

BEFORE THE INSURANCE COMMISSIONER OF THE STATE OF IOWA

In the matter of the application of)	
DONEGAL MUTUAL INSURANCE)	ORDER
COMPANY for approval of a plan to)	(Iowa Code Chapter 521A)
acquire control of LE MARS MUTUAL)	
INSURANCE COMPANY)	

A. BACKGROUND

Donegal Mutual Insurance Company (hereinafter referred to as the “applicant”) submitted to the Iowa Insurance Division, on March 18, 2002, a “Form A” filing in furtherance of its application for approval of a plan to acquire Le Mars Mutual Insurance Company (hereinafter, “Le Mars”). Le Mars is a domestic insurance company, licensed and organized under Iowa law. Notice of a public hearing regarding the application was mailed to the applicant on or about March 25, 2002 and a copy of the notice posted on the insurance division’s website. Additionally, each Le Mars policyholder was mailed information regarding the proposed acquisition of Le Mars – including a notice of the public hearing. The hearing was combined with a hearing relating to the applicant’s request for approval, pursuant to Iowa Code chapter 521, of consolidation with Le Mars.

The combined hearing was held April 25, 2002, at which time both the applicant and interested persons were given an opportunity to present testimony and other evidence. Both the applicant and Le Mars offered evidence by testimony and exhibit. No other interested persons or policyholders attended the hearing. At the conclusion of the hearing, the record remained open for the applicant to supply additional information. All requested information was supplied by May 6, 2002, at which time the record closed.

This order, which relates only to applicant’s request for approval, pursuant to Iowa Code chapter 521A, of a plan to acquire Le Mars, represents final administrative action and may be appealed to the Iowa District Court pursuant to Iowa Code chapter 17A (2001). A separate order will be entered regarding applicant’s request for approval pursuant to Iowa Code chapter 521.

B. JURISDICTION

The insurance commissioner’s jurisdiction arises under Iowa Code § 521A.3(4)(a) (2001), which provides:

a. The commissioner shall approve any merger or other acquisition of control referred to in subsection 1 if, after a public hearing on such

merger or acquisition, the applicant has demonstrated to the commissioner all of the following:

- (1) After the change of control the domestic insurer referred to in subsection 1 will be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed.*
- (2) The effect of the merger or other acquisition of control will not substantially lessen competition in insurance in this state.*
- (3) The financial condition of any acquiring party will not jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders.*
- (4) The plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are not unfair or unreasonable to policyholders of the insurer and are not contrary to the public interest.*
- (5) The competence, experience, and integrity of those persons who would control the operation of the insurer are sufficient to indicate that the interests of the policyholders of the insurer and of the public will not be jeopardized by the merger or other acquisition of control.*

Procedures for making application to acquire control of an Iowa domestic insurer are found at 191 IAC chapter 45 (“Insurance Holding Company Systems”).

C. EVIDENCE PRESENTED

Evidence relevant to this Order may be summarized as follows:

Donald H. Nikolaus, president of the applicant, testified that the applicant is a property and casualty insurance company formed in 1889 and domiciled in Pennsylvania. The applicant owns approximately 62% of a publicly traded entity called Donegal Group (traded on the NASDAQ market system under the symbols DGICA and DGICB). The combined companies – applicant and Donegal Group -- had gross written premiums of \$256 million in 2001 and gross earned premium of \$195 million during the same period. Consolidated assets total \$523 million.

Mr. Nikolaus further testified that the applicant has previously been involved in acquisitions similar to the proposed transaction with Le Mars. In each such transaction, the applicant has infused capital to a “capital constrained” company experiencing operating and underwriting profitability issues. Each of those companies has now demutualized, returned to profitability and is rated “A” by the rating agency, A.M. Best.

In the proposed transaction with Le Mars, the applicant will pay Le Mars \$4 million, secured by a surplus note. Five members of the Le Mars board of directors will then be

replaced by the applicant's appointees, giving the applicant control of the board. Following the change of control, Le Mars will follow an operational plan outlined in detail in the "Plan of Operations," attached as exhibit F to applicant's "Form A" (hearing exhibit D-1). That plan, along with a "Service Agreement" (also in hearing exhibit D-1) contemplate, among other things, that Le Mars will (1) continue to withdraw from business in North Dakota, (2) implement expense control and reduction programs, (3) restore underwriting profitability, (4) negotiate more favorable reinsurance agreements and (5) review retention of outside service providers.

Mr. Nikolaus testified that, if the proposed transaction proceeds as planned, Le Mars will be sufficiently capitalized to expand its business in Iowa and offer additional competition in the Iowa market. He anticipates an improved rating for Le Mars from A.M. Best, following implementation of the plan of operations. Mr. Nikolaus explained that the applicant sees Le Mars as part of a plan of expansion of the applicant's activities into Midwestern states, building upon current operations in Ohio. Demutualization of Le Mars would likely occur after the company has been returned to operating profitability.

In addition to testimony, the applicant offered exhibits D-1 through D-5, which were received into evidence. Exhibit D-4 is the affidavit of Donald H. Nikolaus. Exhibit D-5 is the affidavit of Ralph G. Spontak, chief financial officer of Donegal. Each affidavit supplies additional detail to supplement the testimony of Mr. Nikolaus, described above.

