

refer to those two entities as DRC and National Merit, respectively.

Through its acquisition of DRC, Trinity would acquire control of National Merit and various other operating insurance company subsidiaries of DRC domiciled in states other than Washington. For convenience, throughout the rest of my testimony I will refer to DRC and all of its insurance company subsidiaries collectively as the DRC Companies.

Through its ownership of Trinity, Unitrin would be the ultimate controlling person of National Merit following Trinity's acquisition of DRC. In light of this proposed acquisition, Trinity filed a Form A Statement seeking the approval of its acquisition of control over National Merit with the Washington State Office of the Insurance Commissioner, and I am here today to testify in support of that Form A Statement. For convenience, I will refer in my testimony to the Washington State Office of the Insurance Commissioner as the OIC.

3. Q: How long have you been employed by Trinity?

A: I have been employed by Trinity since May of 2001 when I was employed as the President of Unitrin Multilines Insurance and President of Trinity.

4. Q: Do you currently hold any other professional titles, positions or designations?

A: Currently I am President of the following two (2) segments within the Unitrin property casualty insurance operations: the Kemper segment and the Unitrin

Direct segment. In addition, I am the Unitrin Group Executive for property and casualty business and am a Chartered Property Casualty Underwriter. In my capacity as Group Executive, the Unitrin Specialty segment reports to me.

5. Q: Please describe your educational background.

A: I earned my Bachelor's degree from St. Cloud State University.

6. Q: Have you been authorized by Trinity to speak on its behalf at this Form A hearing?

A: Yes, I have been authorized to speak on behalf of Trinity in my capacity as President.

7. Q: Could you give us a brief description of your involvement and role in the proposed transaction?

A: Yes. In my role as Trinity's President, and my role as the President of the Unitrin Direct segment of Unitrin's property casualty insurance operations, which is the segment in which DRC and its operating companies will be housed following the acquisition, I personally reviewed and commented on various drafts of the Stock Purchase Agreement and the corresponding regulatory filings and I was consulted by our business personnel and legal counsel on various issues related to the deal negotiations and regulatory filings as and when matters developed, and I generally have been involved in and have personal knowledge of Trinity's internal business considerations and planning in connection with this transaction.

8. **Q: As part of your involvement with this proposed transaction, did you have occasion to review the Form A Statement that is the subject of this proceeding and the supplemental materials provided to the OIC, and if so, do you believe that the Form A Statement and the supplemental materials provided to the OIC are complete, true and current in all material respects?**

A: Yes, I personally reviewed the Form A Statement and the supplemental materials and correspondence provided to the OIC and I believe those materials are complete, true and current in all material respects. For convenience, throughout my testimony I will refer to the Form A Statement and the supplemental materials and correspondence provided to OIC as the Application.

9. **Q: Have there been any material changes with respect to the information contained in the Application?**

A: To the best of my knowledge, no.

10. **Q: Were DRC and National Merit provided a copy of the Application?**

A: Yes. Susan Claflin was provided a copy of the Application on behalf of DRC and National Merit in her capacity as a Director, General Counsel and Secretary for both entities.

B. Overview of Unitrin and Trinity

1. Q: Would you please explain, in very general fashion, the business of Unitrin and Trinity?

A: Unitrin is a diversified financial services company with subsidiaries engaged in the property and casualty insurance, life and health insurance and automobile finance businesses. As Dave Bengston previously testified, Unitrin is financially strong and as of September 30, 2008, reported total assets of \$9.2 billion and shareholders' equity of \$1.8 billion.

Unitrin's Property and Casualty Insurance Group (the "P&C Group") consists, for A.M. Best rating purposes, of nineteen (19) property and casualty insurance companies and is ranked as the forty-second (42nd) largest property and casualty group and the twenty-second (22nd) largest automobile insurance writer in the United States when measured using 2007 net premiums written. Of the total revenues of \$2.1 billion that Unitrin reported in the first nine months of 2008, nearly \$1.8 billion pertained to insurance premiums of which approximately \$1.3 billion, or 72.8%, represents personal lines property and casualty premium revenues, primarily auto and homeowners business. Trinity is the lead company in the P&C Group. For 2008, A.M. Best assigned the P&C Group a Financial Strength Rating of A (*Excellent*).

