

**SAUCON MUTUAL INSURANCE COMPANY**  
**SEPTEMBER 1, 2015 INFORMATIONAL HEARING ON PLAN OF CONVERSION**  
**WRITTEN TESTIMONY**  
**OF**  
**STEPHEN BAJAN**

**Introduction**

I am Stephen Bajan, Chief Executive Officer of Saucon Mutual Insurance Company. In my position at Saucon Mutual, I oversee the operations of Saucon Mutual and have been integrally involved with Saucon Mutual's Board and its outside consultants in the deliberations, evaluations and decisions undertaken by the Board to propose and adopt a Plan of Conversion to be filed with the Pennsylvania Insurance Department and presented to Saucon Mutual's members.

I am providing testimony on Saucon Mutual's policyholders (perpetual and term), the nature of our perpetual policies as compared to our term policies, the specifics of the consideration that would be received by both perpetual and term policyholders if the Conversion is approved and effectuated, and the process that the Company undertook to identify all policyholders eligible for consideration under the Conversion.

**Saucon Mutual's Policyholders**

Saucon Mutual is approved to write homeowners and dwelling property coverages in Pennsylvania. The Company has written no new policies since the Plan of Conversion was initially adopted by the Board on August 27, 2014 (the "Record Date"). As Brian Regan noted in his written testimony, the Company has not written any new perpetual insurance policies since December 2005 and has written approximately 9 term policies since that time. Its book of business as of the Record Date consisted of 369 perpetual policies and 25 term policies. The Company currently has 351 perpetual policyholders (94% of total policies in force) and 22 term policies (6% of total policies in force).

### **How Perpetual Policies Differ from Term Policies**

Perpetual policies share certain characteristics with term policies but also have some important differences. Perpetual and term policies have identical underwriting, policy documentation and types of covered claims. However, perpetual policies differ from term policies in the following ways:

- **Policy Term**: Term policies are issued with a one-year policy term and, unless renewed, the policy expires at the end of each annual policy term. In contrast, perpetual policies have no specified term and stay in effect until terminated by either the policyholder or by Saucon Mutual under the terms of the policy (e.g. upon the sale or vacancy of the property or within a specified time after the death of the policyholder).
- **Premium – Cost of Coverage**: Under a term policy, the policyholder pays a premium at inception and annually at renewal in order for the policy to remain in effect. In contrast, a perpetual policyholder pays a one-time deposit (at the time of inception of the policy) and, unless coverage is increased or new coverage is added during the life of the policy, the perpetual policyholder does not pay any additional amounts for the policy to remain in effect. The amount of the deposit paid at the inception of coverage is calculated as a multiple of what the initial premium would be for a term policy (Saucon Mutual's most recent multiplier for perpetual homeowners coverage was 15, so that, if a term policy's initial premium was \$1,000, the perpetual policy's deposit would be \$15,000). Further, while a term policyholder would receive no refund of the annual premium paid (unless a policy was cancelled mid-term and, upon which, the term policyholder would receive a refund of a portion of the annual premium), when a perpetual policy is cancelled for any reason, the perpetual policyholder receives a full refund of the deposit amount held by Saucon Mutual – regardless of whether Saucon Mutual has paid losses to the policyholder under the policy. In the late 1990s with the approval of the Pennsylvania Insurance Department, Saucon Mutual returned some perpetual deposits held for existing policies issued prior to the mid-1990s. Most such policies were low value policies with a maximum coverage of \$27,000 and minimal deposits (\$175 or less). Thus, Saucon Mutual currently has some in force perpetual policies where no deposit currently is held by the Company.

- Source of Revenue to Pay Claims: Because perpetual policies provide for a full refund of the deposit amount held by the insurer upon cancellation of the policy, the insurer is required to record the deposit as a liability on its financial statements. Thus, the insurer receives no direct revenue from issuing perpetual policies and must rely on investment returns in order to have funds to pay claims under the policies and operating expenses of the Company and to generate a profit. In contrast, insurance operations associated with term policies, including claim payments, are funded predominantly through ongoing policyholder premiums.

### **Consideration to be Paid to Perpetual & Term Policyholders in the Conversion**

Policyholders, as members of a mutual insurer, are entitled to certain membership rights, including voting rights, such as the right to elect directors and approve a conversion to a stock insurer, and the right to participate in any dividends declared by the board of directors. When a mutual insurer converts to a stock insurer, these membership rights are extinguished.

In consideration for this loss of membership rights, Saucon Mutual's Plan of Conversion provides for consideration to be paid to Saucon Mutual's policyholders who were members on the Record Date. As set forth below and in the Conversion documents posted on the Department's website, this consideration differs slightly for perpetual and term policies based upon the differences between perpetual and term policies as previously described:

- **Consideration: Perpetual Policyholders**

A. Cash Payment. A cash payment equal to (i) the actual number of calendar days that the policy had been in effect from its issuance until the closing date of the Conversion, multiplied by (ii) \$0.2787 per day, and then rounding that amount to the nearest whole dollar. For example, a member who is a perpetual policyholder whose policy had been in effect for 10 years (i.e., 3650 days) would receive a cash payment of \$1,017; and a member who is a perpetual policyholder whose policy had been in effect for 10 years plus 120 days (i.e., 3770 days) would receive a cash payment of \$1,051. The aggregate amount of cash payments to all members who are perpetual policyholders under this cash payment was estimated to be approximately \$1,197,061 assuming a closing date of July 31, 2015 and will be slightly higher with a later closing date.