Dennis J. Bixenman, chairman of the board of directors of Le Mars, testified regarding the business activities of Le Mars over the past few years, during which Le Mars has experienced substantial underwriting and operating losses, and a decline in surplus. From December 31, 1998 to December 31, 2001, underwriting losses totaled \$19,859,628. During the same period, Le Mars' surplus declined by \$6.5 million. Additionally, Le Mars anticipates higher costs for purchase of reinsurance in future years, increasing the company's operating expenses. Bixenman explained that in his sixteen years as a director of Le Mars, the company had not returned a profit from its insurance underwriting.

Mr. Bixenman further testified that, in light of Le Mars' ongoing financial difficulties, rating agency A.M. Best had gradually down-graded the company. Whereas Le Mars' rating had been "A minus" in September, 1998, the rating on December 11, 2000 had been reduced to a "B plus." Significantly, on February 21, 2002, A.M. Best placed Le Mars under review for a further downgrade of its rating.

Mr. Bixenman also testified that the board of directors of Le Mars had unanimously approved the proposed transaction with the applicant. He stated that he and the other members of the board feel that the proposed transaction is in the best interest of policyholders because it will improve the economic condition and viability of Le Mars.

Exhibits offered by Le Mars established that the proposed transaction had been submitted to the members of the mutual at a special meeting held April 25, 2002. The members of

Le Mars approved the proposed transaction with Donegal by the following vote: In favor, 2104; opposed, 124; abstaining, 174 (Exhibits L-1 and L-2).

D. FINDINGS OF FACT

Based on the above-described evidence, the commissioner finds as follows:

1. After the change of control, Le Mars will be able to satisfy requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed.

Donald Nikolaus testified that, in conjunction with the proposed change of control, the applicant will provide Le Mars with \$4 million in capital, in exchange for a surplus note. This contribution will enlarge the company's surplus to approximately \$12.5 million. Coupled with plans for re-underwriting Le Mars' business and containing costs – including reinsurance expenses – these plans should leave Le Mars in a financial condition to continue to satisfy requirements for a license to write the lines of insurance for which it is presently licensed.

2. The acquisition will not substantially lessen competition in insurance in Iowa.

Both Mr. Nikolaus and Mr. Bixenman testified that the acquisition will not lessen insurance competition in Iowa. Their testimony was based on the observation that the applicant is not currently selling insurance products in the Iowa market. Thus, the acquisition of Le Mars by the applicant will not directly result in any consolidation or shrinkage of sales activities. Moreover, the plans of the applicant call for Le Mars, which presently has less than a 1% market share in Iowa, to continue to sell the products in Iowa that it currently sells – and expand those activities over time. Should Le Mars be able to expand its activities in the future, the proposed transaction would serve to increase insurance competition in Iowa, rather than decrease it.

3. The financial condition of the applicant will not jeopardize the financial stability of Le Mars or prejudice the interest of its policyholders.

Testimony by Donald Nickolaus, along with documentation included in the Form A filing, provide adequate assurance of the financial stability of the applicant. The surplus of the applicant is approximately eight times that of Le Mars, and the applicant is rated "A" by the rating agency, A.M. Best. Future plans for Le Mars, including withdrawal from business in North Dakota, implementation of expense control and reduction programs, restoration of underwriting profitability, negotiation of more favorable reinsurance agreements and review of outside service providers, should enhance its financial stability without prejudicing the interests of policyholders

4. The plan which applicant has to acquire Le Mars is not unfair or unreasonable to policyholders of Le Mars and is not contrary to the public interest.

Mr. Bixenman's testimony reviewed the recent financial history of Le Mars, including the fact that no underwriting profit has been achieved during the past sixteen years. Surplus has recently declined by about \$6.5 million, requiring the company to take some action to add to its capital. Under these circumstances, the applicant's plan to strengthen Le Mars with \$4 million in capital, and review all aspects of its business, not only makes sense but is in the public interest.

5. The competence, experience and integrity of those persons who would control the operation of Le Mars are sufficient to indicate that the interests of policyholders and of the public would not be jeopardized by the proposed transaction.

Biographical information contained in applicant's Form A filing indicates its officers and employees are of good character, with prior successful participation in the insurance business. The testimony of Mr. Nickolaus established the record of success the applicant has had in acquiring and revitalizing a group of insurance companies which had experienced difficulty – Southern Mutual Insurance Company, Delaware Mutual Insurance Company, Pioneer Mutual Insurance Company, Pioneer Insurance Company of Greenville, New York, and Southern Heritage Insurance Company. Thus, the interests of policyholders and the public will not be jeopardized by the competence, experience and integrity of persons who will control if Le Mars if the proposed transaction is approved.

F. CONCLUSIONS OF LAW

The application should be approved pursuant to Iowa Code section 521A.3(4)(a) (2001), contingent upon the applicant and Le Mars completing proposed transaction in the manner set forth in the applicant's Form A filing.

IT IS SO ORDERED this 3rd day of June 2002.

THERESE M. VAUGHAN
Commissioner of Insurance

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Or-Donegal+LeMars (521A '02)