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Overview of M&A Activity

A total of 43 life and property-casualty insurance M&A transactions were announced in the first eight months of 2013, representing approximately $5.5 billion of aggregate deal value.* Announced life deal volume was on pace with 2012, while aggregate deal value more than doubled. Through August 31, 2013, 13 life M&A transactions ($2.9 billion of deal value) were announced, compared to 15 life M&A transactions ($1.3 billion of deal value) in the first eight months of 2012. Both announced property-casualty deal volume and value have declined significantly in 2013 from 2012 levels. Through August 31, 2013, 30 property-casualty M&A transactions ($2.6 billion of deal value) were announced compared to 49 property-casualty transactions ($8.0 billion of deal value) in the first eight months of 2012.

The most significant life transactions announced so far in 2013 have been Protective Life's acquisition of MONY Life Insurance Company from AXA ($1.06 billion),** SCOR's acquisition of Generali's U.S. life reinsurance operations ($750 million), Resolution Life Holdings' acquisition of Lincoln Benefit Life from Allstate ($600 million)** and Global Atlantic's acquisition of Aviva USA's life insurance operations for an undisclosed sum. Protective has been an active consolidator of U.S. life insurance properties for a number of years, including Liberty Life (2010), United Investors (2010) and J.P. Morgan Chase Life (2006).** The MONY transaction is consistent with Protective's strategy, providing it with a large block of seasoned policies with limited exposure to product and equity market guarantees at a price that is immediately accretive to earnings. Meanwhile, the disposition will permit AXA to redeploy the capital that supported this business elsewhere in the group and to finance acquisitions in higher growth markets, such as Asia. SCOR's acquisition of Generali's U.S. operations follows its acquisition of Transamerica Re (2011)** and furthers SCOR's strategy of becoming a major participant in the U.S. life reinsurance sector. The transaction permitted Generali to shed a non-core U.S. asset, a growing trend among European insurers. Resolution's acquisition of Lincoln Benefit is noteworthy because it represents the company's first step in realizing a relatively novel strategy in the U.S.; *viz.*, acquiring life insurers not to write new business but to run them off and release their embedded value. Resolution Group, Resolution's U.K. affiliate, has pursued a similar strategy in the U.K. in recent years. Finally, the long-anticipated announcement of the Aviva transaction, which is connected with Apollo/ Athene's acquisition of Aviva U.S.,** is consistent with that group's stated strategy of focusing on longevity risks. It also is significant in that it is the first deal announced by Global Atlantic following its separation from Goldman Sachs in May 2013.

Also in the life sector, Berkshire Hathaway has announced two notable annuity transactions to date in 2013. In February, the company said that it had entered into a reinsurance transaction with a subsidiary of CIGNA** pursuant to which Berkshire reinsured $4 billion of guaranteed minimum death benefit and guaranteed minimum income benefit exposures. In June, Berkshire announced that it would pay $285 million for Hartford Life International Ltd., Hartford's U.K. variable annuity business. The deal will bring $1.75 billion of assets to Berkshire. The transactions are significant because they involve variable products, which are problematic for many potential buyers. For Berkshire, however, these transactions represent an opportunity to use its sizable balance sheet to take on exposures at favorable prices.

* Deal volume and value amounts in this report are derived from SNL's database.

** Willkie Farr & Gallagher advised on this transaction.

Several significant property-casualty transactions have been announced to date in 2013. The largest was Travelers' $1.1 billion agreement to purchase Dominion of Canada General Insurance Co. from E-L Financial Corp. The transaction, which is the first acquisition for Travelers since 2010, furthers the company's strategy of using M&A to expand its international operations. Dominion is a personal and commercial lines carrier that will significantly expand Travelers' exposure to risks in Canada. Also of note, Enstar Group, one of the most active buyers of property-casualty properties in recent years, has announced two acquisitions to date in 2013. In June, Enstar said that it had agreed to acquire Atrium Underwriting Group and Arden Reinsurance Company for an aggregate price of $262.6 million.** Atrium is a Lloyd's managing agency and syndicate with third-party-names capital, and Arden is a Bermuda reinsurer. In July, Enstar announced that it and private equity firm Stone Point would acquire Torus Insurance from an investor group including private equity funds First Reserve and Corsair Capital for cash and stock equal to $692 million.** Torus has U.S., Bermuda and U.K. insurance subsidiaries and a Lloyd's managing agency and syndicate. Historically, Enstar has focused on acquiring run-off insurance and reinsurance companies. These transactions, however, represent an expansion into "live" underwriting. In addition, both involve Lloyd's. A key driver of London market property-casualty M&A in 2013 has been the desire on the part of both industry and private equity buyers to gain entrance to the Lloyd's market. Finally, in September, American Family Insurance, a mutual insurer that focuses on property, casualty and auto insurance, announced it had agreed to buy Homesite Group, Inc. for $616 million from a group of shareholders, including Alleghany Corporation.** Homesite is a direct-to-consumer seller of homeowners, renters and condominium insurance. The acquisition is American Family's second in the last 12 months, and its largest to date.