From a public reporting, branding and management standpoint Unitrin has organized its property casualty insurance operations into four (4) distinct

segments. Those segments consist of Kemper, Unitrin Specialty, Unitrin Direct and the property insurance business of Unitrin's Life and Health Insurance segment. Trinity and the subsidiaries which comprise the Kemper business segment provide personal automobile, homeowners, inland marine, boat owners, dwelling fire and personal umbrella insurance to preferred and standard risk customers. Trinity's subsidiaries which comprise the Unitrin Specialty business segment provide nonstandard personal and commercial automobile insurance. The Kemper and Unitrin Specialty products are distributed through independent insurance agents. Certain of Trinity's subsidiaries provide property products which are sold and serviced by a career agency force in the homes of customers. Such products primarily include basic fire and extended coverages.

Trinity's subsidiaries which comprise the Unitrin Direct business segment write a broad spectrum of automobile insurance risks, ranging from preferred to nonstandard private passenger automobile customers and, most recently, personal homeowners, renters and condo insurance in selected markets. Such business is written on a "direct marketing" basis, meaning that neither independent nor career agency force agents are used in the distribution process, but rather these products are sold primarily through direct mail advertisements, Web insurance portals, Web sites and other various forms of direct-to-consumer advertising. In addition, one subsidiary in this segment specializes in the sale of personal automobile and homeowners insurance through employer-sponsored voluntary benefit programs and "affinity" relationships. Because of the similar business models between the

Unitrin Direct segment and the DRC Companies, the latter – including National Merit – will be housed within the Unitrin Direct segment of Unitrin's property and casualty insurance operations following the acquisition.

C. The Business Rationale for the Transaction

1. Q: Dave Bengston has already summarized the details of the transaction itself, including the pricing model utilized by Unitrin and Trinity when deciding to pursue the acquisition. Can you in addition explain the business purpose or rationale behind Trinity's acquisition of the DRC Companies and whether you believe the acquisition will enhance the operations of both insurance organizations?

A: Yes. The DRC Companies have a very similar business model to that used by the Unitrin Direct segment of Unitrin's property and casualty insurance operations. Specifically, the DRC Companies – including National Merit – all utilize a "direct marketing" model similar to that used by Unitrin Direct.

Thus, as I mentioned earlier, National Merit and the other DRC Companies will operate as part of the Unitrin Direct business segment following the acquisition, which as I also mentioned is one of the three business segments I am responsible for within the Unitrin organization. Adding the DRC Companies to the Unitrin Direct segment results in a combined "direct marketing" segment that will have direct written premium of more than \$400 million, which in turn provides the potential for greater economies of scale within a business model that is already

existing and well known within Unitrin Direct. Moreover, by joining the Unitrin family of companies, National Merit and the other DRC Companies gain the significant competitive and operational benefits of being part of a larger and financially stronger organization with more diversified business models and product offerings within the insurance marketplace, including potentially higher A.M. Best ratings. These strengths, in turn, enhance National Merit and the other DRC Companies' ability to continue to offer Washington policyholders and the public access to quality insurance coverage.

National Merit is licensed in Idaho, New York, Oregon, Pennsylvania and Washington and provides automobile liability and physical damage insurance on a direct basis to consumers. The acquisition of National Merit along with the other DRC Companies underscores Unitrin's commitment to personal lines insurance sold directly to customers. The distribution channels built by the DRC Companies will complement the Unitrin Direct segment's existing direct-to-consumer and affinity distribution channels. At the same time, while the distribution methods, product offerings, service philosophies and claims administration techniques utilized by the DRC Companies are similar in nature to those utilized by Unitrin Direct, there are notable aspects of each organization that are unique in these regards and thus the combination of these two direct market organizations should enhance the overall operational model for both organizations.

For example, as I stated earlier, the DRC Companies and Unitrin Direct both distribute products on a direct-to-consumer basis. Policies are bound via internet websites or through licensed call center agents. Both the DRC Companies and Unitrin Direct use various marketing techniques to attract consumers, such as: direct mail advertising, internet portal sources, company owned websites, and affinity and employer sponsored marketing programs. However, the DRC Companies manage a particularly large and unique program called the "Teachers Insurance Plan" which would complement and bolster Unitrin Direct's affinity program. Thus, the post-acquisition combined Unitrin Direct business segment would be able to market to a broader customer segment through multiple direct-to-consumer marketing channels.

