Report on the Zone Association Examination

of

AFFILIATED FM INSURANCE COMPANY
Johnston, Rhode Island

as of

December 31, 2012

State of Rhode Island and Providence Plantations
Department of Business Regulation
Insurance Division

State of Rhode Island and Providence Plantations
DEPARTMENT OF BUSINESS REGULATION
1511 Pontiac Avenue, Bldg. 69-2
Cranston, Rhode Island 02920

Insurance Division

DIRECTOR'S ORDER

The attached Report of Examination as of December 31, 2012, of the condition and affairs of AFFILIATED FM INSURANCE COMPANY, was recently completed by duly qualified examiners, pursuant to the provisions of the Rhode Island General Laws.

Due consideration has been given to the comments of the examiners regarding the operation of the Company and its financial condition, as reflected in the report.

It is therefore ORDERED that said Report be, and it is hereby, adopted and filed and made an official record of this Department as of this date.

DEPARTMENT OF BUSINESS REGULATION

Paul McGreevy
Director / Insurance Commissioner

ORDER # 13-063

DATED: 12/11/13

TABLE OF CONTENTS

November 8, 2013

Honorable Paul McGreevy
Insurance Commissioner
State of Rhode Island and Providence Plantations
Department of Business Regulation
1511 Pontiac Avenue, Bldg. 68-2
Cranston, Rhode Island 02920

Dear Commissioner McGreevy:

In accordance with your instructions and pursuant to Chapters 13, 13.1 and 35 of Title 27 of the General Laws of the State of Rhode Island, an examination has been made as of December 31, 2012 of the financial condition and affairs of

AFFILIATED FM INSURANCE COMPANY

at its home office located at 270 Central Avenue, Johnston, Rhode Island. The report of such examination is herewith submitted.

Affiliated FM Insurance Company, also referred to within this report as “Affiliated FM” or “the Company,” was previously examined as of December 31, 2008. Both the current and prior examinations have been conducted by the Insurance Division of the State of Rhode Island (“Insurance Division”) representing the Northeastern Zone of the National Association of Insurance Commissioners (“NAIC”).

SCOPE OF EXAMINATION

The current examination was performed in compliance with the above-mentioned sections of the General Laws of the State of Rhode Island, as amended, and covered the intervening four-year period ended December 31, 2012. The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook* ("Handbook"), Risk-Focused Examination Process. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about corporate governance, identifying and assessing inherent risks, and evaluating the controls and procedures used to mitigate those risks. The examination included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and the NAIC *Annual Statement Instructions*. The examination process included a business risk assessment to focus examination procedures on those areas considered to have greater risk in order to identify significant operating issues and/or deviations from statutory accounting practices that may affect solvency. All accounts and activities of the Company were considered in accordance with the Risk-Focused Examination Process.

The Company instructed their independent accounting firm to make available for review all work papers concerning procedures followed, tests performed, information obtained, and conclusions reached pertinent to the firm's audit of the Company's financial statements for the years ended December 31, 2011 and December 31, 2012. The work papers of the independent accounting firm were reviewed in order to ascertain the extent to which procedures were employed to determine compliance with statutory requirements and guidelines. The work papers and analyses prepared by the independent accounting firm were utilized to the extent possible. Where applicable, the independent accounting firm's work papers have been incorporated into the examination process.

At December 31, 2012, FMIC Holdings, Inc., a wholly owned subsidiary of Factory Mutual Insurance Company ("FMIC"), owned 100% of Affiliated FM's outstanding common stock and 65.5% of its outstanding preferred stock. Appalachian Insurance Company ("Appalachian") owned the remaining 34.5% of the preferred stock. Examinations of both FMIC and Appalachian, the common stock of which is also 100% owned by FMIC Holdings, Inc., were conducted concurrently with this examination, with reports thereon submitted under separate cover. FMIC and Appalachian are chartered in the State of Rhode Island, and located in Johnston, Rhode Island.

COMPANY HISTORY

The Company was chartered by an Act of the General Assembly of the State of Rhode Island at its January 1949 session. The Charter was amended in 1969, 1975, 1980, 1988, and 1994.

Prior to July 1, 1971, Affiliated FM was owned by the Associated Factory Mutual Insurance Companies, which consisted of Allendale Mutual Insurance Company (then named MFB Mutual Insurance Company), Arkwright-Boston Manufacturers Mutual Insurance Company, Philadelphia Manufacturers Mutual Insurance Company (which has since merged with Arkwright-Boston) and Protection Mutual Insurance Company. On July 1, 1971, Allendale Associates, Inc. a wholly owned subsidiary of Allendale Mutual Insurance Company ("Allendale Mutual") acquired the capital stock of Affiliated FM that was owned by Allendale and Arkwright-Boston. Further acquisitions in 1974 and 1977 from Protection Mutual and Philadelphia Manufacturers resulted in Allendale Associates, Inc. attaining 100% ownership of the 30,000 shares of Affiliated FM's outstanding common stock. Finally, on July 1, 1999, Allendale Associates, Inc. changed its name to FMIC Holdings Inc. The name change was the result of the three remaining factory mutual companies (Allendale Mutual Insurance Company, Arkwright Mutual Insurance Company, and Protection Mutual Insurance Company) merging into Allendale, with Allendale Mutual subsequently changing its name to Factory Mutual Insurance Company. The group currently operates under the name FM Global.

