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CLIENT/MATTER NUMBER
027702-0102

July 22, 2016

ADVANCED VIA E-MAIL

Ms. Kristin L. Forsberg
Insurance Financial Examiner
Bureau of Financial Analysis and Examinations
State of Wisconsin
Office of the Commissioner of Insurance
125 South Webster Street
P.O. Box 7873
Madison, WI 53707-7873

Re: Form A – Acquisition of Control of United National Specialty Insurance Company by State National Companies, Inc. and State National Insurance Company, Inc.

Dear Ms. Forsberg:

Reference is made to your letter regarding the above-captioned matter, dated July 7, 2016. Please find below the requests made in that letter (in bold type) and a response to each request from State National Companies, Inc. (“SNC”) and State National Insurance Company, Inc. (“SNIC”)

Exhibit 2(b) and Exhibit 6 contain confidential information that could put SNC and SNIC at a competitive disadvantage if it were to become known by the public. SNC and SNIC take reasonable efforts to keep this information confidential. Accordingly, the information constitutes a “trade secret” under Section 134.90(1)(c), because it “derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use” and because the information “is the subject of efforts to maintain its secrecy that are reasonable under the circumstances.” As you are aware, trade secrets are exempt from the public records law under Section 19.36(5), Wis. Stat. and Wis. Admin. Code § Ins 6.13(2). Additionally, OCI may withhold this information from disclosure under Section 601.465(1m)(a), Wis. Stat. and Wis. Admin. Code § Ins 40.05. Accordingly, we request that you do not release Exhibit 2(b) or Exhibit 6 to the public. Additionally, the biographical affidavit enclosed with this letter as Exhibit 11 is submitted subject to a request for confidential treatment under Section 601.465, Wis. Stat.

1. Form AA – Consent to Jurisdiction: s. Ins 40.19 of the Wisconsin Administrative Code requires that any person required to file consent under s. 617.11 (5) of the Wisconsin Statutes shall do so using the Consent to Jurisdiction Statement (Form AA)

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found at the end of Chapter 40 of the Wisconsin Administrative Code. Please submit an executed “Consent to Jurisdiction” statement.

An executed Form AA Consent to Jurisdiction Statement for State National Companies, Inc. and State National Insurance Company, Inc. is being sent to your attention under separate cover.

2. Nephila Capital, Ltd.: Item 8 of the Form A discussed an “Alliance Agreement” between State National, Nephila Capital, Ltd. (“Nephila”) and Nephila Holdings, Ltd. (“Holdings”) dated November 15, 2015, as amended, whereby Holdings has an option to acquire ownership of UNSIC from State National, and in certain circumstances, State National has an option to sell a portion of its ownership of UNSIC to Holdings.

In addition, Item 8 states that State National and Nephila have agreed to transition some of the admitted insurance business written by State National and its affiliates which is reinsured by Nephila to UNSIC after the closing. Please provide the following information:

a) Please provide the dollar value of premiums ceded by the State National and its affiliates to Nephila for each of the last 3 years. In addition, please discuss how this business is reported and disclosed in State National Insurance Company, Inc.’s statutory financial statements and in the Notes to Financial Statements.

SNIC and its affiliates recorded the following direct written premiums related to the Nephila program:

2015 - \$85,688,140

2014 - \$29,966,699

2013 - \$0

Note that these premiums are not directly ceded to Nephila, as Nephila is not a licensed reinsurer. For the years ending 2014 and 2015, this business was ceded to Ananke Re, LTD., an affiliate of Nephila. This business is recorded in the statutory financials statements (and in the Notes to the Financial Statements) in the same manner as all other Program Services business.

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b) Please provide a copy of the referenced “Alliance Agreement” between State National, Nephila Capital, Ltd. and Nephila Holdings, Ltd.

A copy of the Alliance Agreement, as amended, is enclosed with this letter as Exhibit 2(b), and is being submitted pursuant to a request for confidential treatment, as discussed above.