In addition, both the DRC Companies and Unitrin Direct offer various personal lines property and casualty products with a large emphasis on personal auto insurance. However, the DRC Companies also offer Umbrella (Liability) insurance, and Unitrin Direct offers Homeowners insurance. The combined set of product offerings -- Auto, Homeowners, and Umbrella products -- would create a more diversified core product suite for the combined Unitrin Direct business segment than either Unitrin Direct or the DRC Companies currently provides.

The DRC Companies and Unitrin Direct also have similar service philosophies. For each organization, every contact with a customer is highly valued and it is each company's goal to exceed their respective customers' expectations. Both the DRC Companies and Unitrin Direct provide 800 numbers to customer service call

centers to handle customer needs. In addition, Unitrin Direct also offers on-line service options for its customers. For example, if they choose, Unitrin Direct customers can make most changes to their insurance policy(ies) via the internet, an option customers of the DRC Companies currently do not have. Unitrin Direct's on-line service capabilities should enhance the service options and capabilities of the DRC Companies.

Finally, the general claims practices of the DRC Companies are similar to those of Unitrin Direct. For example, both entities use the same service providers for such things as glass repair, after-hours first notice of loss, salvage, and loss estimation tools. However, the claims organizations complement one another by providing a greater geographic reach than either organization currently has on its own. The size of the combined entities may also support more field staff appraisers, which should enhance service to the respective customers or claimants of Unitrin Direct and the DRC Companies. In addition, Unitrin Direct offers expanded business hours to customers for first notice of loss, which should also enhance the service options for customers or claimants of the DRC Companies.

In short, based on all of the things I have described, I believe the acquisition could result in the two organizations, as well as their respective policyholders and claimants, benefitting from the financial security and more efficient cost structure of the larger combined organization, a larger suite of available products, greater on-line service capabilities, and enhanced claims services and business hours.

D. Statutory Standards of Review

1. Q: The next set of questions I will ask address the six criteria which the Washington State Insurance Code lists for the OIC to consider in approving this transaction. Are you familiar with these requirements, which are set forth in Section 48.31B.015 of the Washington Insurance Code?

A: Yes, I am familiar with the standards of review as set forth in that section of the Washington Insurance Code.

2. Q: After the change of control, will National Merit be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed?

A: Yes. The selling shareholders have represented to us that all of the DRC Companies – including National Merit – meet all of the requirements of applicable law for holding their state licenses to conduct business in the lines of insurance they are currently writing, and through our own due diligence we did not uncover any information to the contrary. In addition, Trinity has no current plans to make any changes in the operations of National Merit that would adversely impact the ability of National Merit to maintain its current licenses.

3. **Q: Will the effect of the acquisition of control be to substantially lessen competition in insurance in Washington or tend to create a monopoly therein?**

A: No. The acquisition will not substantially lessen competition in insurance in Washington or tend to create a monopoly therein. The only potentially overlapping lines of business between Unitrin entities and National Merit are Other Liability, Private Passenger Auto Liability, and Private Passenger Auto Physical Damage. Based on 2007 direct written premium figures, the two groups' combined market share in Washington in these lines of business are less than 1%, 1.7%, and 1.7%, respectively, based on data from the A.M. Best State/Line Financial database version 2008.7. So the combination of these two organizations will not materially alter the respective market shares of either organization within the State of Washington and will not result in a combined organization with a statistically significant share of the Washington insurance market in any line of business. In addition, as mentioned in Dave Bengston's testimony, the Federal Trade Commission – which I understand reviewed this transaction from a federal antitrust perspective – did not object to the proposed transaction and granted early termination of the requisite waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 on September 26, 2008.

