FM Global celebrated 50 years of working together. Over the decades, Eastman has grown considerably—they now boast the largest single chemical site in FM Global’s portfolio—with customers in more than 100 countries and revenues of approximately US\$9 billion (2016). Eastman’s market-driven approach takes advantage of world-class technology platforms and requires best-in-class partnerships to deliver its innovative products and solutions while maintaining a commitment to safety and sustainability.



*Top left:* Chris Ferguson (left), FM Global senior account manager, with Eastman’s Peter Roueche  
*Top center:* Tree dedication honoring the companies’ 50-year relationship. *Left to right:* Peter Roueche; Mark Cox; Mark Costa, Eastman chairman and CEO; and Malcolm Roberts, FM Global senior vice president, Eastern division manager  
*Top right:* Eastman corporate offices, Kingsport, Tennessee, USA  
*Left:* Mark Cox and Peter Roueche

# Financial Information

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## INVESTMENT REPORT

The tables on page 22 show key measures of FM Global's investment portfolios, including asset class weights and returns relative to benchmarks. Return on total assets for 2016 was 6.65 percent, compared to benchmark at 6.40 percent.

Stocks performed well in 2016 with the S&P 500 index returning 11.96 percent. This was the result of both the expectation of moderate earnings growth in 2017 and modest expansion of the multiple investors are willing to apply to earnings. The increase in valuation is particularly notable as it occurred despite 1) an increase in U.S. interest rates, which is expected to continue in 2017, and 2) uncertainty brought on by political developments, most notably the U.S. election outcome and the vote by the United Kingdom to exit the European Union.

Regarding the U.S. election, the market reaction to date has been a net positive, as investor expectations of potential lower corporate tax rates, less regulatory constraints and a generally more favorable business environment have offset risks surrounding other policies, most notably potential global trade changes. While FM Global's total stock return at 10.77 percent lagged the total stock index (the total stock benchmark returned 11.17 percent including its international stock component), an overweighted position in stocks, at approximately 50 percent of investment holdings, was a positive asset allocation factor.

Our fixed income benchmark, a modified Barclays aggregate index with a roughly 4.5 year duration, returned 2.13 percent. This return was the result of coupon income offset modestly by bond price declines later in the year. The rise in bond yields later in the year reflected both Federal Reserve policy and the related prospect for continued improved employment conditions and somewhat higher economic growth and inflation. As shown in the tables, our relative bond performance was well above benchmark in the largest bond subsegment (high grade taxable bonds), with FM Global's portfolio return at 2.54 percent. The company's return on total assets also benefitted by its allocation to high yield bonds, with FM Global's high yield portfolio return at 14.47 percent.

As a summary comment, following on a long trendline of declining interest rates and healthy returns from lower risk assets including high grade bonds, 2016 saw investors place higher valuations on some more volatile asset sectors including stocks and high yield bonds. Even at the higher valuations, most analyses indicate that equities still offer an attractive opportunity/risk profile for the longer-term investor. FM Global's investment focus is on this longer-term horizon, enabled by the company's strong balance sheet positioning and ability to accept shorter-term volatility.

Thus while stocks are expected to remain volatile, and a move lower off the recent gains could clearly occur over the near term, the company ended 2016 with what we consider a full weight in equities, modestly above the 48 percent benchmark weight and substantially above the fixed income asset orientation of most of our competitors.

In addition to providing functional support to FM Global's business operations, the real estate group manages 4.8 million ft.<sup>2</sup> (450,000 m<sup>2</sup>) of investment properties. These real property assets provide an additional element of portfolio diversification. They also provide a cost-effective approach in meeting FM Global's ongoing real estate needs, while enhancing the value of its properties. For 2016, commercial properties produced \$109 million in revenue and \$32.7 million in cash flow.

*† All financial values in U.S. dollars.*

## INVESTMENT REPORT

Rates of Return	2016		2015	
	Portfolio	Benchmark	Portfolio	Benchmark
Total managed investment portfolio	6.65%	6.40% <sup>1</sup>	1.53%	1.22% <sup>1</sup>
Debt securities				
Investment-grade taxable bonds	2.54%	2.13% <sup>2</sup>	1.57%	1.46% <sup>2</sup>
Municipal bonds*	2.23%	1.69% <sup>3</sup>	5.15%	4.62% <sup>3</sup>
High-yield bonds	14.47%	17.49% <sup>4</sup>	-3.72%	-4.61% <sup>4</sup>
Equity securities – total	10.77%	11.17% <sup>5</sup>	0.94%	0.68% <sup>5</sup>
Internally managed stock portfolio	11.51%	11.96% <sup>6</sup>	1.49%	1.38% <sup>6</sup>
International stock portfolios (ETF's and outside managed)	3.72%	4.50% <sup>7</sup>	-2.33%	-1.61% <sup>7</sup>

<sup>1</sup> Weighted S&P 500 Plus Global Stock Index (48%), Custom Barclays Index (45%), T Bill (7%)

<sup>2</sup> Custom Barclays Index

<sup>3</sup> Barclays Muni 2-12 Year

<sup>4</sup> Merrill Lynch U.S. High-Yield Master II Constrained Index

<sup>5</sup> S&P 500 Index (89%) plus MSCI All World ex. U.S. (11%)

<sup>6</sup> S&P 500

<sup>7</sup> MSCI All World ex. U.S.

\* Taxable equivalent return.

Pretax Contribution to Surplus (in millions) <sup>†</sup>	2016	2015
Investment income	\$ 335	\$ 326
Realized gains	251	264
Unrealized gains (losses)	443	(330)
	<u>\$ 1,029</u>	<u>\$ 260</u>

As of December 31 Holdings (in millions) <sup>†</sup>	2016		2015	
	Total	Percentage	Total	Percentage
Equity securities	\$ 7,673	48.1%	\$ 7,063	47.8%
Taxable debt securities	4,116	25.8	3,851	26.1
Municipal debt securities	1,900	11.9	1,825	12.3
Short-term funds	1,403	8.8	1,215	8.2
Alternative investments:				
Private Equity	335	2.1	366	2.5
Hedge Funds	523	3.3	461	3.1
Total	<u>\$ 15,950</u>	<u>100.0%</u>	<u>\$ 14,781</u>	<u>100.0%</u>

<sup>†</sup> All financial values in U.S. dollars.

## MANAGEMENT'S STATEMENT ON **INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of FM Global is responsible for establishing and maintaining adequate internal control over financial reporting and for the preparation and integrity of the accompanying financial statements and other related information in this report. The consolidated financial statements of the Company and its subsidiaries, including the notes to consolidated financial statements, were prepared in accordance with U.S. generally accepted accounting principles and include judgments and estimates, which, in the opinion of management, are applied on an appropriately conservative basis. The Company maintains a system of internal and disclosure controls intended to provide reasonable assurance that assets are safeguarded from loss or material misuse, that transactions are authorized and recorded properly, and that the accounting records may be relied upon for the preparation of the financial statements. This system is tested and evaluated regularly for adherence and effectiveness by the Company's staff of internal auditors.

The audit committee of the Board of Directors, which comprises directors who are not employees of the Company, meets regularly with management and the internal auditors to review the Company's financial policies and procedures, its internal control structure, the objectivity of its financial reporting and the independence of the Company's independent public accounting firm. The internal auditors have free and direct access to the audit committee, and they meet periodically, without management present, to discuss appropriate matters.

Because of inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements and even when determined to be effective, can only provide reasonable assurance with respect to financial statement preparation and presentation. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

These consolidated financial statements are subject to an evaluation of internal control over financial reporting conducted under the supervision and with the participation of management, including the chief executive officer and chief financial officer. Based on that evaluation, conducted under the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, management concluded that its internal control over financial reporting was effective as of December 31, 2016 and December 31, 2015.



Thomas A. Lawson  
President and  
Chief Executive Officer



Kevin S. Ingram  
Senior Vice President and  
Chief Financial Officer

## REPORT OF **INDEPENDENT AUDITORS**

### *The Board of Directors and Policyholders of Factory Mutual Insurance Company and Subsidiaries*

We have audited the accompanying consolidated financial statements of Factory Mutual Insurance Company and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in policyholders' surplus, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

#### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Factory Mutual Insurance Company and Subsidiaries at December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The signature of Ernst & Young LLP is written in a cursive, handwritten style in black ink.