3. Holding Company Structure/Ownership:

a) Ownership of State National Companies, Inc.: The Form A states that 28.485% of the outstanding common stock of State National Companies, Inc. represents shares held by Terry Ledbetter individually, and by trusts, and a private foundation for which Terry Ledbetter is the grantor.

Please provide a breakout of the % ownership held by Terry Ledbetter individually, by each trust (please include the name of each trust, and indicate whether the trust is revocable or irrevocable), and by the private foundation (please include the name of the private foundation).

A table setting forth a breakout of the percentage ownership in SNC held by Terry Ledbetter individually, by each trust (indicating each trust’s name and whether it is revocable or irrevocable), and by the private foundation is enclosed with this letter as Exhibit 3(a).

b) SNC Financial GP, LLC and SNC Financial LP, LLC: Please explain the business purpose of these entities, the role these entities serve in the State National holding company system, and the ownership of these entities.

SNC Financial GP, LLC and SNC Financial LP, LLC are wholly owned subsidiaries of SNC. SNC Financial GP, LLC and SNC Financial LP, LLC own 1% and 99%, respectively, of TBA Insurance Group, Ltd. (“TBA”). SNC Financial GP, LLC and SNC Financial LP, LLC have no current business activities other than their ownership of TBA.

c) T.B.A. Insurance Group, Ltd: Please explain the business purpose of this entity, the role this entity serves in the State National holding company system, and the ownership of this entity.

TBA is wholly owned by SNC Financial GP, LLC and SNC Financial LP, LLC (as described in response to Question 3(b), above), and its ultimate parent is SNC. TBA is licensed as a managing general agent for SNC’s insurance subsidiaries in connection with SNC’s Lender Services segment and oversees the underwriting of the CPI business. In addition, under a separate management agreement, TBA provides business development, financial monitoring and other oversight functions to SNC’s insurance subsidiaries.

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In addition, if T.B.A. Insurance Group, Ltd. is an MGA, please discuss: Does the Texas Dept. of Insurance consider State National Insurance Company, Inc. to be a producer-controlled insurance company? If yes, please discuss the reporting, disclosure and other requirements for producer-controlled insurance companies under Texas law.

TBA holds an MGA license in the State of Texas. However, to our knowledge, the Texas Department of Insurance does not consider TBA to be a “controlling producer” in any capacity, and specifically, with respect to SNIC. In addition, it may be material to note that, based on NAIC guidance updated during the first quarter of 2016, Texas has not adopted, and has no current activity to adopt, the Business Transacted with Producer Controlled Property/Casualty Insurer Model Act.

d) T.B.A. Statutory Trust I, III, and IV: Please explain the purpose and nature of these Trusts, identify the owners of each trust (and the % ownership), their investment holdings, and the reason for their placement between T.B.A. Insurance Group, Ltd. and State National Intermediate Holdings, Inc. within the holding company system.

SNC has three statutory business trusts (the “Trusts”) that were formed between 2002 and 2004, for the sole purpose of issuing \$44.5 million of trust preferred securities in private offering transactions. The Trusts used the proceeds from these offerings, together with the equity proceeds received upon their initial formation from TBA, to purchase variable-rate subordinated debentures issued by TBA. All voting securities of the Trusts are owned by TBA, and the debentures are the sole assets of the Trusts. The Trusts meet the obligations of the trust preferred securities with the interest and principal paid on the debentures. SNC does not have a variable interest in the Trusts and therefore does not consolidate the Trusts. The placement of the Trusts in the organization chart as an offshoot to the line between TBA and State National Intermediate Holdings, Inc., (“SNIH”) is intended to show that SNIH and the common shares of the Trusts are both owned by TBA. There is no relationship between the Trusts and SNIH.

e) Holding Company Registration Statement: Please provide a copy of State National Insurance Company, Inc.’s 2015 Form B/C Holding Company Registration Statement.