A large number of insurance broker deals have been announced in 2013, as in prior years. Most of these deals are small, private transactions, but two are worth noting here. First, on April 15, 2013, private equity firm Madison Dearborn announced that it had entered into a merger agreement to acquire National Financial Partners, a provider of benefits, wealth management and insurance services, in a deal valued at $1.3 billion. The transaction closed in July 2013. Second, on August 5, 2013, private equity firm Hellman & Friedman agreed to acquire Hub International for $4.4 billion. The sellers, Apax Partners and an affiliate of Morgan Stanley, had taken the company private in 2007 for approximately $2.0 billion.

Life Insurance: The DFS Approves Two Private Investor Transactions; the NAIC Reacts to the Private Equity Trend; and the State of Life Insurance M&A

In recent years, private equity firms, hedge funds and other private investors have largely supplanted strategic buyers in the acquisition of U.S. annuity businesses. Two large investment management groups, Apollo and Guggenheim, have been at the forefront of this trend. Apollo's announced acquisitions, through its affiliate Athene, include Liberty Life (2011), Investors Insurance (2011), Presidential Life (2012) and Aviva (U.S.) (2012).** Guggenheim's announced acquisitions include Security Benefit (2010), EquiTrust (2011), Industrial Alliance (U.S.) (2012) and Sun Life (U.S.) (2012). In addition, an affiliate of hedge fund Harbinger acquired F&G Life** from Old Mutual in 2011. Recent sale processes involving life

** Willkie Farr & Gallagher advised on this transaction.

insurers have included a spate of private equity firms and other private investors seeking to replicate the successes of Apollo, Guggenheim and Harbinger, a trend that has been reported widely in the financial press.

The private investor acquisitions tend to share some general characteristics. First, the acquisitions have been priced at discounts, sometimes substantial, to the target's book value. Second, they are usually accompanied by one or more large reinsurance cessions from the target to an offshore affiliate of the acquirer and/or an unaffiliated third party. Such reinsurance transaction(s) may be on a modified coinsurance basis or may be secured by a Reg. 114-type trust or a funds-withheld arrangement. Third, the target's excess capital, attributable in large measure to the reinsurance transaction(s), is dividended up to help finance the acquisition. Fourth, the target's investment portfolio is restructured to increase exposure to asset classes in which the private investor has expertise, such as alternative investments, high-yield bonds and structured securities.

The NY DFS Approves the Guggenheim/Sun Life and Athene/Aviva Transactions

In late 2012, two significant private investor deals were announced: Guggenheim agreed to acquire Sun Life (U.S.), and Athene Holding, a Bermuda-based insurer partially backed by Apollo, agreed to acquire Aviva's U.S. operations.** Both acquisitions involved New York domestic insurance companies, and therefore required the prior approval of the New York Department of Financial Services (the "DFS") under the New York Insurance Holding Company Act.

On April 18, 2013, New York Superintendent of Financial Services Benjamin M. Lawsky announced in a speech that the DFS had become concerned about the acquisition of insurance companies by private equity firms. Superintendent Lawsky asserted that private equity firms have a potential "short-term" focus on "maximizing their immediate financial returns" that is not "necessarily a natural fit for the insurance businesses." In particular, the Superintendent questioned whether private equity-owned insurers are making riskier investments, which could result in an inability to honor policy obligations.

In May 2013, the Capital Markets division of the DFS issued to approximately 10 New York-domiciled life insurers requests for special reports pursuant to Section 308 of the New York Insurance Law. The insurers were asked to provide information and documents relating to inquiries, offers or solicitations received from "private investors" since January 1, 2010 to acquire, reinsure or invest in such insurers' annuity or life insurance businesses. The DFS also issued subpoenas to approximately six private equity funds and other groups that have entered into transactions with, or shown interest in transactions with, life insurance companies. The subpoenas requested all documents, defined broadly to include all communications, including voicemails and emails, concerning the firms' analyses, evaluations, term sheets, sources of funding and the like with respect to proposed acquisitions of, investments in or reinsurance of any annuity or life business.