4. **Q: Do you believe that Unitrin's or Trinity's financial condition is such as might jeopardize the financial stability of the National Merit, or prejudice the interests of its policyholders?**

A: No. Audited consolidated financial statements of Unitrin and its subsidiaries for the years ended December 31, 2007, 2006, 2005, 2004 and 2003 (as set forth in Unitrin's Annual Reports on Form 10-K for the years then ended, as filed with the Securities and Exchange Commission) have been provided to the OIC in this regard. In addition, Trinity provided the OIC with copies of its annual statements for the years ended December 31, 2007, 2006, 2005, 2004 and 2003. As that record reflects and as Dave Bengston testified and I reiterated earlier, the Unitrin organization as a whole is strong financially, and employs conservative capital management and investment philosophies. It is therefore my belief that joining the Unitrin family of companies will only serve to improve National Merit's financial stability and advance the interests of its policyholders by making it part of a larger and financially stronger organization.

I repeat in particular the fact that, as of September 30, 2008, Unitrin reported total assets of \$9.2 billion and shareholders' equity of \$1.8 billion. Of the total revenues of \$2.1 billion that Unitrin reported in the first nine months of 2008, nearly \$1.8 billion pertained to insurance premiums of which approximately \$1.3 billion, or 72.8%, represents personal lines property and casualty premium revenues, primarily auto and homeowners business. Also as of September 30, 2008, Trinity reported statutory basis admitted assets of \$2.9 billion and total

surplus of \$891 million.

I also note Dave Bengston's testimony concerning the conservative capital management and investment philosophies employed by Unitrin and Trinity. There are five specific facts to highlight in that regard. First, Trinity is funding the entire purchase price with its own existing cash resources and is not incurring any debt to pay for this acquisition. Second, Unitrin and Trinity currently enjoy strong financial strength ratings with all of the major ratings agencies. Third, Unitrin and Trinity managed to avoid the catastrophic economic losses that some insurance organizations with less conservative capital management and investment philosophies have experienced. Fourth, Unitrin and Trinity are being proactive by putting enhanced procedures in place to determine and monitor Trinity's capital position on a daily basis, and by taking an even more conservative approach to their investment portfolio by selling or otherwise divesting themselves from various assets that were no longer consistent with this more conservative approach. Finally, there are covenants contained in the definitive agreement for this transaction that essentially require the DRC Companies to similarly divest themselves from certain alternative assets that were not consistent with Unitrin's and Trinity's investment approach.

In short, I think all of these factors make it clear that neither Unitrin's nor Trinity's financial condition is such as might jeopardize the financial stability of National Merit, or prejudice the interests of its policyholders.

5. **Q: Other than as described in the Application or in this testimony, are there any current plans or proposals that Unitrin or Trinity have to liquidate National Merit, sell its assets, consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management that are unfair and unreasonable to policyholders of National Merit and not in the public interest?**

A: No. Trinity has no current plans or proposals to declare an extraordinary dividend or make other distributions, liquidate, sell the assets of (other than such sales of assets as may be contemplated in the ordinary course of business), merge or consolidate or make any other material change in the business operations, corporate structure or management of National Merit, and thus there are no such current plans would could be seen as unfair or unreasonable to policyholders of National Merit or against the public interest.

As disclosed in the Application, Trinity contemplates that National Merit may enter into a number of affiliated transactions with certain Unitrin wholly-owned subsidiaries following the closing of the acquisition, including Trinity itself and Unitrin Services Company, an Illinois general business corporation ("Unitrin Services"). While the specifics and timing of each and every one of these various transactions have not been formulated, it is anticipated that National Merit will enter into various service agreements with Unitrin Services and a 100% quota share reinsurance arrangement with Trinity effective as of or sometime after the closing of the acquisition, which are affiliated transactions that are in place with

most of Trinity's insurance company subsidiaries. As part of the Application, Trinity provided sample copies of contracts that are traditionally used by Unitrin and Trinity for these internal service and reinsurance arrangements, and a review of those documents confirms that such transactions are fair and reasonable to the subsidiary and its policyholders and not adverse to the interests of the general public. Moreover, in connection with any such service or reinsurance arrangements, and any other affiliated transactions involving National Merit as a party, once the specifics and timing of such transactions have been formulated and the parties thereto agree to proceed with such transactions, Trinity will cause National Merit to provide formal notice to, and/or request the approval of, the OIC to the extent required by the laws of the State of Washington before proceeding with those transactions.