Boston, Massachusetts  
March 1, 2017

## CONSOLIDATED BALANCE SHEETS

(in thousands)

December 31	2016	2015
Assets		
Investments:		
Debt securities	\$ 6,015,600	\$ 5,676,100
Equity securities	7,673,300	7,062,700
Other securities	858,300	827,200
Real estate	608,800	592,600
Total Investments	<u>15,156,000</u>	<u>14,158,600</u>
Cash and cash equivalents	1,485,300	1,296,900
Recoverable from reinsurers	1,267,400	1,341,700
Premium receivable	732,900	605,400
Prepaid reinsurance premium	247,200	240,800
Premises and equipment	400,000	382,900
Other assets	853,300	878,600
Total Assets	<u>\$ 20,142,100</u>	<u>\$ 18,904,900</u>
Liabilities		
Unpaid losses and loss adjustment expenses	\$ 3,864,900	\$ 3,901,500
Reserve for unearned premium	2,452,000	2,419,200
Current and deferred income taxes	825,800	703,200
Other liabilities	1,078,800	844,500
Total Liabilities	<u>8,221,500</u>	<u>7,868,400</u>
Policyholders' surplus		
Accumulated other comprehensive income	1,333,300	1,246,000
Retained earnings	10,587,300	9,790,500
Total Policyholders' surplus	<u>11,920,600</u>	<u>11,036,500</u>
Total Liabilities and Policyholders' surplus	<u>\$ 20,142,100</u>	<u>\$ 18,904,900</u>

See accompanying notes.

## CONSOLIDATED STATEMENTS OF INCOME

(in thousands)

Year ended December 31	2016	2015
Gross premium earned	\$ 5,439,800	\$ 5,458,200
Ceded premium earned	(1,431,900)	(1,448,200)
Net premium earned	4,007,900	4,010,000
Membership credit	(407,200)	(430,900)
Net premium earned after membership credit	<u>3,600,700</u>	<u>3,579,100</u>
Investment-related income	451,800	435,400
Fee-related income	69,800	64,000
Total revenue	<u>4,122,300</u>	<u>4,078,500</u>
Net losses and loss adjustment expenses	1,903,400	1,985,400
Insurance-related expenses	1,060,800	1,033,400
Investment-related expenses	184,900	179,900
Fee-related expenses	54,200	53,100
Total losses, loss adjustment and other expenses	<u>3,203,300</u>	<u>3,251,800</u>
Income from operations	919,000	826,700
Net realized investment gains	251,200	264,200
Income before income taxes	<u>1,170,200</u>	<u>1,090,900</u>
Income tax expense	373,400	353,100
Net income	<u>\$ 796,800</u>	<u>\$ 737,800</u>

See accompanying notes.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

Year ended December 31	2016	2015
Net income	\$ 796,800	\$ 737,800
Other comprehensive income (loss):		
Increase (decrease) in net unrealized appreciation on investments in debt and equity securities, net of income tax expense of \$136,100 for 2016 and income tax benefit of \$110,500 for 2015	306,900	(219,600)
Benefit plan assets and liabilities, net of income tax benefit of \$46,100 for 2016 and income tax expense of \$6,700 for 2015	(109,000)	7,000
Foreign currency translation adjustment, net of income tax expense of \$7,100 for 2016 and income tax benefit of \$42,400 for 2015	(110,600)	(126,100)
Other comprehensive income (loss)	87,300	(338,700)
Comprehensive income	<u>\$ 884,100</u>	<u>\$ 399,100</u>

## CONSOLIDATED STATEMENTS OF CHANGES IN POLICYHOLDERS' SURPLUS

(in thousands)

Year ended December 31	2016	2015
Retained earnings at beginning of year	\$ 9,790,500	\$ 9,052,700
Net income	796,800	737,800
Retained earnings at end of year	<u>10,587,300</u>	<u>9,790,500</u>
Accumulated other comprehensive income at beginning of year	1,246,000	1,584,700
Other comprehensive income (loss)	87,300	(338,700)
Accumulated other comprehensive income at end of year	<u>1,333,300</u>	<u>1,246,000</u>
Policyholders' surplus at end of year	<u>\$11,920,600</u>	<u>\$11,036,500</u>

See accompanying notes.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

Year ended December 31	2016	2015
<b>Operating activities</b>		
Net income	\$ 796,800	\$ 737,800
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	65,200	61,600
(Increase) decrease in premium receivable	(127,500)	64,800
Increase (decrease) in reserve for unearned premium	32,800	(57,400)
(Decrease) increase in unpaid losses and loss adjustment expenses	(36,600)	29,300
Decrease in recoverable from reinsurers	74,300	31,300
Increase (decrease) in current and deferred income taxes	16,700	(160,600)
Net realized investment gains	(251,200)	(264,200)
(Increase) decrease in prepaid reinsurance premium	(6,400)	34,100
Other	152,600	104,400
Net cash provided by operating activities	<u>716,700</u>	<u>581,100</u>
<b>Investing activities</b>		
Net sales (purchases) of short-term investments	99,200	(65,500)
Purchases of debt, equity and other securities	(4,255,100)	(4,391,700)
Sales and maturities of debt, equity and other securities	3,724,600	3,935,500
Capital expenditures	(116,900)	(104,100)
Other	19,900	7,900
Net cash used in investing activities	<u>(528,300)</u>	<u>(617,900)</u>
Increase (decrease) in cash and cash equivalents	<u>188,400</u>	<u>(36,800)</u>
Cash and cash equivalents at beginning of year	1,296,900	1,333,700
Cash and cash equivalents at end of year	<u>\$ 1,485,300</u>	<u>\$ 1,296,900</u>

See accompanying notes.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 1. Significant Accounting Policies

#### Basis of Presentation

The consolidated financial statements are stated in U.S. dollars and have been prepared on the basis of U.S. generally accepted accounting principles, which differ in some respects from statutory accounting practices prescribed or permitted by the State of Rhode Island and Providence Plantations, Department of Business Regulation, Insurance Division. On the basis of statutory accounting practices, consolidated policyholders' surplus was \$11,519,400 and \$10,546,700 at December 31, 2016 and 2015, respectively; net income for the respective years then ended was \$695,800 and \$651,400.

The process of preparing financial statements in conformity with U.S. generally accepted accounting principles requires the use of management's estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

The Company provides comprehensive lines of property coverage and supporting services for industrial and institutional properties throughout the world.

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions were eliminated in consolidation.

#### Reclassification

Certain amounts reported in the 2015 Notes to Consolidated Financial Statements have been reclassified to conform to the 2016 presentation.

#### Cash Equivalents

Cash equivalents are short term, highly liquid investments that are both readily convertible into known amounts of cash and so near to maturity that they present insignificant risk of changes in value due to changing interest rates. Cash equivalents include money market funds carried at fair value and debt securities purchased with maturities of three months or less at acquisition and are carried at amortized cost, which approximates fair value. The effect of changes in foreign exchange rates on cash balances was immaterial.

#### Investments

Debt and equity securities are classified as available-for-sale and are stated at fair value with the unrealized appreciation or depreciation, net of tax, reported directly in other comprehensive income. The cost of securities sold is based upon the specific identification method.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of mortgage and asset-backed securities, over the estimated life of the security adjusted for anticipated prepayments. This amortization and accretion is included in investment-related income. For mortgage and asset-backed debt securities, the Company recognizes income using a constant effective yield based on anticipated prepayments over the economic life of the security. The mortgage and asset-backed debt securities are accounted for under the retrospective method and prepayment assumptions are based on market expectations. When actual prepayments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments, and any resulting adjustment is included in investment-related income.

## NOTES TO **CONSOLIDATED FINANCIAL STATEMENTS** DECEMBER 31, 2016 AND 2015

(in thousands)

### **Note 1.** Significant Accounting Policies *(continued)*

Other securities consist primarily of partnerships and alternative investments, which are accounted for under the equity method. As a result of the timing of the receipt of valuation data from the investment managers, these investments are generally reported on with up to a three-month lag. Changes in the Company's equity in the net assets of these investments are included in income as net realized investment gains.