In 1975 the Company issued $100 par value 7% cumulative preferred stock in accordance with a charter amendment completed that same year. In 1978 and 1979 the Company issued additional preferred stock, and in 1982 it accomplished a reorganization whereby one-half of the total 7% cumulative preferred stock outstanding at that time, amounting to $7,250,000, was exchanged by the holders thereof for surplus notes bearing interest at 7%. The Company's preferred stock has always been issued at par. The holders of preferred stock have no voting rights and the Company may, at its discretion, redeem any such shares issued and outstanding.

On October 11, 1995, Allendale Associates, Inc. purchased an additional 50,000 shares of the Company's $50 par value common stock. This capital stock purchase received the necessary approval from the Rhode Island Insurance Division, and the Company filed the necessary amendments to its Articles of Incorporation.

To enable the Company to increase its capacity to write additional business, and to improve its surplus position, from time to time it has issued interest-bearing surplus notes. Originally issued for a one-year term, the notes contain a provision that they are automatically renewed from year to year unless the Company redeems them. The redemption may only take place, once prior written approval of the Rhode Island Department of Business Regulation is obtained. As of December 31, 2012, all surplus notes have been redeemed.

At December 31, 2012 FMIC Holdings, Inc. owns all 80,000 shares of the Company's $50 par value common stock for a total of $4,000,000, and it owned 47,500 shares, or 65.5%, of the $100 par value 7% cumulative preferred stock, for a total of $4,750,000. Appalachian Insurance Company owns 25,000 shares or 34.5% of the Company's $100 par value 7% cumulative preferred stock for a total of $2,500,000.

MANAGEMENT AND CONTROL

Stockholders

The bylaws, as amended, provide that the Annual Meeting of the Company shall be held at the principal offices of the Company, or at such other place as may be stated in the notice of the meeting, at 9:00 a.m. on the second Thursday of April in each year. Special meetings shall be called at any time by the Chairman of the Board, the Chairman of the Executive Committee, or the President, or by request in writing addressed to the Secretary by any five directors.

At all meetings of the shareholders, the presence, in person or by proxy, of one-fifth of the shareholders shall be necessary to constitute a quorum. The vote of a smaller number of shareholders may adjourn the meetings from time to time. When a quorum is present at any meeting, all questions except amendments to the bylaws shall be decided by a majority vote of those present in person or by proxy.

Board of Directors

The Charter provides that the management of the business and affairs of the Company shall be vested in a Board of Directors, the number of which shall be fixed from time to time by the bylaws. At the Annual Meeting of the Company, directors shall be elected by the shareholders, each for a term of three years, to succeed that class of directors whose term then expires. In case of any increase in the number of directors, one-third of the additional number shall be elected for the then unexpired portion of the term of those directors whose term expires in the year in which the increase is made; one-third for the unexpired portion of the term of those directors whose term expires in the year following that in which such increase is made, and one-third for the unexpired portion of the term of those directors whose term expires in the second year next after that in which such increase is made. All directors shall serve until their successors are elected and qualified.

The bylaws provide that the number of directors shall be set at up to twenty-one unless and until a different number shall be determined by action of the Board. If the Board of Directors shall decrease the number of directors, such decrease shall not be effective with respect to terms of directors then holding office until the expiration of each such directors term. Directors shall be elected as prescribed by the Charter of the Company. The directors may fill any vacancy in their own body occurring between annual meetings. Any vacancy existing at the time of the annual meeting may be filled by the shareholders at said meeting. The person chosen to fill any vacancy shall hold office for the unexpired term of the class in which such vacancy exists.

A quorum of the Board of Directors shall consist of a majority, and a majority vote of the directors in attendance at any meeting of the Board of Directors shall, in the presence of a quorum, decide its action. Less than a quorum of the Board of Directors may adjourn the meeting from time to time. When a meeting is adjourned to a specific time and place, notice of the adjourned meeting need not be given.

While the bylaws make no reference to a mandatory retirement age for directors, at a meeting of the Board of Directors on March 7, 1979, it was voted to establish a policy that no director could be elected for a new term following attainment of age 68. Subsequent to the merger, this policy was reaffirmed in the July 13-14, 1999 Board of Directors' minutes. The foregoing policy was still in force at December 31, 2012.

The membership of the Board of Directors, together with the principal business or professional affiliation of each director was as follows at December 31, 2012:

Name	**Business Affiliation**	**Term Expires**
Frank T. Connor	Executive Vice President and Chief Financial Officer Textron, Inc.	2014
Walter J. Galvin	Vice Chairman Emerson Electric Co.	2015
John A. Luke Jr.	Chairman and Chief Executive Officer MeadWestvaco Corporation	2014
Jonathan D. Mariner	Executive Vice President and Chief Financial Officer Major League Baseball	2014
Gracia C. Martore	President and Chief Executive Officer Gannett Co., Inc.	2014
Christine M. McCarthy	Executive Vice President Corporate Real Estate, Sourcing, Alliances and Treasurer The Walt Disney Company	2013
Robert J. O'Toole	Director and Retired Chairman and Chief Executive Officer A.O. Smith Corporation	2013
John R. Paloian	Chief Operating Officer RR Donnelley	2013
David Pulman	President, Global Manufacturing and Supply	2013

	GlaxoSmithKline	
Edward J. Rapp	Group President Caterpillar Inc.	2015
Shivan S. Subramaniam	Chairman and Chief Executive Officer Factory Mutual Insurance Company	2015
James C. Thyen	President and Chief Executive Officer Kimball International, Inc.	2013
Alfred J. Verrecchia	Chairman of the Board Hasbro, Inc.	2013

Committees

The bylaws, as amended, provide that the Board of Directors shall elect an Executive Committee and a finance committee to which certain powers and responsibilities may be delegated. The bylaws also provide that the Board may elect from their own number, any other Committees they deem advisable, and may delegate to such committees authority to exercise the powers of the Board with respect to the duties of the committee. Committees elected by the Board of Directors consisted of the following at December 31, 2012:

