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INSURANCE AND FINANCIAL SERVICES REPORT

TAKEOVER DEFENSES — AN INSURANCE INDUSTRY PERSPECTIVE

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The possibility of outsiders seeking to gain control of a company in a hostile transaction is a contingency every management group should be prepared to address. While such transactions are in general uncommon (and in the insurance industry less so), the ramifications for a company caught unprepared can be devastating. This article discusses the nature of the risk and steps which a board and management can take now to minimize the likelihood of a third party attempting such a transaction, or succeeding if one is attempted. The focus of this article is on companies in the insurance industry and some of the unique considerations associated with a hostile transaction in that sector. However, many of the concepts discussed below have general applicability to companies in other industries.

Background

As used in this article, the term “hostile transaction” refers to two distinct types of actions against a company: (i) an unsolicited offer to acquire a controlling interest in the company’s voting securities, or (ii) an action or series of actions designed to gain control of the company’s board of directors. The first type of action can take a variety of forms, ranging in degree of seriousness from a private expression of interest to the commencement by the third party of a previously unannounced tender offer for the voting stock of the target company. The second type of action

generally involves a third party soliciting proxies in a proxy contest for voting in favor of that party’s nominees for election to the target company’s board of directors.

The use of hostile transactions as a tactic for gaining corporate control reached its zenith in the mid-1980s. There were a variety of reasons for this, notably the ready availability of debt financing for such transactions and the relative weakness of takeover defenses among potential target companies. Since that time, however, the frequency of hostile transactions has decreased due to, among other things, developments in the Delaware caselaw regarding takeover defenses, the creation and widespread implementation of shareholder rights plans (“poison pills”) and the existence of strong equity markets during most of the 1990s. Very recently, there has been a noticeable rise in hostile transactions, perhaps due in part to the relatively low share price valuations of some companies as the overall equity markets have steeply declined. Among the more notable recent examples of hostile transactions are Weyerhaeuser’s pending proposal to acquire Willamette Industries and Royal Dutch/Shell’s pending efforts to obtain control of Barrett Resources Corp. Another interesting recent development is AIG’s unsolicited offer to acquire American General made during the pendency of American General’s potential merger with Prudential Plc.

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Because of the requirement that state insurance regulatory approval be sought prior to obtaining control of an insurance company, hostile transactions in the U.S. insurance industry occur less frequently than in other industries. Nonetheless, at least 15 such transactions have been attempted in the insurance industry since 1990, with the would-be acquiror succeeding in several instances. Among the more recent examples of insurance industry hostile transactions are Nationwide's acquisition of ALLIED Group, Inc. and its related companies in 1998, Markel Corp.'s acquisition of Gryphon Holdings in 1998, HCC Holdings unsuccessful bid for The Centris Group in 1999, and Cendant's unsuccessful bid for American Bankers in 1998. Another interesting transaction, which still is pending, is the hostile bid of American Union Insurance Co. for the stock of Meridian Insurance Group, a publicly-traded affiliate of Meridian Mutual. Following announcement of the offer, Meridian Mutual entered into a merger agreement with State Auto Mutual and its subsidiary, Meridian Insurance Group. The Meridian/State Auto merger awaits closing and American Union has filed suit in a federal district court in Indianapolis.

While many hostile transactions do not result in a change of control of the target, the disruption caused by such an overture can be significant. An enormous amount of management time generally will be required to assist the board in assessing the bid and, if appropriate, defending against it. The financial cost can be high as well. For example, Willamette Industries recently disclosed that it estimates the costs associated with defending against the unwanted offer it received from Weyerhaeuser will approximate \$50 million. Accordingly, time spent in advance by a company's management to put in place appropriate takeover defenses to deter an unwanted attack may be well worth the investment.