A copy of State National Insurance Company, Inc.’s 2015 Form B/C Holding Company Registration Statement is enclosed with this letter as Exhibit 3(e).

4. SNIC’s Financial Examination Report: Please provide a copy of SNIC’s most current financial examination report (as of 12/31/10).

A copy of SNIC’s most current financial examination report (as of 12/31/2010) is enclosed with this letter as Exhibit 4.

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5. Redomestication to Texas: The Form A indicates that the Applicant intends to cause UNSIC to redomesticate from Wisconsin to Texas immediately after the closing, and has filed the appropriate paperwork with the Commissioner of the Texas Dept. of Insurance to facilitate the redomestication.

Please provide the contact information (name, email address, telephone #) for the individual at the Texas Dept. of Insurance responsible for overseeing the redomestication application.

Stefanie Capparelli, Insurance Specialist in Company Licensing and Registration, is responsible for overseeing the redomestication application at the Texas Department of Insurance. Please see below for her contact information:

Phone Number – (512) 676-6386

Email Address – Stefanie.Capparelli@tdi.texas.gov

6. Share Purchase Agreement: The Share Purchase Agreement (Form A – Exhibit 1) states that the Schedules and Exhibits referenced in the Share Purchase Agreement are an integral part of the agreement; however, the Share Purchase Agreement filed with the Form A did not include the referenced Schedules and Exhibits.

Please provide a complete list of all Schedules and Exhibits referenced in the Share Purchase Agreement, along with a complete copy of all Schedules and Exhibits listed.

A list of all Schedules and Exhibits referenced in the Share Purchase Agreement, and a complete copy of all Schedules and Exhibits listed, are enclosed with this letter as Exhibit 6, and are filed subject to a request for confidential treatment, as discussed above.

7. Pre-Closing Affiliated Agreements: Article 4.23 of the Share Purchase Agreement states that, except as set forth in Section 4.23 of the Disclosure Schedules, there are no agreements between the Company and any Affiliate that will continue after the Closing Date.

a) Please provide a list of all existing agreements between UNSIC and any affiliate.

The existing agreements between UNSIC and its affiliates are as follows:

- Reinsurance Pooling Agreement dated January 1, 2009, by and among United National Insurance Company (“UNIC”), Diamond State Insurance Company (“DSIC”), Penn-America Insurance Company (“PAIC”), Penn-Star Insurance

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Company (“PSIC”), UNSIC, Penn-Patriot Insurance Company (“PPIC”) and American Reliable Insurance Company (“ARIC”).

- Trust Agreement dated December 31, 2010, by and among UNIC, UNSIC, and Brown Brothers Harriman Trust Company, N.A. (“BBH”), as trustee.
- Quota Share Reinsurance Contract by and between UNSIC and DSIC, dated July 1, 2016.
- Net Retained Insurance Liability Quota Share Reinsurance Contract by and between UNSIC and Global Indemnity Reinsurance Company, Ltd. (“GIRE”) effective January 1, 2007.
- Reinsurance Trust Agreement by and between UNSIC, GIRE, and BBH, as trustee, dated January 1, 2004.
- Amended and Restated Cost Allocation Agreement by and among Global Indemnity Group, Inc. (“GIGI”), American Insurance Service, Inc. (“AIS”), UNIC, DSIC, UNSIC, American Insurance Adjustment Agency, Inc. (“AIAA”), Global Indemnity Insurance Agency, LLC (“GIIA”), J.H. Ferguson & Associates, LLC (“Ferguson”), Penn-America Group, Inc. (“PAG”), PAIC, PSIC, PPIC, Penn Independent Corporation (“PIC”), Global Indemnity Group Services, LLC (“Global Indemnity Group Services”), Collectibles Insurance Services, LLC (“CIS”), PIC Holdings, Inc. (“PIC Holdings”), ARIC and U.S. Insurance Services, Inc. (“USIS”), dated January 25, 2005.
- Amended and Restated Tax Sharing Agreement by and among GIGI, AIS, UNIC, DSIC, UNSIC, AIAA, GIIA, Ferguson, PAG, PAIC, PSIC, PPIC, PIC, Global Indemnity Group Services, CIS, PIC Holdings, ARIC, and USIS dated January 25, 2005.

b) In addition, please discuss whether UNSIC plans to file a Form D with OCI for the termination of these agreements, and the expected date this filing will be made (or alternatively, if this Form D filing has been made with OCI, please provide a copy of the filing).