Executive Committee

Shivan S. Subramaniam, *Chairman*
Walter J. Galvin
John A. Luke, Jr.
Robert J. O'Toole
Edward J. Rapp

Audit Committee

Edward J. Rapp, *Chairman*
Frank T. Connor
Jonathan D. Mariner

Finance Committee

Walter J. Galvin, *Chairman*
Christine M. McCarthy
John R. Paloian
Shivan S. Subramaniam

Compensation Committee

John A. Luke, Jr., *Chairman*
Gracia C. Martore
Robert J. O'Toole
David Pulman
James C. Thyen
Alfred J. Verrecchia

Officers

The bylaws provide that the Board of Directors shall elect the executive officers of the Company. Executive officers consist of a Chairman of the Board, a President, a Secretary, a Treasurer and, at the option of the Board of Directors, one or more Vice Chairmen of the Board, a Chairman of the Executive Committee, one or more Executive Vice Presidents, and one or more Senior Vice Presidents. The executive officers elected shall serve until the first meeting of the directors following the succeeding annual meeting of the Company and until their respective successors are elected and qualified, unless sooner removed by the vote of the Board of Directors. In addition, the directors may from time to time elect officers to hold office at the pleasure of the Board. Any person may hold more than one office, except that the offices of President and Secretary may not be held by the same person.

The executive officers of the Company shall have all the powers and privileges and shall perform all the duties incumbent upon them by law, or prescribed by the bylaws or by the Board of Directors of the Company. The executive officers of the Company shall also have the authority to incur all necessary expenses for the proper conduct of the business of the Company.

The officers serving and their respective titles at December 31, 2012 are as follows:

Shivan Subramaniam	Chairman and Chief Executive Officer
Jonathan Hall	Executive Vice President
Thomas Lawson	Executive Vice President
Bret Ahnell	Senior Vice President

Gerardo Alonso	Senior Vice President
Jeffery Burchill	Senior Vice President
Brion Callori	Senior Vice President
Kenneth Davey	Senior Vice President
Rodney Fisher	Senior Vice President
James Galloway	Senior Vice President
Chris Johnson	Senior Vice President
Paul LaFleche	Senior Vice President
Kenneth Lavigne	Senior Vice President
Michael Lebovitz	Senior Vice President
Jeanne Lieb	Senior Vice President
William Mekrut	Vice President and Treasurer
John Pomeroy	Senior Vice President and Secretary
Enzo Rebula	Senior Vice President
Michael Turner	Senior Vice President
Z. Alex Tadmoury	Senior Vice President
Roberta Butler	Senior Vice President

Conflict of Interest

The Company has in place a "Statement of Policy Relative to Business Conduct" ("Policy") with accompanying guidelines that sets forth the expected conduct of its directors and employees in relation to the organization and the community in which FM Global conducts business. This policy statement includes the following sections:

- Statement of Policy Relative to Business Conduct
- Conflict of Interest
- Political Activities
- Confidentiality and Security of Information
- Statement of Electronic Privacy and Usage
- Antitrust Guidelines
- Statement of Policy on Anti Bribery and Corruption

Each covered individual is expected to accept responsibility for maintaining compliance with this Policy at FM Global. On an annual basis, directors, officers and managerial and professional employees are asked to review the Policy and confirm their review and compliance electronically. An electronic log is maintained of all employee acceptances with continuous follow-ups until all employees other than those on medical or military leave have accepted. Separate follow-ups are made with the directors. The documentation is maintained in the Law and Governmental Affairs Department, under the Corporate Secretary's direction, as the organization's principal compliance officer.

Corporate Records

The records of the meetings of the Members, Board of Directors, and all committees thereof were reviewed as part of this examination. The meetings appeared to be held in accordance with the Company's bylaws and did not contain evidence of any actions contrary to the Company's charter, bylaws, or the Rhode Island General Laws. Matters of regulatory significance are commented throughout this report where deemed appropriate.

FIDELITY BONDS AND OTHER INSURANCE

At December 31, 2012, the Company and its affiliates were named insureds on a Financial Institution Bond ("Bond") issued by an insurer authorized to transact business in Rhode Island. The following is a summary of the coverages provided under the Bond:

Insuring Clause	Single Loss Limit of Liability	Single Loss Deductible
Employee Dishonesty and Fraudulent Acts	$25,000,000	$500,000
On Premises	$25,000,000	$500,000

In Transit	$25,000,000	$500,000
Forgery or Alteration	$25,000,000	$500,000
Counterfeit Currency	$25,000,000	$500,000
Trading Loss	$25,000,000	$500,000

The coverage provided under the Bond to the Company and its affiliates exceeds the minimum amount suggested by the NAIC for the level of exposure.

The Company is also protected by additional insurance policies providing coverage for workers' compensation, general liability, property, automobile liability, umbrella, directors' and officers' liability, employment practices liability, employed lawyers, and pension and employee welfare fiduciary responsibility. Management has determined the adequacy of these coverages.

OFFICERS' AND EMPLOYEES' WELFARE AND PENSION PLANS

The Company had no employees. All services necessary for functioning of the Company were provided by employees of FMIC, and there were expense allocations to Affiliated FM for these services.