Form of the Hostile Transaction

As mentioned above, a hostile transaction can commence in a variety of forms, with varying degrees of seriousness. Many hostile transactions begin as an informal, uninvited expression of interest in negotiating

a merger or other form of business combination transaction. Depending on the nature of the response and the aggressiveness of the would-be acquiror, this type of inquiry may be followed by a "bear hug." A bear hug generally comes in the form of a call or letter to the target's board setting forth the parameters of a potential transaction, including an indication as to price and structure. If the bidder wants to put additional pressure on the target, it may publicize a bear hug letter, generally accompanied by a public relations campaign designed to tout the terms of the proposal. An added benefit to the would-be acquiror is that the public announcement of the takeover proposal usually prompts a large movement of the stock into the hands of arbitrageurs and others who may have a very short-term time horizon for profiting from a deal. The point of this "public bear hug" generally is to gain support from the target's shareholders for the offer (which will be at a premium to the market price of the stock), thereby pressuring the target's board to negotiate with the acquiror. If this tactic doesn't succeed in drawing the target's management into negotiations, the acquiror may take its offer directly to the target's shareholders by launching a tender offer for the shares of the target's stock.

From the point of view of an acquiror, a tender offer has two advantages. One is that it permits the acquiror to bypass the target's management and acquire control directly. An added advantage, if the tender offer is not preceded by communications with the target's management, is the element of surprise – a management faced with an unanticipated tender offer is at a disadvantage in terms of marshalling the resources necessary to assess the offer and, if appropriate, defend against it. This can be of critical importance in the public relations battle which inevitably accompanies a hostile transaction, by giving the acquiring party the first and best opportunity to state its case to the target's shareholders, employees and other constituencies.

Due to the prevalence of poison pill and other defenses which are described below, and the now well-recognized legal right of a target company to "just say no" to a hostile transaction in appropriate circumstances, a tender offer frequently may not be

effective alone. Accordingly, after a would-be acquiror has taken one or more of the steps described above (or even in lieu of taking such steps), it may initiate a proxy contest for the purpose of obtaining control of a majority of the seats on the target's board of directors. It may also commence litigation against the target company and its board, seeking judicial action to eliminate takeover defenses. The end result of such a campaign, if successful, is that the newly-elected majority may then cause the board to dismantle the target's takeover defenses and then approve a consensual business combination transaction between the target and the acquiror.

Excellent defenses to a tender offer or proxy contest exist and are discussed below. With careful planning and preparation, these defenses give a company time to evaluate an offer and take any appropriate responses.

Aspects of Hostile Transactions Unique to Insurance Companies

A hostile acquiror of an insurance company or insurance holding company must overcome regulatory hurdles which are unique to the insurance industry. Most states in the U.S. have statutes which prohibit the direct or indirect acquisition of "control" of an insurance company domiciled in that state (a "Control Statute") without first obtaining approval of the state's insurance regulator. Under the NAIC's Insurance Holding Company System Act, some form of which has been enacted in most states (the "Model Act"), "control" is broadly defined as the "power to direct or cause the direction of the management and policies" of the insurer, and is presumed to exist if a person owns or controls 10% or more of a company's voting stock. In order to obtain approval to acquire such control, the acquiror generally must file a "Form A" application with the insurance departments in the state or states where the insurance companies sought to be acquired are domiciled. The application requires that extensive information be disclosed about the acquiror, the transaction and the acquiror's future plans for the target. In most states, a public hearing on the transaction will be required by the Control Statute or

may be ordered by the insurance regulator prior to the regulator ruling on the merits of the transaction. The transaction may not be closed until the Form A application has been reviewed and approved, a process which may take two to four months but frequently takes longer in contested situations.

The requirement that a regulator approve the proposed hostile transaction before its completion is a significant advantage to the target. A chief benefit of launching an unsolicited tender offer to acquire a target's voting stock is speed to closing and, in some cases, the element of surprise. These advantages are lost as a result of the regulatory approval process. The securities tendered in the tender offer may not be accepted by the acquiring company until the regulatory approval has been obtained. It has even been argued in at least one situation of which the Editors are aware that the mere making of an offer to acquire voting securities of an insurance company requires authorization from the relevant state regulator. While such a view may not be tenable under the Control Statutes of most states, it creates another potential line of attack in defending against an unwanted offer. In any event, the lengthy period of time it may take an acquiror to obtain regulatory approval gives the target company ample time to marshal defenses and formulate a publicity campaign against the acquiror and its offer.

