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Bybee, Cressinda

From: Steve Bajan <steve.bajan@sauconinsurance.com>
Sent: Monday, December 08, 2014 11:44 AM
To: Bybee, Cressinda
Cc: froggenbaum@saul.com; Brian T. Regan (bregan@rlbaccountants.com)
Subject: Substantive Response to Stellar Letter
Attachments: Stellar Bybee Response Letter.pdf

Ms. Bybee:

Please find attached Saucon Mutual's substantive response to Anthony G. Stellar's letter of objection to our Conversion Filing. The original of this letter is on its way to you via first class mail as is a copy of this letter to Mr. Stellar. I am available for any further discussion on this matter if needed.

Best regards,

Stephen Bajan
CEO

Saucon Mutual Insurance Company
610.868.1832

Saucon Insurance Agency
EMPLOYEE BENEFITS • HOME • AUTO • COMMERCIAL
610.868.1800

74 West Broad Street, Suite 300
Bethlehem, PA 18018
Fax: 610.317.0998

www.sauconinsurance.com

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December 8, 2014

Cressinda E. Bybee, PIR
Insurance Company Licensing Specialist
Bureau of Company Licensing & Financial Analysis
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

CERTIFIED MAIL-RETURN RECEIPT REQUESTED

RE: Conversion & Corresponding Form A Filing for Proposed Change of Control of Saucon Mutual Insurance Company
Response to Comment filed by Anthony Stellar

Dear Ms. Bybee:

This letter is the response by Saucon Mutual Insurance Company ("Saucon Mutual") to the comments submitted to the Pennsylvania Insurance Department ("Department") by letter dated September 30, 2014 by Anthony G. Stellar, a member of the Board of Directors of a competing local insurance company. Mr. Stellar submitted the letter on behalf of himself and as Trustee of the Deborah Stellar Trust.

Mr. Stellar's letter objects to the Saucon Mutual Plan of Conversion ("Plan") that Saucon Mutual filed with the Department. Mr. Stellar's letter states:

A. That the Plan adopted by Saucon Mutual's board of directors differs from some other mutual-to-stock conversions undertaken by Pennsylvania mutual insurers in that, rather than providing to members a right to purchase stock of the converted insurance company or its stock holding company, the Plan instead provides for purchase of the stock of Saucon Holding Company (which will wholly own the converted Saucon Mutual) by members of the board and management of Saucon Mutual.

B. That Mr. Stellar expects, together with others, to propose a plan of conversion for Saucon Mutual that will be fair to policyholders and consistent with Pennsylvania's Mutual-To-Stock Conversion Act (the "Conversion Act").

With respect to Mr. Stellar's objections, we respectfully respond as follows:

1. Saucon Mutual's Selected Means of Conversion: The Conversion Act provides for several different processes to convert a mutual insurance company into a stock insurance company, such as:

74 West Broad Street • Suite 300 • Bethlehem, PA 18018
Telephone: (610) 868-1832 • Fax: (610) 317-0998 • www.sauconmutual.com

- A "Subscription Rights Conversion", in which eligible members of the mutual insurance company receive a nontransferable right to purchase a portion of the capital stock of the converted insurance company or its newly-formed holding company. If all such stock is not purchased by the members, it may be offered to others – including persons affiliated or unaffiliated with the insurer; or
- An "Alternative Plan of Conversion" where, in lieu of subscription rights, eligible members may receive cash, additional policy benefits or other consideration, a combination of both, or in the case of a partial conversion, a membership interest in a mutual holding company.

Mr. Stellar correctly notes that since the Conversion Act became effective in 1996, some Pennsylvania mutual insurers such as Old Guard Mutual, Mercer Mutual, Penn Millers Mutual, and Educators Mutual have been converted into stock insurance companies by means of the subscription rights approach.

However, a number of Pennsylvania mutual insurers have utilized the "Alternative Plan of Conversion" approach to convert into stock insurance companies. Examples include Hanover Mutual, Philanthropic Mutual, Provident Mutual, and Select Risk Mutual, in which the plans of conversion provided for cash, policy credits or other consideration to eligible members in lieu of subscription rights. Other examples include Tuscarora-Wayne Mutual, Washington Mutual, the Philadelphia Contributionship, in which the plans of conversion provided for partial conversions where members were provided membership rights in a mutual holding company in lieu of subscription rights.