STATUTORY DEPOSITS

As of December 31, 2012, the Company maintains the following statutory deposits either for the protection of all policyholders, or for the protection of policyholders within those particular jurisdictions:

State	Description	Book/Adjusted Carrying Value	Fair Value
Rhode Island	Bond	$3,214,582	$3,330,573
Total Rhode Island Deposits (*Note 1*)		$3,214,582	$3,330,573
California	Bond	566,090	586,516
Georgia	Bond	25,272	26,184
Massachusetts	Bond	50,544	52,368
New Mexico	Bond	808,700	837,880
North Carolina	Bond	303,262	314,205
Oklahoma	Bond	303,262	314,205
Oregon	Bond	672,232	696,488
Total Other Deposits		2,729,362	2,827,846
Total Statutory Deposits		$5,943,944	$6,158,419

Note 1: The deposit maintained in Rhode Island is for the benefit of all policyholders while the deposits maintained in all other jurisdictions are for the benefit of policyholders in that particular jurisdiction.

PLAN OF OPERATION

Affiliated FM Insurance Company is a member of the FM Global Group, and specializes in providing commercial property insurance for the middle market segment of business and industry. The Company provides innovative products and services designed to protect assets, improve operating reliability, reduce the overall cost of risk, and help maintain the profits and market share of its clients.

Affiliated FM's products and services are delivered through a select network of agents and brokers on a global basis. The Company's strategy is to develop long term relationships with its brokers and clients through its property underwriting knowledge, expertise and products, customized property loss prevention engineering programs, responsive and efficient services in a highly automated environment, and prompt, professional, flexible, and fair claims services.

With offices in North America, Europe and Australia, Affiliated FM has positioned itself to support middle market clients as they expand their worldwide reach, and provide tailored underwriting and loss prevention engineering solutions for facilities around the world. This includes new product development tailored to the specific needs of target market segments.

TERRITORY

A review of certificates of authority or compliance in effect at December 31, 2012, verified that the Company is licensed to transact business in all states, as well as the District of Columbia, Guam, The Commonwealth of the Northern Mariana Islands, Puerto Rico and the Virgin Islands The Company is also licensed by the Dominion of Canada, all provinces thereof, and the Northwest Territories.

In 2012, approximately 49.7% of the Company's direct premiums written were derived from the following five jurisdictions: California (13.9%); Canada (13.5%); New York (9.9%); Texas (6.3%) and Washington (6.1%).

GROWTH OF COMPANY

The following table shows the business trend (in dollars) of the Company for the most recent five years, as reported in its filed Annual Statements ($000's):

	2012	2011	2010	2009	2008
Net Premiums Written	444,225	389,213	347,670	381,758	336,173
Net Underwriting Gain/(Loss)	61,338	(73,830)	72,021	119,568	4,383
Net Income (Loss)	85,992	(23,689)	86,442	115,391	32,903
Total Admitted Assets	2,302,163	1,874,643	1,915,425	1,621,717	1,470,532
Total Liabilities	1,268,064	969,063	982,064	793,503	774,997
Policyholders' Surplus	1,034,098	905,580	933,362	828,214	695,535

LOSS EXPERIENCE

The Company's Losses and Loss Adjustment Expenses ("LAE") incurred as a percentage of Premiums Earned for the most recent five years, as reported in its filed Annual Statements is as follows:

	2012	2011	2010	2009	2008
Losses Incurred	56.7	91.8	47.0	37.8	72.1
LAE Incurred	3.0	3.4	3.7	4.1	5.5

REINSURANCE

Ceded Reinsurance

Factory Mutual Insurance Company ("FMIC") and its subsidiaries, Affiliated FM Insurance Company ("Affiliated"), Appalachian Insurance Company ("Appalachian"), FM Insurance

Company Limited ("FMI"), FM Global de Mexico, S.A. de C.V. ("FM Mexico"), and such other companies as may be controlled by these companies, if any, and their Quota Share Reinsurers (collectively referred to as the "Company" for purposes of this section) are named reinsureds on the following reinsurance treaties in force at December 31, 2012:

- Core Reinsurance Treaty ("CRT")

Effective July 1, 2012, the Company entered into a reinsurance treaty covering risks classified as property, boiler and machinery, and non-physical damage per the Company's original policies. The limit of coverage is $150,000,000 in respect to each risk declared, each loss. The maximum recovery in any one loss occurrence shall not exceed $500,000,000. As respects to earth movement losses in the Pacific Northwest Region (the states of Washington, Oregon and the Canadian Province of British Columbia), the maximum recovery per occurrence is increased by $200,000,000 to $700,000,000. The CRT can be used on a pro rata or excess of loss basis.

- Property Excess of Loss Reinsurance Contract

Effective July 1, 2012, the Company entered into a joint protection program which provides per risk and catastrophe reinsurance on business classified as property, boiler and machinery, and non-physical damage. The limit and retention for each layer as of December 31, 2012 is as follows:

<table>
<tr><th>PER RISK</th><th colspan="2">CATASTROPHE</th></tr>
<tr><td rowspan="3"></td><td colspan="2">$300M excess of $1,000M
(Pacific Northwest Region Earth Movement Only)</td></tr>
<tr><td colspan="2">$150M excess of $850M
(Worldwide All Perils and U.S. Named Southeast Storm)</td></tr>
<tr><td colspan="2">$300M excess of $550M
(Worldwide)</td></tr>
<tr><td>$300M excess of $400M</td><td colspan="2">$150M excess of $400M
(Worldwide)</td></tr>
<tr><td>$150M excess of $250M</td><td>50% FM Global Co-Participation</td><td>$100M excess of $300M
(Worldwide)</td></tr>
<tr><td>$250M Per Risk Retention</td><td colspan="2">$300M Catastrophe Retention</td></tr>
</table>

- <u>Maximum Capacity Treaty (“MCT’)</u>

Effective April 1, 2012, the Company entered into a reinsurance treaty whereby business classified as property, boiler and machinery, and non-physical damage per the Company’s original policies, is used on an excess of loss basis. This treaty is used on the Company’s "best of class" business and the risk limit is $400,000,000 each risk, each loss. This treaty excludes flood and earth movement, but includes fire following.