Impairments in equity securities deemed to be other than temporary are reported as a component of income before income taxes. Impairments in debt securities deemed to be other than temporary are segregated into credit risk and non-credit risk impairments. Credit risk impairments are reported as a component of income before income taxes. Non-credit risk impairments are recognized in other comprehensive income. Securities are reviewed for both quantitative and qualitative considerations in the determination of impairments.

Under a securities lending program with an agent, the Company has temporarily loaned certain debt securities. Borrowers of these securities must deposit with the agent an amount of cash and/or securities equal to 102 percent of the loaned securities' fair value for U.S. currency-denominated securities or 105 percent of the loaned securities' fair value for foreign-denominated securities. The portion of collateral received in securities is held in trust by the agent. The portion of collateral received in cash is invested by the agent in high-quality, short-term investments. The Company continues to receive the interest on the loaned debt securities as the beneficial owner, and the loaned debt securities are included in the investment portfolio of the Company. The cash collateral and the obligation to return that collateral are included in other assets and other liabilities, respectively, on the Consolidated Balance Sheets.

In the normal course of business, the Company has investments in variable interest entities (VIEs) primarily as a passive investor in residential mortgage-backed securities, commercial mortgage-backed securities, and private equity limited partnerships issued by third party VIEs. The Company is not the primary beneficiary of these VIEs. The Company's maximum exposure to loss with respect to these investments is limited to the investment carrying values included in the Company's Consolidated Balance Sheets and the unfunded commitments related to partnerships and private equity investments. The Company has unfunded commitments of \$437,200 and \$163,300 as of December 31, 2016 and 2015, respectively.

### **Income Taxes**

The Company files consolidated U.S. and foreign income tax returns as required by law. The income tax expense is based on income before taxes reported in the consolidated financial statements. Deferred income taxes are provided, when appropriate, for the effects of temporary differences in reporting income and expenses for tax and financial reporting purposes. Deferred income taxes are also provided for unrealized appreciation or depreciation of investments, for pension and postretirement liabilities and for foreign currency translations.

The Internal Revenue Service (IRS) has completed its examination of the Company's federal income tax returns through 2012. There are no current IRS examinations in process.

### **Deferred Costs**

Premium taxes and commissions, the principal business acquisition costs, are deferred to the extent recoverable and are amortized over the period during which the related premium is earned. Deferred costs are included in other assets.

Certain pre-rental and other expenses incurred by the Company's real estate limited liability corporation subsidiaries are deferred and amortized over the lives of the various tenant leases.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### **Note 1.** Significant Accounting Policies *(continued)*

#### **Real Estate and Premises and Equipment**

Premises and equipment are stated at net book value, and depreciation is recorded on a straight-line basis over the estimated useful lives of the respective assets. Upon retirement or sale, the cost of the asset disposed of and its related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in net realized investment gains. The net book value of the Company's investments in land and buildings is included in real estate, whereas the net book value of the Company's occupied land and buildings, furniture, fixtures, and equipment is included in premises and equipment.

#### **Unpaid Losses and Loss Adjustment Expenses**

Liabilities for unpaid losses and loss adjustment expenses are based on case estimates or reports from ceding companies. Estimates of incurred-but-not-reported (IBNR) reserves are based on historical experience and management analysis.

Although the above-described amounts are based on estimates, management believes recorded liabilities for unpaid losses and loss adjustment expenses are reasonable and adequate to cover the ultimate settlement cost of losses incurred. These estimates are continually reviewed and adjustments to such estimates are reflected in current operations.

#### **Premiums**

The Company issues term premium policies. The term premium is earned on a daily pro-rata basis over the life of the policy, which is typically one year. Unearned premium is the amount of unexpired written premium related to policies in force.

#### **Translation of Foreign Currency**

The Company translates the financial statements of its foreign operations into U.S. dollars from the functional currency applicable for each foreign unit, which is the currency of the country representing the primary economic environment in which each operation conducts business. Foreign currency balances are re-measured to the respective functional currencies, and the resulting foreign exchange gains or losses are reflected in earnings. Functional currency assets and liabilities are then translated into U.S. dollars at the exchange rates in effect at the end of the period, while income and expenses are translated at average rates. Foreign currency translation adjustments are recorded as a separate component of the Consolidated Statements of Comprehensive Income, net of income taxes.

#### **Reinsurance**

In the normal course of business, the Company seeks to reduce losses that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk with other insurance enterprises. Reinsurance premiums and losses and loss adjustment expenses ceded under these arrangements are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contract.

## NOTES TO **CONSOLIDATED FINANCIAL STATEMENTS** DECEMBER 31, 2016 AND 2015

(in thousands)

### **Note 1.** Significant Accounting Policies (*continued*)

#### **Retirement Income Plans and Postretirement Benefit Plans Other than Pensions**

Noncontributory retirement income plans cover the vast majority of employees. The Company's funding policy is generally to contribute the net periodic pension cost each year, as determined pursuant to the guidance in *Compensation – Employee Benefits (ASC 715)*. However, the contribution for any year will not be less than the minimum required contribution, nor greater than the maximum tax-deductible contribution allowed by each country.

The Company provides certain health care and life insurance benefits for retired employees and their dependents. The plans are contributory, with retiree contributions adjusted annually, and contain other cost-sharing features, such as deductibles and coinsurance. Current service and interest costs of postretirement health care and life insurance benefits are expensed on an accrual basis.

#### **Investment-Related and Fee-Related Income**

Investment-related income primarily consists of interest and dividends from the Company's investment portfolio and income from leased office space, which is earned as services are provided, or over the term of applicable leases. Fee-related income primarily consists of fees for ancillary services.

#### **Accounting Standards Not Yet Adopted**

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes existing revenue recognition guidance with a single model, unless a contract is within the scope of another standard. Under the new guidance, companies must allocate the total contract price to distinct contract components on a standalone selling price basis and recognize revenue upon fulfillment of each performance obligation and provide additional disclosures. The FASB subsequently issued ASU 2015-14, which defers the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2018. The Company is evaluating the impact, if any, that adoption will have on its consolidated financial position, results of operations, and related disclosures.

In May 2015, the FASB issued ASU 2015-09, *Disclosures about Short-Duration Contracts*, which applies to all insurance entities that issue short-duration contracts as defined in ASC 944, *Financial Services – Insurance*. The update requires an insurance entity to provide additional disclosures for its short-duration insurance contracts, including the presentation of incurred and paid claims development tables by accident year. The update is effective for annual reporting periods beginning after December 15, 2016. The Company is evaluating the impact that adoption will have on its financial statement disclosures.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 requires equity investments to be measured at fair value, with changes in fair value recognized in net income. The update is effective for annual reporting periods beginning after December 15, 2017. The Company is evaluating the impact that adoption will have on its financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which supersedes existing lease guidance. Under the new guidance, lessees are to recognize in the statement of financial position a right-of-use asset and a lease payments liability that represent the right to use the underlying asset and the related obligations over the lease term. The update is effective for annual reporting periods beginning on or after December 15, 2019. The Company is evaluating the impact that adoption will have on its financial statements and related disclosures.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 2. Investments

#### Debt and Equity Securities

The following is a summary of securities at December 31, 2016:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 875,400	\$ 25,300	\$ (11,100)	\$ 889,600
Obligations of states and political subdivisions	1,837,800	31,900	(19,600)	1,850,100
Mortgage and asset-backed securities				
Agency	789,500	25,200	(8,000)	806,700
Commercial	203,500	900	(2,300)	202,100
Other mortgage and asset-backed securities	128,200	5,500	(500)	133,200
U.S. corporate securities	1,178,100	48,500	(7,200)	1,219,400
Foreign government securities	542,400	2,300	(4,100)	540,600
Other debt securities	373,300	3,400	(2,800)	373,900
Total debt securities	<u>5,928,200</u>	<u>143,000</u>	<u>(55,600)</u>	<u>6,015,600</u>
Equity securities:				
Consumer discretionary	560,100	501,000	(3,800)	1,057,300
Consumer staples	327,500	341,400	(3,500)	665,400
Energy	277,100	279,500	(400)	556,200
Financials	527,000	521,700	(600)	1,048,100
Health care	641,100	361,800	(6,300)	996,600
Industrials	292,100	301,700	(800)	593,000
Information technology	299,400	645,100	(1,100)	943,400
Mutual funds (international and emerging markets)	942,900	261,000	(17,900)	1,186,000
All other sectors	378,400	250,400	(1,500)	627,300
Total equity securities	<u>4,245,600</u>	<u>3,463,600</u>	<u>(35,900)</u>	<u>7,673,300</u>
Total debt and equity securities	<u>\$ 10,173,800</u>	<u>\$ 3,606,600</u>	<u>\$ (91,500)</u>	<u>\$13,688,900</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 2. Investments (continued)