On July 31, 2013, the DFS issued a press release announcing it had approved Guggenheim's acquisition of Sun Life New York, Sun Life (U.S.)'s New York domestic insurer. According to the press release, Guggenheim agreed to put in place a series of "heightened policyholder protections" that "should serve as a model set of 'guardrails' for addressing the emerging trend of private equity firms seeking to enter the annuity business." The principal policyholder protections noted in the press release are:

- Guggenheim will maintain Sun Life New York's risk-based capital ("RBC") at an amount not less than 450%.

** Willkie Farr & Gallagher advised on this transaction.

- Guggenheim will establish a "backstop" trust account totaling $200 million to be used to replenish Sun Life New York's capital in the event its RBC falls below 450%. The trust account will be held for "at least seven years."
- Guggenheim must obtain prior regulatory approval for any material change in Sun Life New York's plan of operations, including in respect of investments, dividends or reinsurance.
- Sun Life New York will file quarterly RBC reports (rather than only the annual reports required under New York law), and will disclose "necessary information" concerning corporate structures, control persons "and other information regarding the operations of the company."

The transaction closed on August 2, 2013.

On August 14, 2013, the DFS issued a second press release, this time announcing that it had reached an agreement with Athene on a set of heightened policyholder protections in connection with the Aviva U.S. acquisition. The protections announced were substantially the same as those in the Sun Life deal (including an agreement to maintain Aviva New York's RBC at no less than 450%), although the amount of trust funding ($35 million) was lower, presumably due to the smaller size of Aviva's New York operations. In the press release, Superintendent Lawsky announced that the DFS had "worked to build a new model for policyholder protections that will help address the emerging trend of private equity firms and other investment companies entering the annuity business."

The DFS's Guggenheim and Athene press releases have left several important questions unanswered for other participants in the M&A market. First, is the 450% requirement based on authorized control level RBC or company action level RBC? A requirement to maintain a 450% company action level RBC would subject buyers to a high standard, and so we think it is logical to conclude the standard is 450% of authorized control level RBC (or 225% of company action level RBC). Second, what are the terms of the trusts? How are its assets invested? Who gets the investment income? Since the terms of the trust are not public, under New York law we do not expect further information about them to be known publicly unless the DFS provides it. Third, will these new *de facto* requirements apply to all buyers or just "investment companies?" We believe the latter, but will be interested to see where the DFS draws the line between investment company-backed buyers and other insurers, particularly given the substantial stand-alone capitalization and long-term business focus of a company like Athene, which was subjected to the new regime.

Regulatory transparency is generally beneficial for the marketplace, and we hope the DFS provides guidance about its new requirements as soon as possible. It may be that the DFS is evaluating the information it gathered in connection with its subpoenas and Section 308 requests to formulate new regulations or publish best practices for certain acquisitions, and so the answers to the questions above will be generally known when that process is completed. Further, we note that while some more traditionally funded insurers may welcome the DFS's actions and the NAIC's initiatives discussed below (which may be viewed by some as lessening competition in the insurance business), they may not be as happy when the new rules limit competition in the M&A market if they seek to sell non-strategic life and annuity businesses in the future. See "*The State of Life Insurance M&A*."

New York is not the only state focused on the "private investor" issues. On August 15, 2013, the Iowa Insurance Division (the "IID") issued a press release announcing it had approved the Athene-Aviva deal. In its release, the IID announced that the approval was subject to the implementation of a capital maintenance agreement, a five-year moratorium on the payment of dividends by Aviva's Iowa domestic insurer and a special provision eliminating the minimum-size exception for approval of affiliate agreements with respect to Athene, among other things. The terms of the capital maintenance agreement were not disclosed to the public.

The NAIC Reacts to the Private Equity Trend

In May 2013, the Financial Analysis Working Group ("FAWG") of the National Association of Insurance Commissioners ("NAIC") proposed that its parent committee, the Financial Condition (E) Committee, form a new working group to study the increased interest in the life insurance industry by private equity funds. In its referral, FAWG identified possible best practices, as well as potential changes to state laws and regulations incorporating such practices based on NAIC models. These recommendations focus on the acquisition of control process (also known as the Form A process) and insurance regulators' financial examination practices for life insurers.