- Excess Capacity Treaty ("ECT")

Effective May 1, 2012, the Company entered into a reinsurance treaty whereby business classified as property, boiler and machinery, and non-physical damage per the Company's original policies, is used on an excess of loss basis when reinsurance is needed above the Company's generated net capacity. This treaty is used on a location basis, excluding flood and earth movement, but includes fire following. The risk limit is $200,000,000 per cession.

- Woodworking Automatic Facility ("WWF")

Effective April 1, 2012, the Company entered into a reinsurance treaty whereby business classified as property, boiler and machinery, and non-physical damage per the Company's original policies, is used on an excess of loss basis. This treaty is used only for woodworking business and the risk limit is $70,000,000 in excess of $30,000,000.

- Primary Layer Underwriting Strategy Facility (PLUS)

Effective June 1, 2012, the Company entered into a reinsurance treaty whereby business classified as property is used predominantly for earth movement cessions. There are two sections to this treaty. Under Section A, reinsurance is placed over the entire account on an all risk basis, but is used predominantly for earth movement. Under Section B reinsurance is placed on a location basis for earth movement only in Oregon with an aggregate limit of no more than $7,000,000. Under the terms of the PLUS treaty, a maximum of $7,000,000 any one risk shall be ceded and the Company shall retain a minimum co-participation within the PLUS A portfolio of $1,000,000.

- Marine Cargo Excess of Loss Reinsurance Contract

Effective April 1, 2012, the Company entered into an excess of loss reinsurance treaty which protects the net writings of its ocean cargo book of business. The treaty includes three layers which provide coverage up to a maximum of $25,000,000 in excess of $5,000,000.

- Automatic Facultative Capacity Treaty ("AFC")

Effective December 1, 2012, the Company entered into a reinsurance treaty whereby business classified as property, boiler and machinery, and non-physical damage per the Company's original policies, is used on an excess of loss basis. The stand alone Catastrophe limit is $15,000,000 each risk, each loss. For all other perils covered that are not written on a stand-alone basis, the reinsurance limit is $100,000,000 each risk, each loss. The AFC treaty has a maximum recovery limit in any one occurrence of $200,000,000 and the Company's co-participation rate is 21.75% and 9.25% for Section A and Section B, respectively.

- Figure 5 Facility

Effective December 1, 2012, the Company entered into a reinsurance treaty whereby business written and classified as "Figure 5" business or its equivalent, property, boiler and machinery, and non-physical damage per the Company's original policies, is used on an excess of loss basis. Under the terms of the Figure 5 Facility, the reinsurance limit is $25,000,000 each and every risk, each and every loss in excess of no less than $75,000,000. This treaty excludes flood and earth movement, but includes fire following.

Intercompany Reinsurance

The following is a summary of the primary reinsurance agreements in force at December 31, 2012 that have been entered into between affiliated companies within the FM Global insurance holding company system:

- Tripartite Quota Share Pooling Agreement

Factory Mutual Insurance Company participates in a Tripartite Quota Share Pooling Agreement ("Pooling Agreement") with Affiliated FM Insurance Company and Appalachian Insurance Company. Under the terms of the Pooling Agreement which became effective on January 1, 1982, the parties agreed to pool all earned premiums, incurred losses, loss adjustment expenses and underwriting expenses. The pooling percentages, amended as of January 1, 2005 are FMIC - 86%, Affiliated FM - 12% and Appalachian - 2%. The percentages approximate the policyholders' surplus of each Company to the combined surplus for the three companies.

- Property Per Risk Excess of Loss Treaty

Effective January 1, 1982, FMIC entered into a Property Per Risk Excess of Loss Treaty with Affiliated FM Insurance Company whereby FMIC reinsures all business written directly or assumed by Affiliated from other companies. Effective January 1, 2012, the treaty was amended to provide for reinsurance coverage up to $293,320,000 each risk, each occurrence in excess $90,558,000.

- Quota Share Reinsurance Agreement ("FMGM-2")

Effective August 1, 2008, Affiliated FM and FM Global de Mexico, S.A. de C.V. entered into a quota share reinsurance agreement whereby Affiliated FM will indemnify FM Mexico for 100% of the ultimate net loss of the per risk occurrence or the catastrophe occurrence in excess of each policies' local base deductibles up to the ultimate net loss to FM Mexico.

Assumed Reinsurance

The Company's assumed reinsurance portfolio at December 31, 2012 is derived primarily from its participation in mandatory and voluntary pools, in addition to its discontinued casualty and assumed reinsurance operations.

ACCOUNTS AND RECORDS

The accounts and records of the Company are processed and maintained by personnel and information systems located at its home office in Johnston, Rhode Island.

Information Systems

A limited review of the Company's general information technology controls was performed to ascertain the financially significant systems in place, gain an overall understanding of the

Company's information technology environment, and to determine the appropriate controls that should be reviewed in order to evaluate the effectiveness of the IT controls that are in place to mitigate the identified risks. Reviews of the selected risks were performed to determine whether the applicable mitigating controls appeared to be designed and operating effectively during the examination period. This was done utilizing information provided by the Company including various documents and records, and discussions with responsible staff. This review was performed in accordance with the guidance established by the NAIC.