The following is a summary of securities at December 31, 2015:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. treasury securities and obligations				
of U.S. government agencies	\$ 769,600	\$ 15,700	\$ (3,000)	\$ 782,300
Obligations of states and political subdivisions	1,736,100	65,900	(2,600)	1,799,400
Mortgage and asset-backed securities				
Agency	740,000	23,900	(4,900)	759,000
Commercial	169,200	700	(3,100)	166,800
Other mortgage and asset-backed securities	172,100	6,300	(900)	177,500
U.S. corporate securities	1,214,400	31,300	(33,200)	1,212,500
Foreign government securities	424,800	4,900	(700)	429,000
Other debt securities	347,100	4,000	(1,500)	349,600
Total debt securities	<u>5,573,300</u>	<u>152,700</u>	<u>(49,900)</u>	<u>5,676,100</u>
Equity securities:				
Consumer discretionary	533,900	532,400	(13,700)	1,052,600
Consumer staples	255,700	293,700	(1,100)	548,300
Energy	284,300	168,600	(7,800)	445,100
Financials	553,700	386,500	(7,000)	933,200
Health care	515,400	426,400	(1,800)	940,000
Industrials	402,500	267,500	(20,600)	649,400
Information technology	349,700	599,900	(3,800)	945,800
Mutual funds (international and emerging markets)	835,200	240,500	(27,300)	1,048,400
All other sectors	362,800	141,500	(4,400)	499,900
Total equity securities	<u>4,093,200</u>	<u>3,057,000</u>	<u>(87,500)</u>	<u>7,062,700</u>
Total debt and equity securities	<u>\$ 9,666,500</u>	<u>\$ 3,209,700</u>	<u>\$ (137,400)</u>	<u>\$12,738,800</u>

During the years ended December 31, 2016 and 2015, purchases of debt securities were \$2,769,000 and \$3,127,600, respectively. Purchases of equity securities were \$1,297,400 and \$1,182,300, respectively.

During the years ended December 31, 2016 and 2015, proceeds from the sale of debt securities were \$2,213,500 and \$2,677,800, respectively. Proceeds from the sale of equity securities were \$1,293,900 and \$1,113,300, respectively.

The gross realized gains and (losses) on sales of debt and equity securities totaled \$383,600 and \$(86,600) in 2016, and \$358,400 and \$(48,000) in 2015.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 2. Investments *(continued)*

The amortized cost and fair value of debt securities at December 31, 2016 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	\$ 114,300	\$ 116,500
Due after one year through five years	1,987,800	2,031,300
Due after five years through 10 years	2,217,300	2,239,400
Due after 10 years	487,600	486,400
Subtotal	<u>4,807,000</u>	<u>4,873,600</u>
Mortgage and asset-backed securities	1,121,200	1,142,000
Total debt securities	<u>\$ 5,928,200</u>	<u>\$ 6,015,600</u>

The Company has temporarily loaned certain debt securities with a fair value of \$129,300 and \$449,500 at December 31, 2016 and 2015, respectively. At December 31, 2016 and 2015, the Company held total collateral values of \$132,000 and \$459,100 related to these securities, of which cash collateral included in other assets and other liabilities were \$78,800 and \$118,000, respectively.

Included in the Company's debt security portfolio are securities with unrealized losses deemed to be temporary. The total unrealized loss on these securities was \$55,600 (fair value of \$2,764,300) at December 31, 2016, and \$49,900 (fair value of \$1,860,200) at December 31, 2015. The amount of loss that existed for 12 months or more was immaterial for both 2016 and 2015. In reaching its conclusion that these impairments are temporary, the Company considered issuer specific circumstances as well as the fact that the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell before they recover in value or mature.

Included in the Company's equity security portfolio are securities with unrealized losses deemed to be temporary. The total unrealized loss on these securities was \$35,900 (fair value of \$522,700) at December 31, 2016 and \$87,500 (fair value of \$785,200) at December 31, 2015. The amount of loss that existed for 12 months or more was immaterial for both 2016 and 2015. In reaching its conclusion that these impairments are temporary, the Company considered the duration and severity of the decline as well as the near term prospects of the issuer. The Company believes these securities will appreciate over time, and the Company has the ability and intent to hold these securities.

During the years ended December 31, 2016 and 2015, net realized investment gains on other securities were \$10,500 and \$47,800, respectively.

### Credit Risk

All debt security investments have credit exposure to the extent that a counterparty may default on an obligation to the Company. To manage credit risk, the Company focuses on high-quality debt securities, reviews the credit strength of all companies in which it invests, limits its exposure in any one investment and monitors the portfolio quality, taking into account credit ratings assigned by recognized credit-rating organizations.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 3. Fair Value

The valuation techniques required by the *Fair Value Measurements (ASC 820)* guidance are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect market assumptions determined by the Company.

These two types of inputs create the following fair value hierarchy:

**Level 1** Quoted prices for identical instruments in active markets.

**Level 2** Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

**Level 3** Significant inputs to the valuation model are unobservable.

The Company retains independent pricing vendors to assist in valuing invested assets. In compliance with the ASC 820 guidance, the Company conducted a review of the primary pricing vendor, validating that the inputs used in that vendor's pricing process are deemed to be market-observable as defined in the standard.

When available, the Company uses quoted market prices to determine the fair value of investment securities, and they are included in Level 1.

When quoted market prices are unavailable, the Company uses quotes from independent pricing vendors based on recent trading activity and other relevant information. Debt securities are priced by an independent vendor using evaluated market pricing models that vary by asset class. These models incorporate available trade, bid, and other market information, and for structured securities also incorporate cash flow and, when available, loan performance data. The pricing models apply available market information through processes such as benchmark curves, benchmarking of similar securities, and sector groupings. The vendors also integrate observed market movements, sector news and relevant credit information into the evaluated pricing applications and models. These investments are included in Level 2 and are primarily comprised of debt securities.

In infrequent circumstances, the pricing is not available from the pricing vendor, and is based on significant unobservable inputs. In those circumstances, the investment security is classified in Level 3.

The following table presents the Company's invested assets measured at fair value as of December 31, 2016:

Invested Assets, at Fair Value	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities	\$ 6,015,600	\$ 12,000	\$ 6,003,600	\$ —
Equity securities	7,673,300	7,576,000	97,300	—
Total	<u>\$ 13,688,900</u>	<u>\$ 7,588,000</u>	<u>\$ 6,100,900</u>	<u>\$ —</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 3. Fair Value (continued)

The following table presents the Company's invested assets measured at fair value as of December 31, 2015:

Invested Assets, at Fair Value	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities	\$ 5,676,100	\$ 30,800	\$ 5,645,300	\$ —
Equity securities	7,062,700	6,976,800	85,900	—
Total	<u>\$ 12,738,800</u>	<u>\$ 7,007,600</u>	<u>\$ 5,731,200</u>	<u>\$ —</u>

All debt securities are measured at fair value and are classified as Level 2 with the exception of short-term securities which are priced using quoted market prices and therefore classified as Level 1. See Note 2 for a breakout of debt securities by category.

All equity securities are priced using quoted market prices and classified as Level 1 with the exception of certain mutual funds which are priced by the manager using other observable inputs and therefore classified as Level 2. See Note 2 for a breakout of equity securities by category.

There were no transfers of securities between Levels 1 and 2 in 2016 or 2015.

Securities lending collateral held at December 31, 2016 and 2015 is classified as Level 1 in the fair value hierarchy.

### Note 4. Membership Credit

The Company's Board of Directors approved a membership credit to eligible policyholders for 2016 and 2015. These policyholders were eligible for the membership credit at anniversary or renewal of their policies. If renewed, the membership credit was recorded as a reduction of net premium earned at the anniversary or renewal date.