B. Return of Deposits. A return of 15% of each member's deposits held by Saucon Mutual at the time of the closing of the Conversion. Coverage under each policy subject to a return of deposit will continue, unreduced, and will simply be supported by a lesser deposit going forward. The aggregate amount of deposits to be returned to members who are perpetual policyholders is estimated to be approximately \$334,000, less any deposits that are returned before the closing of the Conversion in accordance with policy terms. The balance of a member's deposit (the remaining 85%) will be returned in accordance with policy terms.

C. Removal of Charges for Increases in Policy Limits Under Inflation Adjustment Endorsements. Many of the perpetual insurance policies issued by Saucon Mutual have inflation adjustment endorsements, which are either "Annual Adjustment of Limits" endorsements or "Automatic Increase in Insurance" endorsements (the "Inflation Adjustment Endorsements"). The Inflation Adjustment Endorsements generally cause the policy limit of the perpetual policy to be increased each year to offset the effects of inflation and require the perpetual policyholder to pay an additional deposit to Saucon Mutual because of that annual increase in the policy limit. Commencing on the anniversary date of the issuance of a perpetual policy that first follows the closing date of the Conversion, the converted insurance company (Saucon Insurance Company) would no longer require perpetual policyholders to pay the additional annual deposits for the increases in policy limits under the Inflation Adjustment Endorsements.

For example, for a member who is a perpetual policyholder whose policy had been in effect for 10 years as of the closing of the Conversion and for whom Saucon Mutual holds a deposit of \$11,535, the policyholder would receive (1) a cash payment of \$1,017 under Paragraph A, above, plus (2) a return of deposit of \$1,730 under Paragraph B, above, for a total payment of \$2,747. In addition, the perpetual policyholder would no longer be charged an additional deposit for the increase in policy limit under either of the Inflation Adjustment Endorsements.

- **Consideration: Term Policyholders**

A cash payment equal to the sum of:

A. A cash payment equal to (i) the actual number of calendar days that the policy had been in effect (including all renewals) from its issuance until the closing date of the

Conversion multiplied by (ii) \$0.2787 per day, then rounding that amount to the nearest whole dollar. For example, a member who is a term policyholder whose policy had been issued and then renewed from time to time for a total period of 10 years (i.e., 3650 days) as of the closing date would receive a cash payment of \$1,017; and a member who is a term policyholder whose policy had been issued and then renewed from time to time for a period of 10 years plus 120 days (i.e., 3770 days) as of the closing date would receive a cash payment of \$1,051. The aggregate amount of cash payments to all members who are term policyholders under this cash payment was estimated to be \$31,978 assuming a closing date of July 31, 2015 and will likely be slightly higher with a later closing date;

Plus

B. An additional one-time cash payment equal to 15% of the current premium of the policy. The aggregate amount of cash payments to be made to members who are term policyholders under this provision is estimated to be \$1,800.

For example, a member who is a term policyholder whose policy had been issued and then renewed from time to time for a total period of 10 years as of the closing date of the Conversion and whose current annual premium is \$500 would receive (1) a cash payment of \$1,017 under Paragraph A, above, plus (2) an additional cash payment of \$75 under Paragraph B, above, for a total payment of \$1,092.

As set forth in the Conversion documents posted on the Department's website, the aggregate amount of total payments to all policyholders (perpetual and term) was estimated to be approximately \$1,564,839 assuming a Conversion closing date of July 31, 2015 and will likely be slightly higher with a later closing date. It should be noted that this amount does not include the value of the removal of charges for increases in policy limits under the Inflation Adjustment Endorsements for perpetual policyholders, which value is estimated in the aggregate to be approximately \$500,000.

### **Process to Identify All Policyholders Eligible for Consideration**

Due to the nature of perpetual policies, where coverage typically remains in force for many years with minimal communications between Saucon Mutual and the policyholder, Saucon Mutual undertook a multi-tiered effort to locate all policyholders for the 394 policies on Saucon Mutual's books as of the Record Date to assure that all eligible members would receive

consideration due them under the Plan of Conversion. The initial effort was a certified, return receipt requested mailing that included a “survey” to be completed and returned to the Company to identify current ownership of the property, addresses, etc. as well as seven day classified ads placed in newspapers of dominant circulation in the areas of policyholder concentration and a posting on the Company’s website. Next, phone calls were placed to policyholders for whom mailings were returned by the United States Postal Service as unclaimed by the addressee. The final step was a campaign of in-person visits to addresses of record. Currently the Company has only one policy for which a mailing address has not been confirmed. This policy was a renter’s policy covering contents only in a senior living facility. In its search for the insured the Company discovered an obituary for the deceased insured from which it identified a daughter living in a distant town. Attempts to contact the daughter have been met with no response but efforts will continue.