FAWG's proposed best practices include requiring an acquirer, as part of the Form A process, to demonstrate that policyholders will be fundamentally more secure following the proposed acquisition, and to provide details on the acquirer's investment strategy with respect to the target insurer and the insurance group. FAWG proposes that regulators use tools including:

- engaging an investment banker to determine if the acquirer's investment strategy and related affiliate agreements are giving appropriate consideration to private equity firm fees and arrangements with broker-dealers;
- obtaining pro forma results under specific stress scenarios;
- requiring the acquirer to enter into a capital maintenance agreement supporting the net worth of the target operations;
- requiring more information regarding cash flows and reserves as well as reserving methodologies;
- limiting the investment strategy used with respect to any assets held in trust to ensure they meet asset-liability matching and applicable state insurance law requirements;
- obtaining specific commitments from the acquirer regarding state insurance laws and regulations; and
- obtaining information from the acquirer regarding investment returns necessary to meet investor demands and the acquirer's plans to seek such returns through its insurance company investment.

In addition, FAWG recommended that insurance regulators consider using an investment specialist to carry out continuing financial analysis of the insurer and its affiliates, including annual targeted examinations to ensure that the insurer's investment strategy provides a prudent approach to investing policyholder funds. Further, FAWG recommended coordination with international regulators, detailed review of the investment portfolio of the insurer and its affiliates, ongoing stress tests and a review of agreements with affiliates and non-affiliates related to fee agreements and reinsurance arrangements. FAWG also recommended, as a best practice, examinations of private equity-owned reinsurers that assume annuity risks from U.S.-regulated insurers. Finally, FAWG suggested amendments to specific state laws such as the Credit for Reinsurance Model Law, state investment laws and RBC formulas.

On July 17, 2013, the E Committee voted unanimously to establish the proposed Private Equity Issues (E) Working Group, which will be chaired by Douglas Stolte, Deputy Commissioner of Financial Regulation of the Virginia Bureau of Insurance.

The State of Life Insurance M&A

We believe that life insurance M&A has entered a period of uncertainty due to several factors, including recent regulatory developments relating to private equity buyers, the consequences of the designation or possible designation of certain large life insurers as "systemically important financial institutions" or "SIFI's," and a rising interest rate environment.

There is significantly regulatory concern and uncertainty around the growing volume of private equity life M&A transactions, which may have a negative influence on deal making going forward. Private equity firms have stimulated significant competition in recent sales processes and have enhanced valuations received by sellers of these properties at a time when few other buyers have been present. Onerous "policyholder protections" or "best practices" could suppress returns on life and annuity properties. If too severe, they may push private equity firms out of the sector altogether as they seek better returns from investments in other industries. While that may serve certain industry participants' interests, it begs the question of who will be left to buy many of these properties if private equity exits the market? In some cases, there will not be many alternatives. Large U.S. strategics have shifted their focus to Asia and Latin America, and have expressed limited or no interest in consolidating U.S. life insurance properties. European strategics are more likely to be sellers than buyers of life businesses at the present time. The mutuals may be well positioned to fill the void, and some of them have shown interest in recent sale processes. Mutuals, however, generally are immune to the earnings-driven pressures that compel stockholder-owned companies to engage in M&A, and absent factors such as rating agency pressure to address an imbalance in mortality and longevity business, may see limited upside in deal making. Perhaps the buyers that are best positioned for now are experienced industry consolidators and run-off specialists, such as Protective and Resolution. Without competition from private equity firms, these companies may enjoy a relatively open field in life M&A, for the short term at least.

Developments at the NAIC also could have a negative effect on life M&A. Good regulation is good for the industry, but we would be concerned about capital requirements and investment limitations that dampen returns and valuations for life insurers. Further, the NAIC needs to think carefully about the possible ramifications of mandatory capital maintenance commitments. While many insurers have acknowledged a *de facto* obligation to maintain RBC levels resulting from market, rating agency or regulatory pressures, the events of the last five years should give pause about the wisdom of a web of *de jure* capital support requirements, particularly when a flexible response to capital issues may produce the best outcome in a time of financial crisis.

We think the possible regulatory designation of certain life insurers as SIFIs may have both a negative and a positive impact on M&A in the sector. On the one hand, we believe there will be a short-term decline in large M&A transactions on the part of insurers that have been designated, are in the process of being designated or are concerned about being designated SIFIs. On the other hand, there may be an increase in divestitures by companies that are trying to rationalize and realign their structures in light of the new regulatory environment, resulting in the availability of additional properties on the market.