### Note 5. Reinsurance

The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize its exposure to significant losses from potential reinsurer insolvencies. While such evaluations are intended to minimize the Company's exposure, the ultimate collection of reinsurance recoverables depends on the financial soundness of the individual reinsurers. The reinsurance contracts do not relieve the Company from its obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company; consequently, allowances are established for amounts deemed uncollectible.

The effect of reinsurance on written premium is as follows:

	Year ended December 31	
	2016	2015
Gross written premium	\$ 5,480,500	\$ 5,472,600
Ceded written premium	(1,478,300)	(1,457,800)
Net written premium	<u>\$ 4,002,200</u>	<u>\$ 4,014,800</u>

Ceded losses and loss adjustment expenses incurred for the years ended December 31, 2016 and 2015, were \$392,300 and \$488,400, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 6. Unpaid Losses and Loss Adjustment Expenses

Activity in the net liability for unpaid losses and loss adjustment expenses is summarized as follows:

	Year ended December 31	
	2016	2015
Gross unpaid as of January 1	\$ 3,901,500	\$ 3,872,200
Less: unpaid reinsurance recoverables	1,241,600	1,243,700
Net unpaid as of January 1	<u>\$ 2,659,900</u>	<u>\$ 2,628,500</u>
Net incurred related to:		
Current year	2,182,500	1,933,000
Prior years	(279,100)	52,400
Total net incurred	<u>1,903,400</u>	<u>1,985,400</u>
Net paid related to:		
Current year	724,300	743,900
Prior years	1,120,300	1,210,100
Total net paid	<u>1,844,600</u>	<u>1,954,000</u>
Gross unpaid as of December 31	3,864,900	3,901,500
Less: unpaid reinsurance recoverables	1,146,200	1,241,600
Net unpaid as of December 31	<u>\$ 2,718,700</u>	<u>\$ 2,659,900</u>

As a result of changes in estimates of insured events related to prior years, the provision for losses and loss adjustment expenses decreased by \$279,100 and increased by \$52,400 in 2016 and 2015, respectively. The decrease in 2016 was due to the reduction of incurred-but-not-reported (IBNR) reserves based on actual experience and decreases on a small number of individual losses. The increase in 2015 was primarily attributable to the reserve strengthening for asbestos and environmental due to the Company's exposure analysis.

In establishing reserves for property losses there is uncertainty in management's estimates that cause these estimates to differ from ultimate payments. In establishing the liability for unpaid losses and loss adjustment expenses related to asbestos, environmental and other mass tort-related claims, which applies only to business that is now in runoff, management considers facts currently known and the current state of the law and coverage litigation. Liabilities are recognized for known claims (including the cost of related litigation) when sufficient information has been developed to indicate the involvement of a specific insurance policy and management can reasonably estimate the Company's liability. Liabilities have also been established to cover additional exposures on both known and unasserted claims. Estimates of the liabilities are reviewed continuously. Developed case law and adequate claim history do not exist for such claims, primarily because significant uncertainty exists about the outcomes of coverage litigation and whether past claim experience will be representative of future claim experience.

The Company is the subject of various asserted and unasserted claims and lawsuits covering a wide variety of claims-related issues that arise out of the normal course of its business activities. Potential liabilities arising from litigation and other matters are not considered material in relation to the consolidated financial position or operations of the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 7. Real Estate and Premises and Equipment

Real estate and premises and equipment at December 31, 2016 and 2015 are summarized as follows:

	2016	2015
Land and buildings	\$ 1,303,900	\$ 1,250,200
Furniture, fixtures and equipment	426,400	392,000
Accumulated depreciation	(721,500)	(666,700)
Total	<u>\$ 1,008,800</u>	<u>\$ 975,500</u>

During 2016 and 2015, depreciation expense for real estate and premises and equipment was \$65,200 and \$61,600, respectively.

The Company entered into a build-to-suit lease agreement in 2016 for a new operating office in Singapore. During the construction phase, a financing obligation is recognized equal to all costs funded by the landlord and costs incurred to date are reported as construction in process. The transaction will not qualify for sale-leaseback accounting and the building will be included in "Land and buildings" when construction is complete.

### Note 8. Leases

In connection with its various operating offices located throughout the world, the Company leases office space, land, automobiles, and equipment. These leases are classified as operating leases.

Future minimum lease payments at December 31, 2016, under operating leases with terms of one year or more, are in aggregate \$164,600. The future minimum lease payments for each of the five succeeding years from 2017 to 2021 are \$36,400, \$30,600, \$22,800, \$13,900 and \$9,800, respectively.

During 2016 and 2015, rent expense for all operating leases was \$41,800 and \$42,300, respectively.

### Note 9. Income Taxes

The following is the current and deferred income tax expense (benefit) for the years ended December 31, 2016 and 2015:

	2016	2015
Current income tax expense	\$ 426,000	\$ 383,000
Deferred income tax benefit	(52,600)	(29,900)
Total income tax expense	<u>\$ 373,400</u>	<u>\$ 353,100</u>

A reconciliation of income tax expense computed at U.S. federal statutory tax rates to the income tax expense as included in the accompanying consolidated statements of income follows for the years ended December 31, 2016 and 2015:

	2016	2015
Income tax expense at U.S. federal statutory tax rate	\$ 409,500	\$ 381,800
Tax effect of:		
Nontaxable investment income	(37,300)	(37,000)
Effect of foreign operations	12,500	3,600
Other	(11,300)	4,700
Actual income tax expense	<u>\$ 373,400</u>	<u>\$ 353,100</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 9. Income Taxes (continued)

The significant components of the net deferred tax liability at December 31, 2016 and 2015 are as follows:

	2016	2015
Deferred tax liabilities:		
Deferred acquisition costs	\$ (24,700)	\$ (23,800)
Unrealized appreciation	(1,157,700)	(1,037,000)
Deferred foreign income	(26,800)	(30,200)
Benefit plan expenses	—	(5,200)
Other investment items	(3,100)	(19,800)
Other	(37,000)	(48,400)
Total deferred tax liabilities	<u>(1,249,300)</u>	<u>(1,164,400)</u>
Deferred tax assets:		
Unpaid claims discount	53,200	49,500
Unearned premium reserve	125,700	126,200
Compensation accruals	90,100	83,500
Benefit plan expenses	49,600	—
Unrealized investment losses	78,700	86,600
Unrelieved foreign tax	19,800	26,300
Tax credits	26,800	30,200
Other	77,500	85,200
Total deferred tax assets	<u>521,400</u>	<u>487,500</u>
Valuation allowance	(19,800)	(26,300)
Net deferred tax assets	<u>501,600</u>	<u>461,200</u>
Net deferred tax liability	<u>\$ (747,700)</u>	<u>\$ (703,200)</u>

The Company has established a valuation allowance for its foreign subsidiary's unrelieved foreign tax.

The Company has not recognized a deferred tax liability for the undistributed earnings of certain of its wholly owned foreign subsidiaries that arose in 2016 and prior years, because the Company does not expect those unremitted earnings to reverse and become taxable to the Company in the foreseeable future and the determination of the amount of the unrecognized deferred tax liability related to the undistributed earnings is not practicable. As of December 31, 2016, the undistributed earnings of these subsidiaries were approximately \$272,500.

Income tax paid during 2016 and 2015 was \$366,300 and \$535,000, respectively. In addition, the Company received income tax refunds of \$17,200 and \$28,500 during 2016 and 2015, respectively.

The Company's unrecognized tax benefits are immaterial and it does not expect any material changes within 12 months of the reporting date.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 10. Retirement Income Plans and Postretirement Benefit Plans Other than Pensions

The Company sponsors noncontributory retirement income plans covering the vast majority of employees. The benefits are generally based on years of service and the average of the highest consecutive 60 months of the employee's compensation within the 120 months prior to retirement. The Company's funding policy is to maintain a sufficiently funded level to ensure benefit security and to vary contribution levels as appropriate to business conditions. The Company also has supplemental retirement plans that are noncontributory defined benefit plans covering certain employees.