Independent Audit

The Company is audited annually by an independent accounting firm and audited financial reports were filed with the Insurance Division for all years under examination, as required pursuant to Rhode Island Insurance Regulation 87 (*Annual Financial Reporting*). The accounting firm's work papers from its 2011 and 2012 audits were reviewed and utilized to supplement the examination process, and to avoid duplication of work where deemed appropriate.

Internal Audit

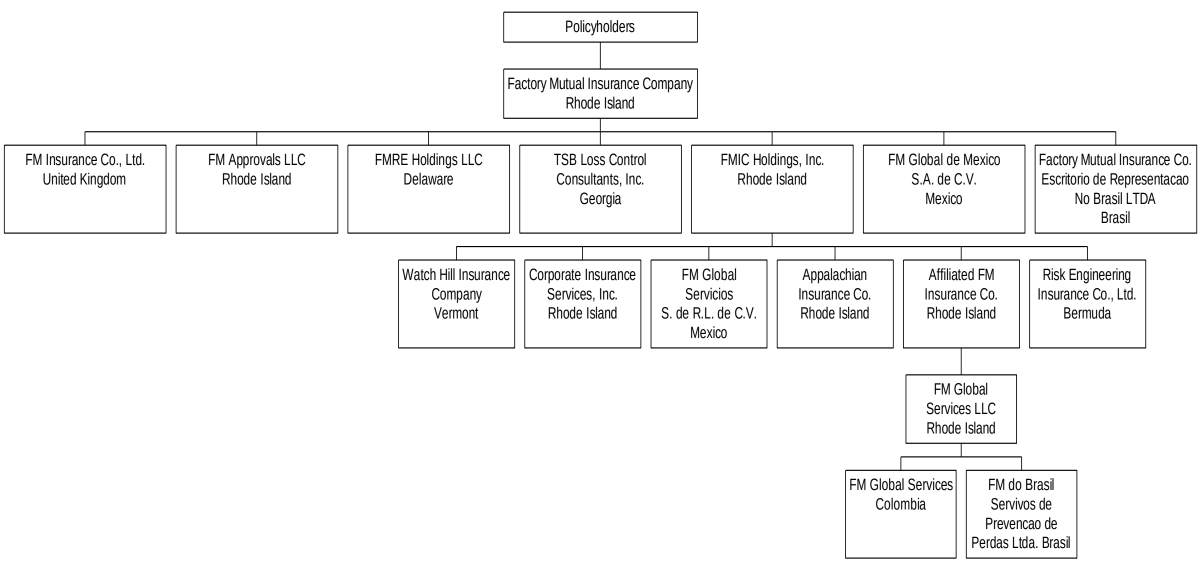
During the course of this examination we obtained copies of certain reports and supporting work papers prepared by the FM Global Internal Audit Department, and we reviewed and utilized portions of the testing performed. This approach was taken for the purpose of improving the efficiency of the examination and, where deemed appropriate, to avoid duplication of work that had already been performed.

INSURANCE HOLDING COMPANY SYSTEM

Factory Mutual Insurance Company, as required under Title 27, Chapter 35 of the Rhode Island General Laws entitled "Insurance Holding Company Systems," filed consolidated registration statements "Form B" and "Form C" with the Rhode Island Insurance Division on its own behalf, and on behalf of its affiliates, , for all years under examination.

Organizational Structure

The following represents an organizational chart, as of December 31, 2012, which reflects the identities and interrelationships between the Company, its parent, affiliated insurers and other members of the holding company system:



Intercompany Agreements

The following represents a summary of the primary intercompany agreements in-force between the Company and the various members of the FM Global holding company system as of December 31, 2012:

Intercompany Cash Management Agreement

Effective February 21, 2003, FMIC entered into a Cash Management Agreement ("Agreement") with several affiliates. Under the terms of the Agreement, any party ("Lender") may from time to time loan to another ("Borrower") such amounts as shall be determined and mutually agreed upon by and between the Lender and Borrower, provided that Lender at all times shall maintain sufficient cash amounts for normal working requirements. All loans made under the Agreement are made on an unsecured basis and at no time shall the aggregate amount of loans outstanding among all parties exceed $150,000,000. Under the terms of the Agreement, interest on any loaned money shall be payable at an annual rate equal to the simple average of the weekly ninety-day U.S. Treasury Bill rates appearing in the Federal Reserve Data section of the *Wall Street Journal*. The settlement terms require that outstanding balances of principal and accrued interest shall be due and payable no later than sixty (60) days following the last day of each calendar quarter. Lender may demand any part or all funds loaned under the Agreement by giving three (3) business days' notice to the Borrower.

Intercompany Tax Sharing Agreement

Effective January 4, 2002 and revised effective December 30, 2003, Factory Mutual Insurance Company and certain subsidiaries that includes Affiliated FM, entered into a tax sharing agreement whereby FMIC collects from or refunds to the subsidiaries the amount of taxes or benefits determined as if the affiliated entities filed separate returns, with current credit for net losses incurred to the extent those losses are included in the consolidated return. Amounts are settled within ninety (90) days of filing of the consolidated federal income tax return.

Management and Service Agreement

Effective July 1, 2001, the Company entered into a Management and Service Agreement with FMIC. Under the terms of the agreement, FMIC provides the Company with the personnel, space, equipment and facilities necessary to conduct business. The agreement stipulates that FMIC shall be paid a monthly fee to be paid within fifty-five (55) days after the end of the month to which it applies. The monthly fee shall be an amount determined by product line cost analysis.