Finally, an increase in interest rates should likewise have an equivocal effect on life M&A. Rising rates will alleviate some of the pressure on insurers that have written business with product guarantees, in particular variable life and annuities, that became problematic in the recent low interest rate environment. As a result, some of these companies may reconsider whether it is still a priority to find a way to dispose of such business. Meanwhile, rising rates may positively affect valuations of life and annuity blocks. Companies that were reluctant to accept a low price or a negative ceding commission for this business in the recent past may find the M&A market offers more attractive terms in a rising rate environment.

Property-Casualty Insurance: London Market and Lloyd's Update; an Uptick in Hostile Activity; and the State of Property-Casualty M&A

London Market and Lloyd's Update

Recent Activity

Thus far, 2013 has been marked by significant M&A activity within the London market generally and, in particular, at Lloyd's of London. Both industry participants and private equity firms have been actively involved as buyers and sellers.

As noted above, in the first half of 2013, auctions were conducted in respect of both Atrium Underwriting Group** and Torus Insurance.** Both deals attracted significant interest from potential buyers, and the sellers in both deals included private equity firms. Enstar, a reinsurance and run-off group located in Bermuda, was the successful bidder for both properties, in partnership with the private equity firm Stone Point Capital.

In addition, in July 2013, New York-based AmTrust Financial Services entered into an agreement to purchase the loss-making Lloyd's vehicle, Sagicor Europe, which includes Sagicor at Lloyd's. The announcement of this transaction came after the collapse of the proposed sale of Sagicor Europe to AnaCap, a European private equity firm, in June 2013 following an extensive auction process. AmTrust was reported to have been seeking to secure a Lloyd's platform for a number of years and turned to M&A after it was not able to obtain approval for a start-up.

In August 2013, London-listed (re)insurer Lancashire Holdings Limited announced its agreement to acquire the Cathedral Group, an integrated Lloyd's vehicle with third-party-names capital, from an investor group including private equity firm Alchemy Partners in a transaction valued at £266 million.** The consideration represented 1.6x Cathedral's net tangible assets at the end of March 2013, which is in line with the multiples achieved by other sellers of Lloyd's franchises such as Atrium, Kiln, Hardy and Talbot. The acquisition will give Lancashire a platform at Lloyd's, the world's leading specialist insurance market. Closing is subject to regulatory approval of the U.K.'s new Prudential Regulation Authority and Lloyd's.

Other significant M&A activity in the U.K. insurance market at mid-year 2013 has involved motor and other personal lines insurers. Among other transactions, private equity firm Aquiline completed its acquisition of Equity Red Star, a motor insurer that is the largest personal lines insurer at Lloyd's, from Insurance Australia Group, and private equity firm CVC Capital Partners agreed to purchase specialist appliance insurer Domestic & General from Advent International for £524 million.

Trends in the Market

M&A activity in the London market so far in 2013 largely continues the trends we saw in 2012. A key driver remains the desire on the part of private equity firms to enter into the Lloyd's market and, for certain other private equity firms already in the market, to sell their stakes at increasingly attractive multiples. Third-party alternative capital in the collateralized reinsurance and insurance-linked securities ("ILS") fund space could impact property-casualty M&A generally. See "*The State of Property-Casualty M&A*." Most of the U.K. deals in 2013 discussed in this report involve specialist reinsurers at Lloyd's that include managing agencies that manage capacity provided by third-party names. Put differently, the traditional Lloyd's model also includes the ability to manage third-party capital and to put such funds to work by underwriting business either on a rated basis or a collateralized basis.

** Willkie Farr & Gallagher advised on this transaction.

The perception remains that M&A activity assures a more straightforward entry into the Lloyd's market, as compared to a syndicate start-up. Several industry buyers have sought to expand and diversify their portfolios and businesses through Lloyd's acquisitions. Industry buyers continue to value the access to international markets, licensing advantages and favorable credit rating and security that participation in the Lloyd's market brings. Although we have seen the Lloyd's Franchise Board recently approve start-up syndicates at Lloyd's in compelling cases with differentiated business plans, it generally is easier at the present time for anyone interested in a Lloyd's platform to acquire an existing one rather than establishing one themselves. At mid-year 2013, there remain several independent Lloyd's-centric managing agencies and syndicates (*e.g.*, Antares, Ark, Barbican, Brit, Canopius, Novae).