In addition, the acquiror can be thwarted by the regulatory review process itself, which typically requires the regulator to satisfy itself with respect to, among other things, (i) the acquiror's financial stability and managerial competence, (ii) that the acquiror's post-closing plans for the company are not contrary to the interests of policyholders or the general public, (iii) that the transaction will not tend to reduce competition for insurance products in the regulator's jurisdiction and (iv) that the transaction will not be prejudicial to policyholders or the insurance-buying public generally. The above standards can be particularly difficult to overcome if the potential acquiror is a financial (as distinguished from a strategic) acquiror, and even more so if the acquiror lacks experience in managing an insurance company or has financing contingencies or a short term exit strategy

for selling its interest in the target. Finally, a target company defending itself against an unwanted offer may be able to gain intervenor status in the proceedings relating to the state regulator's review of the Form A application – thus enabling the target to attack the transaction on the above and other substantive grounds in connection with the regulatory approval process.

It is unclear whether a state's Control Statute would be applied in an attempt to gain control over an insurer via a proxy contest. An argument may be made that neither the Model Act nor most states' Control Statutes contain language squarely requiring regulatory approval to gain control of an insurer through a proxy contest. In fact, such an interpretation was adopted in the two situations of which the Editors are aware in which the issue has been addressed by regulators. Nonetheless, the dearth of authority in this area creates uncertainty, which in turn provides an additional avenue of defense for a target company to pursue in the event a hostile transaction takes the form of a proxy contest.

Certain insurance companies which have recently undergone a demutualization transaction often have another important takeover defense available to them. Many states' demutualization laws prohibit a single person or group from owning more than a specified percentage of the voting securities of a demutualized insurer or its holding company for a period of time following the demutualization, without the prior approval of the state regulator. Under New York's demutualization statute, for example, a third party may not acquire more than 5% of the company's voting securities for a period of five years following the demutualization transaction without applying to the New York Insurance Department for approval. Significantly, the standard for a regulator's review of such an application is not specified in most states' demutualization statutes, and it can be argued that there is a different (and more target-friendly) standard than the one prescribed by most Control Statutes in connection with a Form A application. The purpose of including a limitation on acquiring voting securities in demutualization statutes apparently was to protect the insurer and its policyholders from corporate raiders

during the years immediately following the demutualization transaction, during which period a company may have a relatively low stock price due to lower earnings multiples than its stock company peers. Some authority in the legislative histories of certain states' demutualization statutes could be invoked by a regulator wishing to impose a higher standard than the one required under the state Control Statutes. It should be noted, however, that the limitations under the demutualization statutes, particularly if interpreted broadly by the state regulator, could be subject to challenge as to their constitutionality (although the case that the statutes are unconstitutional was weakened with passage of the Gramm-Leach-Bliley Act in 1999, which contains a provision exempting from federal preemption state laws limiting ownership changes in insurers).

Special Considerations for Mutual Insurance Companies

A mutual or similar non-stock insurance company is in a strong defensive posture by virtue of not having voting securities which can be purchased by third parties – it is not possible for a third party to gain control through a tender offer or similar means. However, there are two potential situations which may be relevant to a mutual company. First, if the mutual company has an affiliate which is publicly-traded, a hostile transaction may be initiated for such affiliate. An example of such a transaction is Nationwide's acquisition of ALLIED Group and its affiliates in 1998. In that transaction, Nationwide tendered for the common shares of ALLIED Group, a downstream publicly-traded affiliate of ALLIED Mutual Insurance Company. The tender offer was accompanied by a proposal to merge Nationwide Mutual and ALLIED Mutual. Due in part to the pressure which Nationwide was able to bring to bear through the tender offer for ALLIED Group, and due to the related nature of the businesses of the three ALLIED entities, the board of directors of ALLIED Mutual ultimately agreed to a merger of Nationwide Mutual and ALLIED Mutual as part of a transaction involving all three ALLIED entities.

A second situation with which a mutual company could be confronted is a proxy contest by a policyholder to nominate a slate of directors to the company's board. While the Editors are not aware of any situation where such a contest has been successful, there have been situations where disgruntled policyholders or others have threatened such an action. In order to decrease the likelihood of even receiving such a threat (which in itself can be a disruptive event), a mutual company and its board may wish to ensure that protections are built in to the company's charter and/or bylaws and implement procedures for nominating and electing directors that minimize the likelihood of such an event.

Of course, if a mutual company is contemplating a demutualization transaction it should review with its counsel the statutory and structural takeover defenses available to it and develop a strategy for dealing with a hostile transaction if one arises during the pendency of its demutualization transaction or thereafter. It is worth noting that it is easier to implement certain structural defenses prior to becoming a public company than after. For example, changes to a company's charter after it is public generally will require shareholder approval. Additionally, certain other changes (such as adoption of a poison pill) may attract attention from shareholder activists or certain institutional investors who may object to any change which has the effect of making a change of control transaction less likely.

