

# **PENNSYLVANIA NATIONAL MUTUAL CASUALTY INSURANCE COMPANY**

## **BOARD OF DIRECTORS CORPORATE GOVERNANCE GUIDELINES**

**2005**

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### **The Mission of the Pennsylvania National Mutual Casualty Insurance Company Board of Directors (“The Mutual Board”)**

The Mutual Board represents the policyholders’ interest in perpetuating the success of Pennsylvania National Mutual Casualty Insurance Company (“Mutual” or “Company”), including optimizing long-term financial returns so as to ensure the financial security of the Company for the benefit of its policyholder-owners. The Board is responsible for determining that the Company is managed in such a way to ensure this result. This is an active, not a passive responsibility. The Board has the responsibility to ensure that Management is always capably executing its responsibilities. The Board’s responsibility is to regularly monitor the effectiveness of Management policies and decisions including the execution of its strategies.

The Board has responsibility to Mutual’s customers, employees, suppliers and to the communities where it operates -- all of whom are essential to a successful business. All of these responsibilities, however, are founded upon the successful profitability and perpetuation of the Company. The Board has a duty to monitor the business and affairs of the Company by gathering and reviewing information, including financial data, concerning the results, present condition, fulfillment of its corporate obligations and future prospects.

### **Guidelines on Significant Corporate Governance Issues**

#### **Selection and Composition of the Board**

##### **1) Board Membership Criteria**

The Mutual Board has created the Directors and Officers Committee to which it has authorized the selection of nominees for Board membership.

The Directors and Officers Committee is responsible for reviewing with the Board, on an annual basis, the appropriate skills and characteristics desired of the Board in the context of the current make up of the board and the annual nominations of candidates for Board membership, as well as to fill Elected Officer vacancies in Mutual. This assessment should include issues of diversity, age, skills such as understanding of general business practices, special areas of expertise, and functions, etc. -- all in the context of an assessment of the perceived needs of the Mutual Board.

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### 2) Extending the Invitation to a Potential Director to Join the Board

The invitation to be considered for nomination to the Board should be extended by the President and Chief Executive Officer of Mutual.

### 3) Selection of New Directors

The Board, the Directors and Officers Committee and the Chief Executive Officer are all instrumental in selecting candidates for Board membership and in making recommendations for election by the policyholders. The Board delegates the screening process involved to the Committee with the direct input from the Chairman of the Board and/or Chief Executive Officer.

### 4) Orientation of New Directors

The Board and the Company have an orientation process for new Directors that includes background material, meetings with senior management and visits to Company facilities.

## **Board Leadership**

### 5) Selection of President and other Elected Officers

The Board is responsible annually to elect from its members a President, a Secretary and a Treasurer. The Board may also elect or appoint one or more Vice Presidents, and such other assistant officers as it deems necessary or advisable.

It has been the practice of the Board to elect the President and Chief Executive Officer as Chairman. The Board is free, however, to make such choice as it deems best for the Company.

### 6) Lead Director Concept

The Board should, in its sole discretion, annually appoint a "lead outside Director," selected by the outside Directors, to chair informal executive sessions of the outside Directors.

## **Board Composition and Performance**

### 7) Size of the Board

The By-laws of the Company specify that the Board will consist of not less than nine (9) nor more than fifteen (15) members. These are to be divided into three (3) classes of not less than three (3) or more than five (5) Directors.

The number of Board members may vary from time-to-time (between 9 and 15) as deemed appropriate and necessary.

### 8) Mix of Inside and Outside Directors

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The Board believes that as a matter of policy there should be a majority of independent Directors on the Board. The Board is willing to have Executive Officers, in addition to the Chief Executive Officer, as Directors. But the Board believes that Management should encourage senior managers to understand that Board membership is not necessary or a prerequisite to any higher Management position in the Company. Executive Officers may attend Board Meetings at the request of the CEO even though they are not members of the Board.