The Company provides health care and life insurance benefits for certain retired employees and their dependents. Employees not eligible for benefits under pre-merger plan provisions, under age 30 as of January 1, 2000, or hired after January 1, 2000, are ineligible for benefits. Other employees may become eligible if they meet certain age and service requirements. The plan is generally contributory, with retiree contributions adjusted annually, and contains other cost-sharing features, including deductibles and coinsurance.

Obligations and funded status are as follows:

	Pension and Supplemental Benefits		Other Benefits	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Fair value of plan assets	\$ 2,623,600	\$ 2,498,400	\$ 144,600	\$ 145,600
Benefit obligations	2,733,000	2,443,900	185,600	186,900
Funded status, end of year	<u>\$ (109,400)</u>	<u>\$ 54,500</u>	<u>\$ (41,000)</u>	<u>\$ (41,300)</u>

The accumulated benefit obligations for the pension and supplemental benefits plans were \$2,301,800 and \$2,127,800, at December 31, 2016 and 2015, respectively.

The net amounts recognized in other assets and other liabilities are as follows:

	Pension and Supplemental Benefits		Other Benefits	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Asset	\$ 127,500	\$ 216,800	\$ —	\$ —
Liability	(236,900)	(162,300)	(41,000)	(41,300)
Total	<u>\$ (109,400)</u>	<u>\$ 54,500</u>	<u>\$ (41,000)</u>	<u>\$ (41,300)</u>

Pretax amounts included in accumulated other comprehensive income are as follows:

	Pension and Supplemental Benefits		Other Benefits	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Net actuarial loss	\$ 884,900	\$ 723,700	\$ 46,400	\$ 50,800
Prior service cost	500	600	6,500	8,200
Net transition asset	(400)	(500)	—	—
Total	<u>\$ 885,000</u>	<u>\$ 723,800</u>	<u>\$ 52,900</u>	<u>\$ 59,000</u>

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension and supplemental benefit plans with an accumulated benefit obligation in excess of plan assets are as follows:

	Dec. 31, 2016	Dec. 31, 2015
Projected benefit obligation, end of year	\$ 181,600	\$ 144,800
Accumulated benefit obligation, end of year	142,200	121,700
Fair value of plan assets, end of year	—	—

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 10. Retirement Income Plans and Postretirement Benefit Plans Other than Pensions *(continued)*

The projected benefit obligation and fair value of plan assets for pension and supplemental benefit plans with a projected benefit obligation in excess of plan assets are as follows:

	Dec. 31, 2016	Dec. 31, 2015
Projected benefit obligation, end of year	\$ 472,100	\$ 391,300
Fair value of plan assets, end of year	254,300	244,300

Other changes in plan assets and benefit obligations recognized in the Consolidated Statements of Comprehensive Income are as follows:

	Pension and Supplemental Benefits		Other Benefits	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Current year actuarial loss	\$ 204,500	\$ 50,200	\$ 100	\$ 300
Amortization of actuarial loss	(43,300)	(58,400)	(4,500)	(4,100)
Amortization of prior service cost	(100)	(100)	(1,700)	(1,700)
Amortization of net transition asset	100	100	—	—
Total recognized in other comprehensive loss (income)	161,200	(8,200)	(6,100)	(5,500)
Net periodic benefit cost	32,900	54,800	7,300	5,800
Total recognized in net periodic benefit cost and other comprehensive loss	<u>\$ 194,100</u>	<u>\$ 46,600</u>	<u>\$ 1,200</u>	<u>\$ 300</u>

The estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2017 are as follows:

	Pension and Supplemental Benefits	Other Benefits
Actuarial loss	\$ 44,400	\$ 3,400
Prior service cost	100	1,700
Net transition asset	(100)	—
Total	<u>\$ 44,400</u>	<u>\$ 5,100</u>

### Assumptions

Weighted-average assumptions used to determine benefit obligations are as follows:

	Pension and Supplemental Benefits		Other Benefits	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Discount rate	3.84%	4.28%	3.98%	4.33%
Rate of compensation increase	4.55%	4.54%	4.40%	4.42%

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 10. Retirement Income Plans and Postretirement Benefit Plans Other than Pensions (continued)

Assumed health care cost trend rates:

	Other Benefits Dec. 31, 2016	Dec. 31, 2015
Initial rate	6.97%	7.44%
Ultimate rate	5.00%	5.00%
Years to ultimate	7 years	6 years

Weighted-average assumptions used to determine net periodic benefit cost are as follows:

	Pension and Supplemental Benefits Dec. 31, 2016	Dec. 31, 2015	Other Benefits Dec. 31, 2016	Dec. 31, 2015
Discount rate	4.28%	3.99%	4.33%	4.00%
Expected long-term return on plan assets	7.17%	7.20%	6.00%	6.00%
Rate of compensation increase	4.54%	4.52%	4.42%	4.41%

Assumed health care cost trend rates:

	Other Benefits Dec. 31, 2016	Dec. 31, 2015
Initial rate	7.44%	7.47%
Ultimate rate	5.00%	5.00%
Years to ultimate	6 years	6 years

### Pension and Supplemental Benefit Plan Assets

The Company's pension and supplemental benefit plan asset allocation and target allocation are as follows:

Asset Class	Target Allocation Dec. 31, 2017	Percentage of Plan Assets Dec. 31, 2016	Dec. 31, 2015
Equity securities	64%	67%	66%
Debt securities	28	23	21
Cash equivalents	5	5	8
Other	3	5	5
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The maturities of debt securities are as follows:

	Dec. 31, 2016	Dec. 31, 2015
Maturity range	0-55 years	0-55 years
Weighted-average maturity	14.96 years	14.75 years

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

## **Note 10.** Retirement Income Plans and Postretirement Benefit Plans Other than Pensions *(continued)*

The fair value measurements of pension and supplemental benefit plan assets at December 31, 2016, are as follows (refer to Note 3 for the valuation techniques):

Asset Class	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities (a):				
Consumer discretionary	\$ 165,800	\$ 165,800	\$ —	\$ —
Consumer staples	108,600	108,600	—	—
Energy	115,800	115,800	—	—
Financials	250,400	250,400	—	—
Health care	181,600	181,600	—	—
Industrials	124,400	124,400	—	—
Information technology	221,600	221,600	—	—
Mutual funds	461,200	279,200	182,000	—
All other sectors	135,100	135,100	—	—
Total equity securities	<u>1,764,500</u>	<u>1,582,500</u>	<u>182,000</u>	—
Debt securities (b):				
U.S. treasury securities and obligations of U.S. government agencies	187,800	—	187,800	—
Mortgage and asset-backed securities				
Agency	71,800	—	71,800	—
Other mortgage and asset-backed securities	22,200	—	22,200	—
U.S. corporate securities	193,000	—	193,000	—
Mutual funds	106,300	—	106,300	—
Other debt securities	8,500	—	8,500	—
Total debt securities	<u>589,600</u>	—	<u>589,600</u>	—
Cash equivalents	<u>140,000</u>	<u>140,000</u>	—	—
Other (c)	<u>129,500</u>	<u>5,600</u>	—	<u>123,900</u>
Total	<u>\$ 2,623,600</u>	<u>\$ 1,728,100</u>	<u>\$ 771,600</u>	<u>\$ 123,900</u>

(a) Includes common stocks and equity mutual funds of which \$141,400 were on loan under a securities lending program as of December 31, 2016.

(b) Includes \$94,100 of debt securities that were on loan under a securities lending program as of December 31, 2016. The total collateralized value of these loaned securities for both items (a) and (b) was \$240,800 and consisted of \$174,100 in Level 1 short-term and money market investments and \$66,700 in Level 2 government agency debt securities.