UNIC filed a Form D with OCI regarding the termination or amendment of these agreements (in either case relating to the proposed transaction) on June 6, 2016. A copy of that Form D filing is enclosed with this letter as Exhibit 7(b).

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8. Quota Share Reinsurance Agreement between UNSIC and Diamond State: The Form A states that, prior to closing, UNSIC and Diamond State will enter into a quota share reinsurance agreement whereby Diamond State will reinsure 100% of all liabilities of UNSIC relating to policies issued by UNSIC prior to closing, including any renewals of the pre-closing policies which UNSIC is obligated by contract or applicable law to issue after the closing of the acquisition.

a) Please provide a copy of the proposed Quota Share Reinsurance Agreement between UNSIC and Diamond State.

A copy of the proposed Quota Share Reinsurance Agreement is enclosed with this letter as Exhibit 8(a).

b) Please discuss the specific types of policies that UNSIC will be obligated to renew by contract or applicable law after closing, and explain why UNSIC is obligated to renew these policies.

By September 30, 2016, the anticipated date of closing, no new or renewal business will be written on United National Specialty Insurance Company. The only activity that is expected to occur after closing is processing endorsements on policies that remain in force after the Closing. All business will be fully earned by September 30, 2017.

c) In addition, please discuss whether UNSIC plans to file a copy of this agreement to OCI in a Form D filing, and the expected date this filing will be made (or alternatively, if this Form D filing has been made with OCI, please provide a copy of the filing).

UNSIIC filed a Form D with OCI regarding the proposed Quota Share Reinsurance Agreement on June 6, 2016. A copy of that Form D filing is enclosed with this letter as Exhibit 7(b).

9. Pre-Closing Dividend or Distribution: Article 10.03 of the Share Purchase Agreement states that the Seller will cause UNSIC to transfer assets, by dividend or distribution, to the Seller in amounts sufficient to reduce the remaining Statutory Capital to the amount set forth in Schedule 10.03(a).

a) Please discuss whether UNSIC plans to file an extraordinary dividend request to OCI for this planned dividend or distribution, and the expected date this request will be filed (or alternatively, if this request has been filed with OCI, please provide a copy of this request).

We understand that UNSIC does plan to file an extraordinary dividend request by the end of July, 2016. UNSIC is currently in the process of finalizing its second-quarter statutory

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financials; once its surplus is determined, the dividend amount will be computed and the request will be filed.

10. Post-Closing Affiliated Agreements: Please provide a list of all affiliated agreements in which UNSIC is expected to participate with any of the State National companies post-closing, along with copies of the proposed affiliated agreements.

Below is a list of the affiliated agreements in which UNSIC is expected to participate with the State National companies post-closing:

(A) Reinsurance Pooling Agreement, effective as of December 31, 2002, or as thereafter applicable to each party thereto, among SNIC, National Specialty Insurance Company (“NSIC”) and United Specialty Insurance Company (“USIC”), pursuant to which these affiliated insurance companies pool the results of underwriting operations by ceding and assuming business by quota-share percentages;

(B) Agreement, effective as of December 29, 1999, or as thereafter applicable to each party thereto, among TBA, SNIC, NSIC, and USIC, pursuant to which TBA earns fees as compensation for the services provided to its insurance subsidiaries in the administration of their insurance business;

(C) Agency Agreement, effective as of January 1, 2003, or as thereafter applicable to each party thereto, among TBA, SNIC, NSIC and USIC, pursuant to which TBA earns commission as compensation for producing certain amounts of business underwritten by its insurance subsidiaries; and

(D) Amended and Restated Tax Allocation Agreement, effective as of June 26, 2014, among SNC, TBA, SNIH, SNIC, NSIC and USIC, pursuant to which these affiliated entities file their federal income tax returns on a consolidated basis.