Takeover Defenses

A stock insurance company or a publicly-traded holding company which owns an insurance company should not rely solely on regulatory obstacles to deter a hostile transaction. There are a number of additional steps which can be taken to strengthen the company's defenses. Some of the more common of these are described below. Of course, all of the mechanisms described below must be examined in light of the specific state law requirements in the jurisdiction where the relevant company is domiciled. Furthermore, a company's counsel should review all potential takeover defenses and any response to a hostile transaction in

light of the fiduciary duties imposed on the company's directors under state law.

- *Poison Pill* — A poison pill may be implemented by the board of directors without shareholder approval and is designed to discourage third parties from acquiring more than a specified percentage of the company's outstanding stock without the board's approval. A typical poison pill provides for the issuance of a special dividend to shareholders in the form of "rights" to purchase additional voting securities in the company. These rights generally are triggered by a purchase or offer to purchase (including by means of a tender offer) more than a specified percentage of the outstanding shares of voting stock of the company (typically 10-20%). The rights enable shareholders (other than the acquiror) to purchase additional securities of the target company, or, in certain circumstances, securities of the acquiror, at a discount, thereby diluting any securities obtained by the acquiror. Due to the severe economic impact on an acquiror's holdings if the rights are activated, an acquiror generally will not take any action which triggers the rights; rather, an acquiror will try to force the board to redeem the pill by applying pressure tactics such as litigation or a public bear hug or seeking to remove and replace the board through a proxy contest. The Delaware courts have recognized properly drafted poison pills as a legitimate defensive mechanism, subject to certain limitations.

Insurance holding companies should consider whether the trigger under their poison pill meshes with the presumed "control" level under relevant Control Statutes (generally 10%) and, if appropriate, amend their pill accordingly.

- *Staggered Board* — A staggered (or "classified") board can be a very effective deterrent to a hostile transaction, particularly in connection with a proxy contest. A staggered board is comprised of multiple classes of directors (generally three), and is permissible in most states. In conjunction with other defenses, such as permitting removal of directors only for cause, a staggered board can effectively require a third party that is waging a proxy contest to wait at least two annual meeting cycles before gaining majority

control of the target's board (and even longer for boards with more than three classes).

- *Action by Written Consent* — Absent express charter provisions to the contrary, Delaware and many other states' laws permit shareholders to take certain actions by written consent without a meeting or prior notice to the company or other shareholders. While a solicitation of shareholder consents for the purpose of taking certain corporate actions (such as removing or electing directors or modifying the company's charter) may be subject to the SEC's proxy rules, the possibility of any such action being taken directly by shareholders should be disabled or limited by an express charter provision. Otherwise, an acquiror may seek to remove the target board at any time, rather than wait for an annual meeting. If the charter permits action by shareholders through written consent, the company should at least consider adopting a bylaw amendment that provides for an orderly consent solicitation process, such as the setting of a record date and other ministerial tasks.

- *Advance Notice Provisions* — Companies should include in their bylaws a provision requiring advance notice to the company prior to any shareholder nominating directors or proposing any matter for action by the shareholders at the annual meeting. Advance notice provides the company with time to evaluate the shareholder proposal and to react appropriately to any proxy contest or shareholder proposal and strengthens the company's defensive posture. Advance notice provisions must be carefully drafted to comply with the applicable state corporate statutes.

- *Supermajority Voting Requirements* — A company may wish to consider requiring a supermajority vote on merger transactions and other fundamental changes (e.g., changes to the charter or bylaws). These requirements generally would need to be included in the charter.

- *Blank Check Preferred* — This feature gives the board of directors the flexibility to issue preferred securities as a defensive measure in the face of a hostile transaction without approval of the shareholders. Such an issuance might be made as part of a transaction with a friendly third party (a "white knight").