(c) Includes private equity partnerships and one real estate partnership.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

## Note 10. Retirement Income Plans and Postretirement Benefit Plans Other than Pensions (continued)

The change in the fair value of the Level 3 Plan investments during 2016 was as follows:

	Other Investments
Balance at January 1, 2016	\$ 116,800
Realized gain	2,900
Unrealized gain relating to instruments still held at the reporting date	2,000
Purchases, sales, issuances and settlements (net)	2,200
Balance at December 31, 2016	\$ 123,900

The fair value measurements of pension and supplemental benefit plan assets at December 31, 2015, are as follows (refer to Note 3 for the valuation techniques):

Asset Class	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities (a):				
Consumer discretionary	\$ 192,600	\$ 192,600	\$ —	\$ —
Consumer staples	89,300	89,300	—	—
Energy	101,300	101,300	—	—
Financials	204,200	204,200	—	—
Health care	164,000	164,000	—	—
Industrials	111,100	111,100	—	—
Information technology	195,600	195,600	—	—
Mutual funds	482,900	306,300	176,600	—
All other sectors	118,100	118,100	—	—
Total equity securities	1,659,100	1,482,500	176,600	—
Debt securities (b):				
U.S. treasury securities and obligations of U.S. government agencies	141,600	—	141,600	—
Mortgage and asset-backed securities				
Agency	62,500	—	62,500	—
Other mortgage and asset-backed securities	29,100	—	29,100	—
U.S. corporate securities	181,700	—	181,700	—
Mutual funds	100,000	—	100,000	—
Other debt securities	7,000	—	7,000	—
Total debt securities	521,900	—	521,900	—
Cash equivalents	194,700	194,700	—	—
Other (c)	122,700	5,900	—	116,800
Total	\$ 2,498,400	\$ 1,683,100	\$ 698,500	\$ 116,800

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 10. Retirement Income Plans and Postretirement Benefit Plans Other than Pensions *(continued)*

- (a) Includes common stocks and equity mutual funds of which \$215,900 were on loan under a securities lending program as of December 31, 2015.
- (b) Includes \$118,500 of debt securities that were on loan under a securities lending program as of December 31, 2015. The total collateralized value of these loaned securities for both items (a) and (b) was \$341,800 and consisted of \$236,100 in Level 1 short-term and money market investments and \$105,700 in Level 2 government agency debt securities.
- (c) Includes private equity partnerships and one real estate partnership.

The change in the fair value of the Level 3 Plan investments during 2015 was as follows:

	Other Investments
Balance at January 1, 2015	\$ 107,400
Realized gain	300
Unrealized gain relating to instruments still held at the reporting date	8,000
Purchases, sales, issuances and settlements (net)	1,100
Balance at December 31, 2015	\$ 116,800

### Other Postretirement Benefit Plan Assets

The Company's other postretirement benefit plan asset allocation and target allocations are as follows:

Asset Class	Target Allocation Dec. 31, 2017	Percentage of Plan Assets	
		Dec. 31, 2016	Dec. 31, 2015
Equity securities	93%	92%	94%
Cash equivalents	7	7	5
Other	—	1	1
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

## **Note 10.** Retirement Income Plans and Postretirement Benefit Plans Other than Pensions *(continued)*

The fair value measurements of other postretirement benefit plan assets at December 31, 2016, are as follows (refer to Note 3 for the valuation techniques):

Asset Class	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities:				
Consumer discretionary	\$ 14,800	\$ 14,800	\$ —	\$ —
Consumer staples	11,700	11,700	—	—
Energy	11,300	11,300	—	—
Financials	17,300	17,300	—	—
Health care	19,800	19,800	—	—
Industrials	14,300	14,300	—	—
Information technology	22,300	22,300	—	—
Mutual funds	11,200	11,200	—	—
All other sectors	11,400	11,400	—	—
Total equity securities	<u>134,100</u>	<u>134,100</u>	<u>—</u>	<u>—</u>
Debt securities:				
U.S. corporate securities	—	—	—	—
Total debt securities	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Cash equivalents	<u>10,000</u>	<u>10,000</u>	<u>—</u>	<u>—</u>
Other (a)	500	500	—	—
Total	<u>\$ 144,600</u>	<u>\$ 144,600</u>	<u>\$ —</u>	<u>\$ —</u>

(a) Includes a real estate partnership.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

## **Note 10.** Retirement Income Plans and Postretirement Benefit Plans Other than Pensions *(continued)*

The fair value measurements of other postretirement benefit plan assets at December 31, 2015, are as follows (refer to Note 3 for the valuation techniques):

Asset Class	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities:				
Consumer discretionary	\$ 21,600	\$ 21,600	\$ —	\$ —
Consumer staples	11,900	11,900	—	—
Energy	10,700	10,700	—	—
Financials	14,000	14,000	—	—
Health care	20,500	20,500	—	—
Industrials	14,500	14,500	—	—
Information technology	19,700	19,700	—	—
Mutual funds	14,600	14,600	—	—
All other sectors	9,600	9,600	—	—
Total equity securities	<u>137,100</u>	<u>137,100</u>	—	—
Debt securities:				
U.S. corporate securities	—	—	—	—
Total debt securities	—	—	—	—
Cash equivalents	7,700	7,700	—	—
Other (a)	800	800	—	—
Total	<u>\$ 145,600</u>	<u>\$ 145,600</u>	<u>\$ —</u>	<u>\$ —</u>

(a) Includes a real estate partnership.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### **Note 10.** Retirement Income Plans and Postretirement Benefit Plans Other than Pensions *(continued)*

#### Pension and Postretirement Plans Asset Investment Narrative

The investment policy of the Pension and Postretirement Plans specify the types of securities that may be used, limits on the amount of the asset classes and subclasses, and general principles used in managing the plans' assets. The overriding objective is to maximize long-term total return of plan assets within constraints established to control risk and volatility. Three primary asset classes represent the first layer of asset allocation, these being equity securities, debt securities and cash equivalents. Since equity securities are expected to provide the highest long-term total return, exposure to equities is emphasized. As a representative example, current approved ranges for the three asset classes in the U.S. pension fund, which is also the largest of the retirement plans, are as follows:

Asset Class	Range
Equity securities	50-80%
Debt securities	10-50%
Short-term investments	0-15%

Equity securities include individual common stocks as well as equity mutual funds and private equity partnerships. All equity investments are based on fundamental analysis of investment variables, including earning prospects, cash flow, balance sheet strength, competitive positioning and other factors. Diversification is emphasized, with specific size limits on individual stocks, international-oriented mutual funds, small capitalization-oriented funds and private equity. Investment returns are benchmarked against standard indices including the S&P 500 and MSCI global stock indices.

Debt securities include individual securities, primarily in the high-grade taxable subcategory, debt mutual funds, as well as an outside managed portfolio of U.S. high-yield bonds. Debt securities are actively managed, using many of the same investment disciplines as in the Company's general account. These disciplines include diversification of securities and ongoing analysis of the fundamental and valuation factors underlying the securities owned.

Short-term investments, defined as debt securities with a maturity of less than one year, are held primarily for liquidity purposes. Safety of principal is the primary consideration of investment in this asset class, and so only the highest quality investments are used. This will principally be money market funds and commercial paper carrying the highest quality ratings.

Expected rate of return assumptions are created based on assessments of future behavior of asset classes. As part of the process, historical relationships are considered. Using a three- to five-year outlook, estimates of numerous variables are combined to gauge economic growth potential. Corporate cash flows are correlated with economic growth but also reflect productivity and profit margin trends, with positive cash flow trends driving favorable return to equity owners. Debt security returns are expected to produce somewhat lower returns with a lower level of volatility compared to equities.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

## **Note 10.** Retirement Income Plans and Postretirement Benefit Plans Other than Pensions *(continued)*

### **Cash Flows**

Employer Contributions	Pension and Supplemental Benefits	Other Benefits
2015	\$ 7,400	\$ —
2016	32,400	—
2017 (expected)	30,300	—

Contributions by participants to the other benefit plans were \$5,500 and \$4,400 for the years ended December 31, 2016 and 2015, respectively.