### 9) Definition of What Constitutes Outside Directors

“Outside directors” are defined as those directors who are non-employees or Officers of the Company or an affiliate. Former officers of the Company, PNHC, Penn National Security Insurance Company (“Security”), or an affiliated company, are considered outside directors after a period of five (5) years or more has expired from the date of their retirement from active service with the Company.

There should be no conflict of interest between any Director and Pennsylvania National Mutual Casualty Insurance Company or affiliate that could be construed in any way to compromise any Board member exercising of independence of judgment.

### 10) Former Officer’s Board Membership

When an Officer-Director retires from his/her officer position, he/she will submit his/her resignation from the Board at the same time. Whether the individual continues to serve on the Board is a matter for discussion at that time with the Chief Executive Officer and the Board.

### 11) Directors Who Change Their Present Job Responsibility

It is the sense of the Board those individual Directors who either embark upon a totally new and different career, or who experience a change in their job position which entails significantly less responsibilities than was the case when they were elected to the Board, should submit a letter of resignation to the Board.

It is not the sense of the Board that in every instance Directors who retire or change from the position they held when they came on the Board should necessarily leave the Board. There should, however, be an opportunity for the Board, via the Directors and Officers Committee, to review the continued appropriateness of Board membership under these circumstances.

### 12) Term Limits/Retirement Age/Policyholder Status

The corporate by-laws specify that Directors terms are to be three (3) years. To continue as Directors, they must be re-elected and qualified. The corporate by-laws also specify that Directors are elected from membership of the organization. Membership is achieved by being

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a policyholder of the Company. Therefore a Director must become a policyholder -- if not already one.

The Board believes that a Director should not normally serve more than four (4) terms of three (3) years each or beyond age 72. Current outside Directors are grandfathered as to term limits and age limits.

Termination of Board service for a Director reaching 72 will be the annual meeting date following the attainment of age 72.

In the case of Officer-Directors, they may serve more than four (4) terms of three (3) years as long as they hold an executive officer position.

While not currently applicable, it is anticipated that if the Company or a subsidiary becomes a public entity, the Directors will be required to hold a minimum amount of corporate stock in the publicly traded company. The amount and time frame for purchase will be determined by the board at the appropriate time.

### 13) Board Compensation

Board compensation should come at the suggestion of the Benefits and Compensation Committee, but with full discussion and concurrence by the Board.

### 14) Executive Sessions of Outside Directors

The outside Directors of the Board may meet informally in Executive Session. The format of any such meetings will include a discussion with the Chief Executive Officer.

### 15) Assessing the Board's Performance

The Directors and Officers Committee is responsible to report annually to the Board as to an assessment of the Board's performance. This will be discussed with the full Board. This should be done following the end of each calendar year. This assessment should be of the Board's contribution as a whole and specifically review areas in which the Board and/or the Management believes a better contribution could be made. Its purpose is to increase the effectiveness of the Board, not to target individual Board members.

### 16) Board's Interaction With Investors, Press, Customers, Etc.

The Board believes that the Management speaks for Pennsylvania National Mutual Casualty Insurance Company. Individual Board members may, from time-to-time at the request of the Management, meet or otherwise communicate with various constituencies that are involved with Pennsylvania National Mutual Casualty Insurance Company. If comments from the Board are appropriate, they should, in most circumstances, come from the CEO and/or the Lead Director.

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### **Board Relationship to Senior Management**

#### 17) Attendance of Non-Directors at Board Meetings

The Board welcomes the attendance at Board meetings of non-Board members. Their attendance is subject to the invitation of the CEO.

#### 18) Board Access to Management

Board members should have reasonable access to Mutual and Security's Management. It is assumed that Board members will use judgment to be sure that this contact is not distracting to the business operation of the Company and that such contact, if in writing, be copied to the Chief Executive Officer.

Furthermore, the Board encourages the Chief Executive Officer to, from time-to-time, bring managers into Board meetings who: (a) can provide additional insight into the items being discussed because of personal involvement in these areas, and/or (b) represent managers with future potential that the senior management believes should be given exposure to the Board.