- *Employee Benefit Takeover Defenses* — There are numerous defenses which can be implemented which fall under this category. All have the effect of making a hostile transaction less attractive or more difficult to implement. One example is employee stock ownership plans (ESOPs), which are designed to invest in securities of the company for the benefit of the company's employees (and which preserve a block of voting stock in the hands of employees of the company who, presumably, will be more likely to vote in favor of incumbent management and against a change of control). It is also common, as an ancillary matter, for a company to enter into "golden parachute," "tin parachute" and accelerated stock option vesting arrangements with employees, all of which are triggered by a change in control.

- *Multiple Class Voting Structure* — Depending on the laws of a company's state of domicile, it may be able to issue multiple classes of voting stock, with certain classes having greater voting weight than others. A number of companies have adopted such structures, typically to preserve voting control with one person or group while selling a higher proportion of the economic value of the company to others. Absent a controlling person or group, however, such a structure may not make sense; moreover, some analysts believe that the sale and subsequent trading price of low-vote stock may be depressed as a result of the voting limitation and perceived reduced likelihood that a takeover premium will be realized.

BANK ACQUISITIONS OF INSURANCE AGENCIES GAINING MOMENTUM

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The March announcement that Wells Fargo & Company is buying ACO Brokerage Holdings Corporation, the parent company of Acordia, Inc., one of the nation's largest independent property and casualty insurance agencies, illustrates a significant and growing trend on the part of banks to acquire insurance agencies, expand their distribution capabilities and broaden their range of financial products. One observer believes that the Wells Fargo acquisition, which creates the largest bank-owned insurance agency in the United States, signals a new direction for the consolidation and convergence of financial services companies. With one large acquisition, Wells Fargo becomes a major player in the distribution of insurance products.

Even prior to the passage of the Gramm-Leach-Bliley Act, bank holding companies could acquire insurance agencies. The passage of the Gramm-Leach-Bliley Act eliminated certain restrictions in federal banking laws concerning insurance sales and explicitly recognized that acting as an agent or broker in the sale of insurance products is an activity considered "financial in nature" and permitted for a financial holding company. Moreover, the Gramm-Leach-Bliley Act requires that state laws regulating sales of insurance products be applied and enforced on a nondiscriminatory basis. State laws which significantly interfere with the ability of a bank to engage in insurance sales or solicitation are pre-empted except for thirteen specific types of state restrictions which have "safe harbor" status under the Gramm-Leach-Bliley Act.

Not all of the Gramm-Leach Bliley Act's provisions have simplified the banks' ability to own and operate insurance agencies. In some cases, there are continuing issues as to whether or not state insurance laws which restrict banks' marketing activities are pre-empted by federal law. The Gramm-Leach Bliley Act

has also added significant privacy and disclosure provisions that must be complied with.

Banks initially focused on buying life insurance agencies, presumably on the basis that life insurance and annuity products were similar to other financial products which they market. A substantial majority of banks that own insurance agencies now market both life insurance and property and casualty insurance products. The primary reasons for the acquisition of an insurance agency by a bank are diversification of its sources of income, creating or expanding a revenue stream that is fee-based income, and expanding the distribution capabilities of the bank.

Banks have acquired more than 200 insurance agencies since 1997, including over 70 agency acquisition in 2000, according to SNL Securities. A recent Conning & Company study entitled "Mergers and Acquisitions and Public Equity Offering: 2001 Edition," points out that in 2000 the distribution sector in the insurance industry accounted for 49% of all merger and acquisition activity and banks accounted for 34% of the M&A activity in this sector. Marsh Berry & Co., a consulting firm specializing in insurance agencies, has pointed out that 13 of the top 100 insurance agencies are either owned by banks or have announced that they are being acquired by banks. The largest five percent of the banks have done about three-fourths of the acquisitions.

Making an acquisition of an insurance agency, rather than organizing one from scratch, has been the easiest, quickest, and most cost-effective method for banks to enter this market. Usually, there are little or no cost savings that can be achieved by a bank buying an insurance agency since the agencies operate on a stand-alone basis. Banks can often achieve economies of scale and greater and wider market penetration by buying multiple agencies. Larger agencies with greater volume can often strike better deals with the insurance companies that issue the insurance products. In most cases, banks hope to achieve success in cross-selling other financial products, but some banks have had greater success than others in that regard.