FINANCIAL STATEMENTS

The results of the examination are set forth in the following exhibits and schedules:

Comparative Statement of Assets
December 31, 2012 and December 31, 2008

Comparative Statement of Liabilities and Surplus and Other Funds
December 31, 2012 and December 31, 2008

Statement of Income
Year ended December 31, 2012

Capital and Surplus Account
December 31, 2011 to December 31, 2012

Reconciliation of Surplus
December 31, 2008 to December 31, 2012

Analysis of Examination Adjustments
December 31, 2012

AFFILIATED FM INSURANCE COMPANY
Comparative Statement of Assets
December 31, 2012 and 2008

	December 31, 2012	December 31, 2008	Increase (Decrease)
Bonds	$1,063,569,679	$1,030,287,739	$33,281,940
Common Stocks	629,507,128	27,914,823	601,592,305
Cash and Cash Equivalents	28,643,739	(4,364,381)	33,008,120
Short-Term Investments	29,561,128	161,237,094	(131,675,966)
Receivables for Securities	3,646,923	385,535	3,261,388
Securities Lending Reinvested Collateral	59,021,560	0	59,021,560
Investment Income Due or Accrued	11,294,555	12,037,826	(743,271)
Uncollected Premiums and Agents' Balances in the Course of Collection	127,686,692	96,379,617	31,307,075
Amounts Recoverable from Reinsurers	336,668,406	87,237,215	249,431,191
Funds Held By or Deposited with Reinsurance Companies	29,845	48,861	(19,016)
Current Federal and Foreign Income Tax Recoverable	0	6,387,393	(6,387,393)
Net Deferred Tax Asset	3,583,000	25,567,000	(21,984,000)
Guaranty Funds Receivable or on Deposit	119,737	999,638	(879,901)
Net Adjustment Due to Foreign Exchange Rate	575,096	0	575,096
Receivable from Parent, Subsidiaries and Affiliates	0	25,196,239	(25,196,239)
Aggregate Write-ins For Other Than Invested Assets	8,255,188	6,159,058	2,096,130
Total Assets	$2,302,162,676	$1,475,473,657	$826,689,019

AFFILIATED FM INSURANCE COMPANY
Comparative Statement of Liabilities and Surplus and Other Funds
December 31, 2012 and 2008

	December 31, 2012	December 31, 2008	Increase (Decrease)
Losses	$562,923,744	$361,473,939	$201,449,805
Reinsurance Payable on Paid Losses and Loss Adjustment Expenses	1,653,961	8,452,644	(6,798,683)
Loss Adjustment Expenses	48,386,482	40,074,157	8,312,325
Other Expenses	60,751	64,410	(3,659)
Taxes, Licenses and Fees	6,703,004	5,577,373	1,125,631
Current Federal and Foreign Income Taxes	40,356,448	26,854,293	13,502,155
Unearned Premiums	354,687,242	240,806,200	113,881,042
Dividends Declared and Unpaid:			
Policyholders	188,889	111,714	77,175
Ceded Reinsurance Premiums Payable	98,172,853	68,858,522	29,314,331
Amounts Withheld or Retained for Account of Others	483,125	385,634	97,491
Remittances and Items Not Allocated	14,464,791	432,801	14,031,990
Provision for Reinsurance	9,721,287	4,737,877	4,983,410
Net Adjustment Due to Foreign Exchange Rate	0	8,832,712	(8,832,712)
Payable to Parent, Subsidiaries & Affiliates	54,988,648	0	54,988,648
Payable for Securities	6,144,320	0	6,144,320
Payable for Securities Lending	59,021,560	0	59,021,560
Aggregate Write-ins For Liabilities	10,107,364	8,334,644	1,772,720
Total Liabilities	1,268,064,469	774,996,920	493,067,549
Common Capital Stock	4,000,000	4,000,000	0
Preferred Capital Stock	7,250,000	7,250,000	0
Gross Paid In and Contributed Surplus	272,939,180	270,210,662	2,728,518
Unassigned Funds (Surplus)	749,909,027	419,016,129	330,892,898
Total Liabilities and Policyholders' Surplus	$2,302,162,676	$1,475,473,711	$826,688,965

AFFILIATED FM INSURANCE COMPANY
Statement of Income
Year Ended December 31, 2012

UNDERWRITING INCOME			
Premiums Earned	$397,099,849		
Deductions:			
Losses Incurred	225,176,400		
Loss Adjustment Expenses Incurred	11,940,013		
Other Underwriting Expenses Incurred	98,645,209		
Net Underwriting Gain or (Loss)		61,338,227	
INVESTMENT INCOME			
Net Investment Income Earned	52,661,331		
Net Realized Capital Gains or (Losses)	12,026,287		
Net Investment Gain or (Loss)		64,687,618	
OTHER INCOME			
Net Gain or (Loss) from Agents' or Premium Balances Charged Off	(136,939)		
Aggregate Write-ins for Miscellaneous Income	(53,613)		
Total Other Income		(190,552)	
Net Income Before Dividends to Policyholders and Before Federal Income Taxes		125,835,293	
Dividends to Policyholders		378,823	
Net Income After Dividends to Policyholders But Before Federal Income Taxes			125,456,470
Federal Income Taxes Incurred			39,464,562
Net Income			$85,991,908

AFFILIATED FM INSURANCE COMPANY
Capital and Surplus Account
December 31, 2011 to December 31, 2012

	Increase in Surplus	Decrease in Surplus	
Surplus as Regards Policyholders, December 31, 2011			$905,580,039
Net Income	$85,991,908		
Change in Net Unrealized Capital Gains	40,621,780		
Change in Net Unrealized Foreign Exchange	2,400,364		
Change in Net Deferred Income Tax	1,141,000		
Change in Non-Admitted Assets		$1,305,509	
Change in Provision for Reinsurance	261,567		
Surplus Adjustments: Paid-in	48,519		
Change in Treasury Stock		507,500	
Aggregate Write-ins for Gains and Losses in Surplus		133,961	
	130,465,138	1,946,970	
Increase in Surplus as Regards Policyholders, for the Year 2012			128,518,168
Surplus as Regards Policyholders, December 31, 2012			$1,034,098,207