An Uptick in Hostile Activity

Hostile activity—whether taking the form of shareholder activism, proxy fights, unsolicited tender offers or deal jumping—is relatively rare in insurance M&A. There are several good reasons for this fact. Most important, such activity may require multiple insurance regulatory approvals or an exemption from such approvals. The regulatory process provides target companies and incumbent management with myriad opportunities to delay and defeat unwanted proposals. In addition, the insurance community is relatively small and close-knit. Many (but not all) of its participants are reluctant to antagonize others by forcing themselves into transactions. As a result, over the years there have been relatively few examples of hostile activity in insurance M&A. Two transactions in the property-casualty sector have provided an exception to this rule in 2013, however.

Fairfax Financial/Catalina Holdings/American Safety

On June 3, 2013, Fairfax Holdings announced that it had entered into a merger agreement to acquire American Safety, a publicly traded specialty property-casualty insurer, for $29.25 per share in cash ($306 million in the aggregate). According to American Safety's merger proxy statement, the announcement followed an active auction process in which numerous parties were invited to participate and several proposals were submitted. The bidders included Catalina Holdings, a Bermuda-based acquirer of run-off property-casualty insurers, which also had a 5.7% stake in American Safety's common shares. At the conclusion of the process, after the bidders were asked to submit their "best and final" proposals, Catalina's bid was $29.00 per share, or $0.25 per share less than Fairfax's.

Although American Safety is a Bermuda company, as is customary in the case of Bermuda M&A transactions, its merger agreement with Fairfax contains Delaware-style no-shop and fiduciary-out provisions. The agreement prohibits American Safety from engaging in specified activities that may facilitate the submission of an acquisition proposal. American Safety's board is permitted to provide confidential information and engage in negotiations with respect to an acquisition proposal only if the board determines in good faith that the acquisition proposal could reasonably be expected to result in a superior proposal and the failure to take such actions would be inconsistent with the board's fiduciary duties under Bermuda law. Further, the agreement prohibits the board from changing its recommendation to shareholders that they vote in favor of the merger or from entering into an agreement with respect to an alternative transaction unless the board determines, in the case of a competing acquisition proposal, that such proposal is superior to Fairfax's proposal and a failure by the board to change its recommendation or enter into such agreement would be inconsistent with its fiduciary duties. The merger agreement contains a matching right in favor of Fairfax, obligating American Safety to negotiate improvements in Fairfax's transaction for two business days prior to entering into an agreement relating to an alternative transaction, and contains standard "force-the-vote" language. Finally, American Safety must pay Fairfax a termination fee if, among other things, American Safety enters into an agreement with respect to an alternative transaction or Fairfax terminates the merger agreement because the board

has changed its recommendation that shareholders approve the Fairfax merger. The agreement also requires American Safety to reimburse Fairfax's expenses (up to $1.5 million) if it is terminated in certain circumstances.

On July 29, 2013, following the filing of American Safety's proxy statement, Catalina sent letters to the members of American Safety's board of directors in which it offered to acquire American Safety for $29.75 per share, and alleged that American Safety's board had breached its fiduciary duties to shareholders. Catalina alleged that American Safety's proxy statement had disclosed various instances in which Fairfax had been favored over Catalina in the auction. In particular, Catalina stated that, had it been told that its bid was only $0.25 less than Fairfax's prior to American Safety's entry into the merger agreement with Fairfax, it would have increased its bid. On July 31, 2013, American Safety announced that Fairfax had provided it with a waiver of certain provisions of the merger agreement enabling it to provide confidential information to Catalina and to engage in discussions with Catalina regarding its revised proposal.

On August 7, 2013, American Safety announced that it had amended its merger agreement with Fairfax to increase the consideration to $29.50 per share. In addition, the amendment increased the termination fee from $9.4 million (or 3.0% of equity value) to $13.4 million (or 4.25% of equity value).

On August 14, 2013, Catalina wrote to American Safety's board, alleging that it had disregarded its fiduciary duties to shareholders in managing the auction process. In particular, Catalina complained that American Safety had agreed to an increase in the termination fee without having any communication with Catalina to determine whether it would raise its bid. Catalina also alleged that the 4.25% termination fee was "clearly above standard termination fee levels for such a transaction involving two competing bidders" and that the fee would deprive shareholders of $0.40 per share of additional value in the event of a higher offer. Notwithstanding, Catalina increased its proposal to $30.75 per share. In addition, it proposed a "market-based" termination fee of $9.2 million.