Copies of these existing affiliated agreements are attached hereto as Exhibits 10-A through 10-D, respectively. The relevant insurance companies plan to file a Form D in order to amend these agreements to include UNSIC.

11. Biographical Affidavits: The Form A filing did not include a biographical affidavit for SNIC director Lonnie Ledbetter. Please provide a biographical affidavit for Lonnie Ledbetter.

A biographical affidavit for Mr. Lonnie Ledbetter is enclosed with this letter as Exhibit 11, and is submitted subject to a request for confidential treatment pursuant to Section 601.465, Wis. Stat.

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12. Opinion of Financial Advisor: Item 4 of the Form A stated that the purchase price was the result of arms' length negotiations between parties, and that Diamond State was represented by independent financial and legal advisors. Please provide a copy of any opinion letters issued by Diamond State's independent financial or legal advisors as to the fairness of the purchase price.

Diamond State did not receive an opinion letter from its independent financial or legal advisors regarding the fairness of the purchase price.

13. Pro Forma Financial Statements:

a) **Direct Business: The Pro Formas show that 100% of the direct business written will be in the Homeowners multi-peril ("HOMP") line, which UNSIC does not currently write (UNSIC currently writes a variety of P&C lines, but not HOMP). This appears to be inconsistent with other information provided in the Form A (which indicates that UNSIC's post-acquisition direct business will consist entirely of renewals that UNSIC is obligated to write). Please explain this discrepancy: If UNSIC does not currently write HOMP – why will its business post-acquisition be in this line?**

b) **Assumed Business: The Pro Formas show that all assumed business will be in the Private Passenger Auto Physical Damage and Credit lines. Please discuss the source and nature of this business (i.e. – will this business consist entirely of business that will be transitioned to UNSIC pursuant to the Alliance Agreement between State National and Nephila, and specifically, what type of business will this be?).**

c) **Ceded Business: The Pro Formas indicate that 100% of direct business written for 2017 – 2019 will be ceded. Please clarify – is this due to the 100% Quota Share Reinsurance Agreement with Diamond State, which will become effective post-closing?**

d) **Territory: UNSIC currently writes almost entirely in PA, IL and Wisconsin. The Pro Formas indicate that UNSIC will write exclusively in CA, NJ and NY for 2017 – 2019. Please explain why UNSIC plans to write only in CA, NJ and NY for 2017 – 2019 (and not in PA, IL and WI where it is currently writing business).**

e) **Pro Forma – Assumptions: The assumptions provided with the Pro Formas state: "[T]he nationwide pro forma presents financial results subsequent to the Reinsurance Pooling Agreement between State National Insurance Company and its affiliates, National Specialty Insurance Company and United Specialty Insurance Company."**

The Form A does not indicate that UNSIC will participate in a reinsurance pooling agreement with its State National affiliates post-closing. Please explain why the

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assumptions state that the nationwide pro formas reflect a reinsurance pooling agreement that is not discussed anywhere else in the Form A.

A detailed response to the questions posed with respect to the Pro Forma Financial Statements is being prepared, and will be submitted to OCI under separate cover.

* * * * *

I trust that the responses provided above, and the enclosures provided with this letter, satisfy the related requests, but should you have any questions or require any additional information, please do not hesitate to contact me. As noted above, we will provide a detailed response to your request 13 as soon as it is finalized.

Very truly yours,



Kevin G. Fitzgerald

cc: David M. Cleff, Esq. (w/o enclosures)
Elise M. Clarke, Esq. (w/o enclosures)

Enclosures