AFFILIATED FM INSURANCE COMPANY
Reconciliation of Surplus
December 31, 2008 to December 31, 2012

Surplus as Regards Policyholders, December 31, 2008			$695,534,791
	Increase in Surplus	Decrease in Surplus	
Net Income	$264,136,286		
Net Unrealized Capital Gains	54,646,921		
Change in Net Unrealized Foreign Exchange Capital Gain (Loss)	9,407,808		
Change in Net Deferred Income Tax	6,309,000		
Change in Non-Admitted Assets	7,708,826		
Change is Provision for Reinsurance		$4,983,410	
Surplus Adjustments: Paid-in	2,728,518		
Dividends to Stockholders		2,030,000	
Aggregate Write-ins for Gains and Losses in Surplus	639,467		
	345,576,826	7,013,410	
Increase in Surplus as Regards Policyholders, for the Years 2009 through 2012			338,563,416
Surplus as Regards Policyholders, December 31, 2012			$1,034,098,207

AFFILIATED FM INSURANCE COMPANY
Analysis of Examination Adjustments
December 31, 2012

The examination of the Company, performed as of December 31, 2012, did not disclose any material misstatements to the financial statements contained in its 2012 Annual Statement filing. Accordingly, the amounts reported by the Company have been accepted for purposes of this report.

COMMENTS ON FINANCIAL STATEMENTS

ASSETS

Bonds **$1,063,569,679**

The amount stated above is the net admitted value of bonds reported by the Company in its 2012 Annual Statement. The majority of bonds owned are held in accordance with two custodial agreements with third parties. All of the remaining bonds ($5,943,944) are held by various states in the form of special deposits.

The quality ratings of the bonds, as established by the Securities Valuation Office ("SVO") of the National Association of Insurance Commissioners ("NAIC") were reviewed. It was noted that approximately 99.8% of the bond portfolio represents either Class 1 or Class 2 securities which are bonds of the "highest" and "high" quality, respectively.

The book/adjusted carrying value, par value, fair value, and actual cost of the bond portfolio as of December 31, 2012, are as follows:

Book/Adjusted Carrying Value	Par Value	Fair Value	Actual Cost
$1,063,569,679	$1,043,594,482	$1,158,685,401	$1,067,789,437

LIABILITIES

Losses and Loss Adjustment Expenses **$611,310,226**

Losses	$562,923,744
Loss Adjustment Expenses	48,386,482
Total	$611,310,226

The reserves for losses and loss adjustment expenses reflected above are the same as those reported by the Company in its 2012 Annual Statement. The reserve calculation prepared by the Company was reviewed by Milliman, Inc. ("Milliman"), consulting actuaries for the Rhode Island Insurance Division. Milliman relied upon the underlying data reported by the Company, and their analyses included a review of the actuarial assumptions and methods used by the Company in determining the reserves, and such tests of actuarial calculations as deemed necessary.

In assisting Milliman with the reserve analysis, the examiners either independently performed or relied upon the procedures performed by the Company's independent accounting firm and Internal Audit Department to verify the integrity of the underlying claims data, including completeness testing. A combination of subjective and statistical sampling techniques was utilized in testing the claims data, as deemed appropriate.

POLICYHOLDERS' SURPLUS

Policyholders' Surplus **$1,034,098,207**

The above amount is the same as that reported by the Company in its 2012 Annual Statement, and consists of the following:

Common Capital Stock	$4,000,000
Preferred Capital Stock	7,250,000
Gross Paid in and Contributed Surplus	272,939,180
Unassigned Funds (Surplus)	749,909,027
Surplus as Regards Policyholders	$1,034,098,207

SUBSEQUENT EVENTS

A review of the minutes of the Board of Directors' meetings for the period subsequent to the examination period was performed to ascertain whether any subsequent events have occurred which would have a material impact on the Company's operations or financial statements. In addition, an inquiry was made of the Company's management regarding subsequent events. Based upon our review, there were no significant events that occurred subsequent to the period covered by this examination requiring disclosure.

CONCLUSION

We have applied verification procedures to the data and information contained in this report using sampling techniques and other examination procedures as deemed appropriate. While sampling and other examination procedures do not give complete assurance that all errors and irregularities will be detected, had any been detected during the course of this examination, such errors and/or irregularities would have been disclosed in this report. Other than what has been noted in the body of this report, we were not informed of, and did not become aware of any errors or irregularities that could have a material effect on the financial condition of the Company as presented in this report.

Acknowledgment is made of the services rendered by Milliman, Inc., the Rhode Island Insurance Division's consulting actuaries.

Assisting in the examination with the undersigned and representing the Rhode Island Insurance Division were Debra Almeida, CFE, Senior Insurance Examiner; Douglas Fowler, Insurance Examiner; Louis Gabriele, CPA, CFE, Insurance Examiner-in-charge; Anthony Humphrey, Insurance Examiner; Theodore Hurley, CPA, CFE, Insurance Examiner-in-charge; John Tudino, CFE, CIE, CFSA, Insurance Examiner-in-charge;

Respectfully submitted,

David A. Paolantonio

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David A. Paolantonio, CFE, CFSA, CISA, AES
Insurance Examiner-In-Charge
State of Rhode Island
Northeastern Zone, NAIC