American Safety's financial adviser instructed Fairfax and Catalina that American Safety's board would meet on August 16 to consider Catalina's latest proposal. Both Catalina and Fairfax were asked to submit their "best and final" offers for American Safety by the close of business on August 15. Catalina confirmed its revised proposal of $30.75. Fairfax did not submit a revised proposal. On August 18, Fairfax and Catalina informed American Safety that Catalina was withdrawing its revised proposal to acquire American Safety and that Fairfax and Catalina had reached an agreement whereby Fairfax would sell American Safety's reinsurance business to Catalina promptly after the closing of Fairfax's acquisition of American Safety. Fairfax previously had agreed to sell this business to Tower Group. Fairfax paid $5 million to Tower, and Tower agreed to terminate the agreement to purchase the reinsurance business.

While, as practitioners, we would have liked to have seen some additions to the small body of Bermuda case law on sales processes and termination fees, we appreciate the benefits to the parties of an amicable resolution of this potential dispute. Bermuda courts will have additional opportunities to consider these issues in the future, particularly if the level of M&A activity in Bermuda accelerates in coming months, as discussed in "*The State of Property-Casualty M&A*" below.

Donegal Group/Gregory Mark Shepard

Donegal Group is a publicly traded insurance holding company. It has property-casualty subsidiaries that are domiciled in Iowa, Maryland, Michigan, Pennsylvania, Virginia and Wisconsin. In all of these states, the acquisition of 10% or more of the outstanding voting stock of one insurer or its holding company creates a rebuttable presumption of a change of control. Donegal Mutual owns shares of Donegal Group's two classes of common stock that entitle it to vote 65.9% of the combined voting power of Donegal Group's common stock.

Gregory Mark Shepard is a private investor who has a particular interest in the publicly traded downstream

subsidiaries of mutual insurance companies. In 2000, he owned 20% of Meridian Insurance Group, a publicly traded subsidiary of Meridian Mutual. He claims to have catalyzed the merger of State Auto Mutual and Meridian Mutual, and the acquisition of Meridian Group by State Auto. In 2003, he acquired approximately 5% of State Auto's common stock and commenced a partial tender offer for additional State Auto shares. The tender offer was unsuccessful, and Shepard terminated it in 2004 and disclosed that he sold his shares to investor Carl Icahn.

Most recently, Shepard has turned his attention to Donegal Group. In 2006, he filed disclaimers of affiliation with insurance regulatory authorities, seeking to purchase up to 14.99% of the voting power of Donegal Group's stock. Regulators in Maryland, Pennsylvania and Virginia approved the disclaimers in 2006 and 2007. The Iowa regulator denied Shepard's disclaimer in the first quarter of 2009, however. Shepard did not contest the Iowa decision, but bought more stock of Donegal, taking him up to the 10% threshold at which a Form A filing would be required. Over the next few years he wrote a number of letters to management of Donegal, in which he expressed criticism of various aspects of the company and its strategy. Also, in 2011 and 2012, he proposed resolutions for the company's annual meeting proxy statement that would pressure it to engage in transactions to enhance shareholder value. The SEC permitted Donegal to exclude these proposals from its proxy statement.

On March 20, 2013, Shepard commenced a tender offer for 962,636 shares of Donegal's Class B Common Stock at $30 per share. If the offer had been successful, Shepard would have owned shares with approximately 22.7% of the voting power of Donegal's common stock. The tender offer was scheduled to expire on April 19, 2013 and was subject to numerous conditions, including the conditions that:

- a minimum of 925,000 shares of Class B Common Stock be tendered;
- three persons selected by Shepard be appointed as new directors of Donegal Group and Donegal Mutual; and
- required regulatory approvals be obtained.

Also on March 20, Shepard submitted Form A filings to Donegal's six domestic insurance regulators, seeking approval of his acquisition of control of Donegal's insurance subsidiaries, as well as a disclaimer of affiliation with bank regulators that was required because Donegal owns a federal savings bank.

Donegal's board of directors appointed an independent committee, which retained independent counsel to review Shepard's proposal. On April 3, Donegal's board of directors recommended that shareholders reject Shepard's tender offer. The board concluded that the offer was "illusory" because Shepard would not be able to satisfy the conditions. Among other things, the board noted:

- the minimum tender condition could not be satisfied unless Donegal Mutual or Donegal's chief executive officer tendered some portion of the shares of Class B Common Stock owned by them, and both had informed the board that they would not tender their shares;
- Donegal Mutual had informed the board that it would not appoint the three directors Shepard recommended, and Donegal Group likewise determined not to appoint Shepard's directors; and
- Shepard would be unlikely to obtain the required regulatory approvals by the expiration date of the tender offer.