Benefit Payments	Pension and Supplemental Benefits	Other Benefits	Other Benefits (Government Subsidy)
2015	\$ 74,300	\$ 11,100	\$ 1,200
2016	78,800	11,700	1,000

Estimated Future Payments	Pension and Supplemental Benefits	Other Benefits	Other Benefits (Government Subsidy)
2017	\$ 87,800	\$ 11,700	\$ 1,000
2018	97,000	11,800	1,000
2019	98,400	11,900	1,000
2020	102,500	12,000	900
2021	108,400	12,100	900
2022-2026	627,700	59,400	4,300

The Company also sponsors a 401(k) savings plan whereby eligible employees may elect annually to contribute from 1 percent to 50 percent of their base pay on a pretax or after-tax basis. Employee contributions are restricted to IRS limits. The Company matches pretax and after tax contributions up to 6 percent of the employee's base pay. Company contributions to the plan were \$20,900 in 2016 and \$20,200 in 2015.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 11. Components of Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income by component, net of income tax, for the year ended December 31, 2016 are as follows:

	Unrealized Appreciation on Investments in Debt and Equity Securities	Benefit Plan Assets and Liabilities	Foreign Currency Translation Adjustment	Accumulated Other Comprehensive Income
Balance at January 1, 2016	\$ 2,013,300	\$ (515,900)	\$ (251,400)	\$ 1,246,000
Other comprehensive income (loss) before reclassifications	469,100	(141,400)	(110,600)	217,100
Amount reclassified from accumulated other comprehensive income	(162,200)	32,400	—	(129,800)
Net current period other comprehensive income (loss)	306,900	(109,000)	(110,600)	87,300
Balance at December 31, 2016	<u>\$ 2,320,200</u>	<u>\$ (624,900)</u>	<u>\$ (362,000)</u>	<u>\$ 1,333,300</u>

The following are reclassifications out of accumulated other comprehensive income to net income for the year ended December 31, 2016:

Unrealized appreciation of investment in debt and equity securities:

Net realized investment gains	\$ 297,100
Other than temporary impairment losses	(56,400)
Total before tax	<u>240,700</u>
Income tax expense	(78,500)
Net of tax	<u>\$ 162,200</u>

Amortization of benefit plan amounts:

Actuarial losses	\$ (47,800)	(a)
Prior service cost	(1,800)	(a)
Net transition asset	100	(a)
Total before tax	<u>(49,500)</u>	
Income tax benefit	17,100	
Net of tax	<u>\$ (32,400)</u>	

- (a) These accumulated other comprehensive income components are included in the computation of net periodic cost (see Note 10).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

(in thousands)

### Note 11. Components of Accumulated Other Comprehensive Income *(continued)*

The changes in accumulated other comprehensive income by component, net of income tax, for the year ended December 31, 2015 are as follows:

	Unrealized Appreciation on Investments in Debt and Equity Securities	Benefit Plan Assets and Liabilities	Foreign Currency Translation Adjustment	Accumulated Other Comprehensive Income
Balance at January 1, 2015	\$ 2,232,900	\$ (522,900)	\$ (125,300)	\$ 1,584,700
Other comprehensive loss before reclassifications	(75,000)	(34,900)	(126,100)	(236,000)
Amount reclassified from accumulated other comprehensive income	(144,600)	41,900	—	(102,700)
Net current period other comprehensive (loss) income	(219,600)	7,000	(126,100)	(338,700)
Balance at December 31, 2015	<u>\$ 2,013,300</u>	<u>\$ (515,900)</u>	<u>\$ (251,400)</u>	<u>\$ 1,246,000</u>

The following are reclassifications out of accumulated other comprehensive income to net income for the year ended December 31, 2015:

#### Unrealized appreciation of investment in debt and equity securities:

Net realized investment gains	\$ 310,400
Other than temporary impairment losses	(94,000)
Total before tax	<u>216,400</u>
Income tax expense	(71,800)
Net of tax	<u>\$ 144,600</u>

#### Amortization of benefit plan amounts:

Actuarial losses	\$ (62,500)	(a)
Prior service cost	(1,800)	(a)
Net transition asset	100	(a)
Total before tax	<u>(64,200)</u>	
Income tax benefit	22,300	
Net of tax	<u>\$ (41,900)</u>	

- (a) These accumulated other comprehensive income components are included in the computation of net periodic cost (see Note 10).

### Note 12. Subsequent Events

Subsequent events were evaluated through March 1, 2017, the date the consolidated financial statements were available to be issued. No material transactions occurred after the balance sheet date that would impact the consolidated financial statements.

# Corporate Governance

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# Business Operations

In addition to its large-risk property insurance line of business, the FM Global Group comprises a number of other key business operations. Several of those are described in this section.



## Corporate Insurance Services

Member of the FM Global Group



**AFM** specializes in commercial property insurance for the middle market. AFM provides tailored underwriting expertise and property loss control engineering through a select international network of broker partners. The organization has office locations in Australia, Canada, France, Germany, Italy, the Netherlands, the United Kingdom and throughout the United States, and it offers coverage in more than 60 countries.

**FM Global Cargo** provides cargo insurance coverage, automated certificate issuance and risk engineering services tailored to the international trade and transportation needs of global businesses.

**Corporate Insurance Services** (CIS) is FM Global's wholly owned brokerage operation, maintaining relationships with a variety of U.S. domestic insurers, Lloyd's of London, excess and surplus lines insurers and specialty companies.

**FM Global Emergency Response Consultants** is an emergency services training organization providing comprehensive training for emergency response personnel and those responsible for organizing, managing and/or directing emergency response activities.

**FM Approvals** offers worldwide third-party testing and certification services for loss prevention products used in commercial and industrial property risk mitigation applications. The FM APPROVED certification mark is globally accepted by regulators and supports decisions about which products will best reduce property risk and help to make businesses more resilient.

**Mutual Boiler Re** provides boiler and machinery insurance in North America, specializing in mechanical, electrical and pressure systems breakdown treaty reinsurance and support services to the commercial property insurance marketplace. Today it works with more than 200 insurance companies, providing coverage to their policyholders.



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## Appointed actuary's report to the Directors of Factory Mutual Insurance Company

Report in respect of a review of actuarial information in, or used in the preparation of, financial statements

This report is provided under section 78 of the *Insurance (Prudential Supervision) Act 2010* ("the Insurance Act"), and relates to a review of the actuarial information in, or used in the preparation of, the financial statements of Factory Mutual Insurance Company ("FMIC (US)") for the year ended 31 December 2016.

The financial statements were authorised for issue by the Board of Directors of FMIC (US) on 1 March 2017 and the accompanying independent auditors' report was issued on 1 March 2017.

### Name of appointed actuary conducting the review

I, Martin Fry, of Taylor Fry Consulting Actuaries ("Taylor Fry") am a Fellow of the New Zealand Society of Actuaries. This review has been conducted by me in my role as appointed actuary to FMIC (NZ).

Other than that of actuary, I confirm that I have no relationship with, or any other interests in, FMIC (NZ) or FMIC (US).

### Solvency margin

I have been provided with a Letter of Representation from the Chief Executive Officer of FMIC (US) to the independent auditors of FMIC (US), which attests that FMIC (US) has complied with the rules and requirements of the State of Rhode Island and Providence Plantations Department of Business Regulation for the period covered by the financial statements for the year ended 31 December 2016. I have not reviewed the calculations underlying the solvency data supplied to the State of Rhode Island but have relied on the attestation of FMIC (US) and the report of the auditors as to their accuracy.

### Work done in relation to actuarial information used in the financial statements

The actuarial information used in the financial statements comprises the outstanding claims liability as at 31 December 2016 shown in the statement of financial position. This amount was determined in accordance with the United States Generally Accepted Accounting Principles (US GAAP), and represents the net central estimate. I have not reviewed the calculations underlying this amount but have relied on the attestation of FMIC (US) and the report of the auditors as to their adequacy.

#### Sydney

Level 11, 55 Clarence Street  
Sydney NSW 2000

P 02 9249 2900  
F 02 9249 2999

#### Melbourne

Level 27, 459 Collins Street  
Melbourne VIC 3000

P 03 9658 2333  
F 03 9658 2344

ACN 087 047 809  
ABN 29 087 047 809  
W [www.taylorfry.com.au](http://www.taylorfry.com.au)



I have not carried out a Liability Adequacy Test. There is a reserve for unearned premium in the accounts that is determined in accordance with US GAAP.

In carrying out this review, I confirm that I have been provided with all required information and explanations from FMIC (US).

### Opinion

In my opinion, based on the Letter of Representation from the Chief Executive Officer of FMIC (US) to the auditors of FMIC (US) and on the independent auditor's report contained in the financial statements, the financial statements for FMIC (US) comply with the solvency standards of the State of Rhode Island.

### Scope and limitations of review

This report is prepared for the Directors of FMIC (US), solely for the purposes set out in section 78 of the Insurance Act and for no other purpose.



Martin H Fry  
Fellow of the New Zealand Society of Actuaries

*13 April 2017*