Wells Fargo's acquisition of Acordia provides it with an insurance agency with over \$400 million in annual revenue and 112 offices in 29 states. Acordia is the fifth largest of all U.S. insurance agencies. Wells Fargo, a financial holding company with over \$272 billion in assets, has had insurance activities since the 1920's and currently has 140 insurance agents. The Acordia acquisition greatly enhances its distribution capabilities and brings Wells Fargo closer to its goal of having insurance, trust and investment management activities contribute twenty-five percent of its total income.

Shortly after the announcement of Wells Fargo's acquisition of Acordia, Acordia also announced in March that it was entering into an alliance with Heath Lambert Group to create an enhanced global retail insurance brokerage network. Heath Lambert is based in London and is the world's sixth largest insurance brokerage and risk management organization. The network, to be called "HLA Global", adds a U.S. servicing capability to Heath Lambert, while Acordia gains access to an established global retail client servicing operation. The combined network, which includes other independent and associated brokers, will have over \$1 billion in revenues and operate in 55 countries. From Wells Fargo's standpoint, the alliance provides an opportunity to increase international risk management using the Heath Lambert international network.

Wells Fargo has not been the only bank to be active this year in acquiring insurance agencies or entering into alliances. In another significant insurance agency acquisition, Wachovia Corporation, a \$74 billion financial holding company, announced in March that it was acquiring Hamilton Dorsey Alston Company, an Atlanta-based insurance broker that specializes in personal and commercial risk management and employee benefits. Hamilton Dorsey, the largest privately held insurance broker headquartered in Atlanta, ranks in the top 80 largest brokers in the United States based on revenues from U.S. clients. Hamilton Dorsey will operate as a separate subsidiary of Wachovia Bank, N.A. Wachovia views the acquisition as part of a strategy to provide insurance services to businesses, as well as risk

management and wealth transfer insurance products for individuals. The intent is to provide a complete array of financial services to commercial and high net-worth customers.

In November, 2000, Wachovia acquired Davis Baldwin, Inc., a Tampa, Florida risk management broker that offers personal and commercial property and casualty life and group products and in September, 1999, Wachovia bought Barry, Evans, Josephs & Snipes, Inc., a Charlotte, North Carolina life insurance agency. With the addition of Hamilton Dorsey, Wachovia Insurance Services will be among the top 25 brokers in the country and a leading broker in the Southeastern United States.

In another example of a recent bank acquisition of an insurance agency, in February of this year, Regions Financial Corporation, a \$43 billion bank holding company based in Birmingham, Alabama, acquired Rebsamen Insurance, Inc., a Little Rock, Arkansas based full-line general insurance brokerage firm. Rebsamen ranks among the 50 largest insurance brokers and is Arkansas' largest independent agency. Approximately 70% of Rebsamen's business is commercial property and casualty insurance. The Regions' acquisition significantly expands its product offerings and revenue stream in the insurance area. Rebsamen will continue to operate under its existing name and management team.

B B & T Corporation, a Winston-Salem, North Carolina financial holding company with \$60.9 billion in assets, has also been a prolific acquirer of insurance agencies in the last several years. It continues to make acquisitions this year. In February, B B & T Insurance Services, a subsidiary of B B & T, acquired Stephens & Company Insurance Services, Inc. of Kennesaw, Georgia. Stephens is the fifth Georgia-based agency owned by B B & T. B B & T Insurance Services is now the eleventh largest retail insurance broker in the United States and the largest independent agency in the Carolinas and Virginia. It operates 28 agencies in North Carolina, 21 in Virginia, four in South Carolina, four in Georgia, three in Maryland, two in West Virginia and one in Tennessee.

In cases where one bank acquires another bank, there is often a good opportunity for the insurance agency operations of the two merging banks to take on much more significance and be a component of the combined banking holding company's expansion plans. This is frequently one of the lesser known elements of synergy in bank mergers. For example, Fifth Third Bancorp is acquiring Old Kent Financial Corp. and expanding its geographic reach. Less known is that the combined entity will have the 30th largest insurance agency, with plans to roll out insurance products in new markets.

As an alternative to acquiring insurance agencies, some banks have entered into joint ventures, strategic alliances or marketing agreements to distribute insurance products. More of these arrangements are designed to be innovative and far reaching. For example, in March, Bank of America entered into a strategic alliance with Farmers Group, Inc., a subsidiary of Zurich Financial Services, under which Bank of America and Farmers will develop and market integrated banking and insurance solutions. The parties intend to go beyond cross-selling and be more innovative in creating and providing comprehensive financial services for their customers and developing a "total customer view" for the delivery of integrated products and services.