I note also that Trinity does not currently anticipate making any changes to the present executive officers of National Merit in connection with the closing of the acquisition. Trinity has not, however, made any formal commitments of any nature to any present officers of National Merit. In connection with the closing of the acquisition, the current directors of National Merit will resign from their current board positions and will be replaced by the following Unitrin/Trinity personnel: David F. Bengston, John M. Boschelli, Eric J. Draut, Samuel L. Fitzpatrick, Edward J. Konar, Richard Roeske, Donald G. Southwell and myself. Biographical affidavits for each of the foregoing individuals were provided with the Application.

6. **Q: Do you believe that the competence, experience, and integrity of those persons who would control the operation of National Merit are such that it would not be in the interest of policyholders of National Merit and of the public to permit the proposed acquisition?**

A: No. To the contrary, I believe that the competence, experience, and integrity of the persons who would control the operation of National Merit are such that it would be in the interest of policyholders and of the public to permit the proposed acquisition. The management teams of Unitrin and Trinity enjoy a well-established reputation within the insurance industry. As evidenced in their biographical affidavits filed in connection with the Application, the individuals who comprise the management teams of Unitrin and Trinity and who will control the operation of National Merit post-acquisition are highly experienced in the property and casualty insurance business and have served in those capacities for similar organizations within Unitrin. I believe that the competence, experience and integrity of the persons who will control the operation of National Merit post-acquisition, as well as those who control Unitrin and Trinity, are beyond reproach.

Another aspect of this transaction worth mentioning in this regard is the fact that this acquisition will bring the DRC Companies -- including National Merit -- within a more traditional insurance holding company ownership structure than is currently the case. Currently, the DRC Companies are ultimately owned by a group of private investors, the majority of which are private equity funds that are not primarily involved in the business of insurance. Following this acquisition,

the DRC Companies – including National Merit – will have Unitrin as its ultimate controlling person, and Unitrin is a well-established, publicly-traded, and transparent insurance organization that – through Trinity and its other various insurance company subsidiaries – has been in the insurance business for decades and has successfully undertaken and completed a number of previous acquisitions of other insurance organizations throughout its history. Such an ownership structure is conversant with the expectations of state insurance departments, has a demonstrated history of running insurance companies with competence, experience, and integrity, as evidenced by its compliance with stringent public disclosure requirements concerning its financial condition and operations. In summary, it is my firm belief that the competence, experience, and integrity of those persons who would control the operation of National Merit are not such that it would not be in the interest of policyholders of National Merit and of the public to permit the proposed acquisition.

7. Q: Do you believe that the acquisition is likely to be hazardous or prejudicial to the insurance-buying public?

A: No. As previously mentioned, I believe that National Merit's affiliation with Unitrin and Trinity can only serve to improve and enhance its financial stability, product offerings, and policy and claims service capabilities, and therefore the transaction is not likely at all to be hazardous or prejudicial to the insurance-buying public and in fact is likely to advance the interests of the insurance-buying public.

To reiterate, by joining the Unitrin family of companies, the DRC Companies – including National Merit – will become part of a larger and financially stronger insurance holding company organization. Within this combined family of companies, there is the potential for greater economies of scale. The combined business segment would be able to market to a broader customer segment through multiple direct-to-consumer marketing channels. The combined set of product offerings would create a more diversified core product suite for the insurance-buying public. Lastly, customers and claimants may benefit from enhanced claims service options and capabilities.

E. Miscellaneous

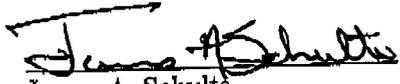
1. Q: Is there anything else that you would like to add at this time?

A: Yes. On behalf of all of us at Trinity, I would like to thank the OIC and Judge Peterson for their prompt attention to this matter and for their professionalism and diligence in reviewing Trinity's Application. Approval of Trinity's pending Application is requested which will allow National Merit to join the Unitrin family of companies as soon as possible. Trinity looks forward to continuing to work with the OIC following the completion of the proposed acquisition.

Verification

I, James A. Schulte, declare under penalty of perjury of the laws of the State of Washington that the foregoing answers are true and correct.

Dated this 7th day of January, 2009, at Chicago, Illinois.



James A. Schulte

President

Trinity Universal Insurance Company