### **Meeting Procedures**

#### 20) Selection of Agenda Items for Board Meetings

The Chairman of the Board will establish the agenda for each Board meeting.

Each Board member is free to suggest to the Chairman of the Board the inclusion of item(s) on the agenda.

#### 21) Board Materials Distributed in Advance

It is the sense of the Board that information and data that is important to the Board's understanding of the business be distributed, whenever practicable, in writing to the Board before the board meets. The Management will make every attempt to see that this material is as brief as possible while still providing the desired information.

#### 22) Board Presentations

As a general rule, presentations on specific subjects should be sent to the Board members in advance so that Board meeting time may be conserved and discussion time focused on questions that the Board has about the material. On those occasions in which the subject matter is too sensitive to put on paper, the presentation will be discussed at the meeting and depending on the nature of the topic, at the request of the CEO, any written material should be returned to the CEO.

### **Committee Matters**

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### 23) Number, Structure and Independence of Committees

There will, from time-to-time, be occasions in which the Board may want to form a new Committee or disband a current Committee, depending upon the circumstances, and as subject to requirements of law. The current Committees are Audit, Benefits and Compensation, Directors and Officers, Executive and Finance/Investment. Even though currently required by Pennsylvania law, the Board, as a matter of corporate governance, believes similarly that the Audit Committee and the Directors and Officers Committee should be comprised entirely of outside Directors (as to voting members), and the Benefits/Compensation Committee should be mainly outside Directors, with those inside Directors on that Committee not being able to vote on matters of executive performance evaluation, executive salary or compensation.

A Committee Charter should be reviewed annually by the Board. Such charters should include function/purpose, membership/organization, meeting schedule/activities and responsibilities and objectives.

### 24) Assignment and Rotation of Committee Members

The Chairman of the Board is responsible, with consideration of the desires of the CEO and individual Board members, for the appointment of Board members to various Committees. Such appointments are subject to approval by the Board.

It is the sense of the Board that consideration should be given to rotating Committee members periodically, but the Board does not feel that such a rotation should be mandated as a policy since there may be reasons at a given point in time to maintain an individual Director's Committee membership for a longer period.

## **Leadership Development**

### 25) Evaluation of the Elected Officers

The full Board shall continuously monitor corporate performance based on objective criteria including accomplishment of long-term strategic objectives, and quarterly objectives of the annual Corporate Operational Plan. The Board will be given the opportunity to review, discuss and approve both Strategic and annual Operational Corporate Plans.

There shall be established a Directors', Officers & Directors Review Committee, as an expanded committee of the Board, whose charter shall be amended to include the establishment of annual performance objectives for the President and CEO, and to conduct annual performance evaluations of the President & CEO and to review performance evaluations of the other Elected Officers, as well as to perform annual assessments of the performance of the Board of Directors. These evaluations will be used by the Directors, Officers & Directors' Review Committee in the course of its deliberations when considering and making a recommendation to the Board as to the compensation of the Chief Executive Officer and the other Elected Officers.

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### 26) Succession Planning

There should be an annual report by the Chief Executive Officer to the Board on succession planning, which annual report would be made at the time of the CEO's discussion of the annual performance evaluations of senior management at the April Board of Directors meeting.

There should also be available, on a continuing basis, the Chief Executive Officer's recommendation as to a successor should he/she be unexpectedly disabled or otherwise unavailable to serve.

### 27) Management Development

There should be an annual report to the Board by the Chief Executive Officer on the Company's program for Management development.

This report should be given to the Board at the same time as the succession planning report noted previously.

### 28) General Provisions

These Corporate Governance Guidelines comprise a statement of intent by the Board of Directors as to the broad contextual backdrop of the parameters of corporate governance, and as such are not intended to be either all-encompassing or self-limiting. The Board of Directors reserves the right to amend, modify, change, or not enforce these Guidelines at any time in the future where such is deemed desirable and/or necessary; moreover, reasonable exceptions to these Guidelines can be made at the recommendation of the President/CEO and the approval of the Board of Directors.