In Phase I of the Bank of America /Farmers marketing plan, Farmers' agents will provide advice-based insurance services from selected Bank of America banking centers. In addition, Farmers' agents will market Bank of America products and services to its customers. Discounts on insurance products will subsequently be offered to qualified Bank of America customers.

Farmers has a network of 17,000 exclusive and independent agents with 18 million policies in force in 10 million households across the United States. Bank of America has 4,000 branches and 13,000 ATM machines. The potential markets for products of each joint venture participant was a major attraction of the strategic alliance. Zurich has entered into a similar arrangement in Europe with Bank of Scotland.

While one cannot be sure how the changes in distribution of insurance products will ultimately evolve or the extent to which the internet will become more of a factor, it is apparent that the forces of consolidation and convergence between banking and insurance have become much more of a presence in the distribution of insurance products in the United States than in the underwriting of insurance.

RECENT M&A AND DEMUTUALIZATION ACTIVITY

A number of significant M&A and demutualization transactions were announced in the first quarter of this year, as consolidation within the insurance and financial services sectors continued.

American General

On March 11th, Houston-based insurance company American General announced a deal to be acquired by British insurer Prudential Plc in a stock transaction valued at \$24.5 billion at the time of announcement. If completed, the transaction would be the largest ever in the insurance industry. However, the deal was quickly challenged by financial services heavyweight, AIG, which on April 3rd announced an offer to acquire all of the shares of American General in a stock transaction valued at \$46.00 per share. The AIG offer represented a premium of approximately 25% over the level at which American General's stock had traded prior to the announcement.

Prudential (which is not related to the U.S.-based Prudential Insurance Company) to date has not modified the terms of its original deal with American General, opting instead to bring litigation against AIG in a state court in Harris County, Texas, a plaintiff-friendly venue which produced the \$10.3 billion verdict in favor of Pennzoil that drove Texaco into bankruptcy proceedings in 1985. The legal theory promoted in Prudential's litigation – tortious interference with a contract—is similar to the one relied upon by Pennzoil in its litigation with Texaco.

Allianz/Dresdner Bank

On April 1st, Allianz AG, Germany's largest insurer, signed an agreement to acquire Dresdner Bank for cash and stock valued at \$22.1 billion. Dresdner is a major German commercial and investment bank (operating through its unit Dresdner Kleinwort Wasserstein), with significant asset management and private banking capabilities. The deal will provide Allianz with significant new distribution channels through Dresdner's retail and private banking network. It has prompted a great deal of speculation about other potential strategic transactions among insurance companies and banks, particularly among those located in Germany and elsewhere in Europe. Similar speculation has been rampant in the U.S. since passage of the Gramm-Leach-Bliley Act and completion of the Citibank/Travelers deal, but thus far very little merger activity between banks and insurers in the U.S. has taken place.

AEGON/J.C. Penney

On March 8th, Dutch insurer AEGON N.V. announced a deal to acquire the direct marketing insurance operations of J.C. Penney for \$1.3 billion. The all cash deal would give AEGON a significant entry into the business of direct writing personal lines insurance products. Penney's direct marketing operation currently sells life, accident and supplemental health insurance

products to Penney's credit card customers. The new distribution channel presumably will enable AEGON to market its life insurance, annuity and other financial products directly to Penney cardholders. AEGON's other significant insurance operations in the U.S. include Monumental Life Insurance Company and the insurance operations of Transamerica Corp., which AEGON acquired in 1999. The parties also executed a 15-year marketing agreement which would provide an expanded product offering to Penney customers.

Anthem Insurance

Anthem Insurance, an Indianapolis-based health insurer, announced in February that it is formulating a plan of demutualization. Anthem is a major Blue Cross/Blue Shield health insurance provider, with more than seven million customers in eight states. In recent years it had acquired a number of Blue Cross companies in the Midwest and Northeastern U.S. Such a transaction, which would be accompanied by an IPO, would create one of the largest publicly-traded health insurance companies in the U.S., based on assets. The Anthem demutualization transaction is consistent with a trend among Blue Cross/Blue Shield companies toward consolidation and increased operational scale, and may cause other Blue Cross/Blue Shield companies to consider demutualization or formation of mutual holding company as a strategic option.

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