In evaluating a strategy for Saucon Mutual, Saucon Mutual's board took a deliberative approach. The board initially noted that Saucon Mutual had not written any new coverage in its core business of perpetual homeowners and dwelling property coverage since 2005, and had written only a small number of term policies since that time. Due to this inactivity, Saucon Mutual has limited insurance operations and infrastructure to support re-entry into the business of actively underwriting new insurance policies. The board established an objective of enabling Saucon Mutual to re-enter the insurance underwriting business. The board also established additional objectives, which were to: (i) reward policyholders for their loyalty to Saucon Mutual; (ii) make a charitable contribution in furtherance of Saucon Mutual's ongoing commitment to the community; (iii) modernize Saucon Mutual's governance structure; (iv) enable the issuance of stock and other financial instruments in order to raise capital, to facilitate potential acquisitions of other businesses, and to incentivize employees; and (v) maintain Saucon Mutual's independence. The board engaged Boenning & Scattergood, a large and reputable independent investment banking firm to determine value and concluded, with the assistance of outside consultants, that a conversion would provide to Saucon Mutual an opportunity to meet these objectives.

The board then evaluated the available paths under the Conversion Act and the advantages and disadvantages of each as they related to the identified objectives.

- The board noted that in recent subscription rights conversions under the Conversion Act, it was typical that only a very small percentage of the stock of the converting insurer or its parent was actually purchased by policyholders, with a large portion of the stock being purchased by unrelated third party investors. Indeed, in some subscription rights conversions, less than 1% of eligible members actually exercised their subscription rights, and 99% of the policyholders received nothing in exchange for their membership interests. The failure of members to exercise their subscription rights may be due to the fact they must put up funds to purchase the stock. A further deterrent may be that an investment in an insurance company tends to be a long-term, illiquid investment where the ability to realize a benefit or gain from the investment is subject to regulatory oversight and/or approval with respect to both dividends and sale of the stock. Moreover, a transaction that involves the purchase by unaffiliated investors of a large percentage of the converting insurance company's stock may result in unknown changes to the objectives and operations of the insurer and greater uncertainties to members of the benefits of stock ownership.

- The Board also noted that a subscription rights demutualization could constitute a public offering of the converting insurer's stock, which would require expensive and time-consuming compliance with federal and state securities laws in connection with the offering, as well as ongoing accounting, compliance and reporting costs in order to operate as a public company from then onward. The board noted that Saucon Mutual's limited infrastructure would not support the conduct of a public offering or of doing business as a public company.

- The board also noted that many shareholders of public companies tend to favor the company adopting a business strategy that maximizes shareholder returns in the near term, and that this would be incompatible with the board's stated long-term objective of enabling Saucon Mutual to re-enter the insurance underwriting business, since that process will likely take years and will require a patient shareholder base that understands and supports this mission.

  As a result of this analysis, the board determined that a subscription rights conversion was not a suitable method for achieving Saucon Mutual's goals.

- Conversely, the board noted that when a mutual insurance company adopts an "Alternative Plan of Conversion", all eligible policyholders of the insurer could be guaranteed meaningful, valuable compensation upon conversion, the value of which would not be affected by the risk and uncertainty of operations after the closing of the conversion, rather than a mere opportunity to make an investment in an insurance company where the benefits and consequences of the investment would be unknown, and the value of the investment would be subject to risk and uncertainty.

For the foregoing reasons, Saucon Mutual's Board determined that the objectives for Saucon Mutual and its policyholders in pursuing a conversion could best be met by offering the stock of Saucon Holding Company to members of the board and management of Saucon Mutual and by providing for guaranteed consideration to Saucon Mutual's eligible members.

2. <u>Mr. Stellar's Proposal to Submit a Different Plan of Conversion</u>:

Saucon Mutual's board of directors has already approved the Plan that Saucon Mutual submitted to the Department. Under the Conversion Act, the Department must evaluate the Plan as approved by the board and must approve the Plan if it determines that the Plan meets the three standards specified in the Conversion Act, i.e. that the Plan (1) does not prejudice the interests of the members; (2) is fair and equitable; and (3) is not inconsistent with the purpose and intent of the Conversion Act. Thereafter, eligible members of Saucon Mutual will have the opportunity to vote on the Department-approved Plan and, unless the Plan receives an affirmative vote of at least two-thirds of the votes cast by eligible members, none of the provisions of the Plan will be implemented and Saucon Mutual will remain as a mutual insurer.

We note that Mr. Stellar has not yet disclosed his plan of conversion for Saucon Mutual, as he indicated in his September 30 letter that he would do. Indeed, efforts of members of Saucon Mutual's board to reach out to Mr. Stellar to determine his real interest in the conversion and proposals for change to the filed Plan have been unsuccessful. Even if Mr. Stellar circulates a plan of conversion for Saucon Mutual, unless Saucon Mutual's board of directors were to withdraw the plan that had already been approved, approve Mr. Stellar's plan and recommend it to Saucon Mutual's policyholders, Mr. Stellar's plan would not be eligible to be considered by the Department nor eligible to be voted upon by Saucon Mutual's policyholders.

We appreciate the opportunity to provide this response to Mr. Stellar's letter, and we are providing a copy of this response to Mr. Stellar.

Respectfully submitted,

Stephen Bajan
Chief Executive Officer

cc: Anthony G. Stellar