In subsequent filings with the SEC, Shepard extended the expiration date of the tender offer to May 20, 2013 and then to July 31, 2013. In addition, he waived the director appointment condition and another condition related to future option grants. On May 29, 2013, Donegal Group's board again recommended that shareholders reject Shepard's revised tender offer. It noted that while Shepard could waive most of his conditions, the regulatory approval condition, which had not been satisfied, was a matter of law and therefore not waivable.

Shepard permitted his tender offer to expire on July 31, 2013. His press release noted that 394,215 shares of Class B Common Stock had been tendered, and so the minimum tender condition was not satisfied. The shares were returned to their owners.

On August 2, 2013, Shepard sent a letter to Donegal Mutual proposing an "amicable" purchase by him of 3.3 million shares of the Donegal Group Class B Common Stock owned by Donegal Mutual at $22 per share, subject to diligence and financing. Donegal Mutual rejected the proposal.

The defeat of Shepard's multiyear attempt to force a transaction on Donegal demonstrates the continued vitality of the insurance regulatory defense. Shepard's disclaimer permitting him to buy up to 14.99% of the voting stock was premised on the fact that Donegal Mutual owned 65.9% of Donegal's voting stock, which entitled it to control the board and the outcome of shareholder votes. Notwithstanding, Iowa declined to grant the disclaimer, following a public hearing, after considering it for the better part of two years. Although every other applicable state had granted the disclaimer, without Iowa's approval Shepard could not go forward with his purchase plan. Also, Shepard filed six Form A applications when he launched his tender offer in March 2013. By the time the tender offer expired five months later, he had not obtained a single approval for his acquisition of control. In fact, based on materials Donegal filed with the SEC, two states had raised legal issues as to whether Shepard *could make a tender offer at all* without obtaining prior regulatory approval. In addition, several other states had asked Shepard for additional information to "complete" his Form A, and had indicated they would not commence their consideration of his application until the information was supplied. It must have been clear to Shepard that his deal could not proceed unless he was prepared to fight a long and expensive battle before the state insurance regulators. Although there were other reasons for Shepard's failure, this one undoubtedly was among the most important.

The State of Property-Casualty M&A

For many years we and other commentators have been predicting an increased tempo of property-casualty M&A activity—particularly among the Bermuda companies with significant reinsurance operations. Our prediction may be proved correct in 2014. As other commentators have noted, the influence of ILS investors—including dedicated ILS funds, hedge and pension funds and endowments—on the traditional reinsurance and retrocessional natural catastrophe markets has increased capacity and affected pricing. This segment of the reinsurance market historically has been a key contributor to the profits of many of the Bermuda companies, and we and other observers are watching carefully to see if the competitive pressures of non-traditional sources of reinsurance capacity provide a catalyst to deal making in Bermuda as those companies seek to adapt to a changing competitive landscape.

More generally, we believe that the next 12-18 months will look very much the same as the past few years in terms of the number and types of transactions involving property-casualty companies. We do not anticipate there will be significant M&A activity at the holding company legal-entity level. That being said, we do anticipate a continuation of the trend toward transactions involving renewal rights, loss portfolio transfers, Lloyd's and London market entities and specialty insurers. We also believe that, notwithstanding an increasingly challenging pricing environment for run-off property-casualty consolidators such as Enstar and Catalina, such acquirers will remain a formidable presence in the property-casualty M&A market.

Willkie's Insurance Transactional and Regulatory Group

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John J. Lyman

BRUSSELS

Xavier Dieux

PARIS

Christophe H. Garaud

Daniel Hurstel

Daniel Payan

WASHINGTON, D.C.

Christopher S. Petito

NEW YORK
787 Seventh Avenue
New York, N.Y. 10019-6099, U.S.A.
T 212-728-8000
F 212-728-8111

WASHINGTON
1875 K Street, N.W.
Washington, D.C. 20006-1238, U.S.A.
T 202-303-1000
F 202-303-2000

LONDON
City Point, 1 Ropemaker Street
London EC2Y 9AW, England
T +44 20 3580 4700
F +44 20 3580 4800

WILLKIE FARR & GALLAGHER LLP

NEW YORK WASHINGTON PARIS LONDON MILAN ROME FRANKFURT BRUSSELS

in alliance with Dickson Minto W.S., London and Edinburgh

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