

## OFFICE OF THRIFT SUPERVISION

### Approval of Bank Merger Act Application

**Order No.:** 2011-23  
**Date:** March 16, 2011  
**Re:** OTS No. 16137

Province Bank FSB, Marietta, Pennsylvania (Association), seeks the Office of Thrift Supervision's (OTS) approval to acquire Union National Community Bank, Lancaster, Pennsylvania (Bank), pursuant to Section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act or BMA) and 12 C.F.R. § 563.22(a).

#### **The Parties**

The Association is a Deposit Insurance Fund (DIF)-insured, federal savings association and is a direct wholly owned subsidiary of Donegal Financial Service Corporation, Marietta, Pennsylvania (DFSC), and a second-tier subsidiary of Donegal Mutual Insurance Company, Marietta, Pennsylvania (DMIC) and Donegal Group, Inc., Marietta, Pennsylvania (DGI). DMIC and DGI offer personal, farm and commercial insurance products.

The Bank is a DIF-insured, national bank that is regulated by the Office of the Comptroller of the Currency (OCC). The Bank is currently a wholly owned subsidiary of Union National Financial Corporation (UNFC).

#### **The Proposed Transaction**

In the proposed transaction, a newly created entity controlled by DMIC and DGI will merge into UNFC, with UNFC being the survivor. UNFC will then merge into DFSC, with DFSC being the survivor, and immediately thereafter, the Bank will merge into the Association, with the Association being the surviving entity. Current shareholders of UNFC will receive a combination of DGI common stock and cash. Immediately upon consummation of the merger of the Bank into the Association, DMIC and DGI will contribute additional cash to the Association, as described in more detail in the application.

#### **Bank Merger Act Application**

In evaluating a BMA application, OTS is required to consider the effect of the transaction on the capital of the resulting association; the financial and managerial resources of the constituent institutions; the future prospects of the constituent institutions; the effect of the transaction on competition; the convenience and needs of the community; conformance to applicable law, regulation, and supervisory policy; and

factors relating to fairness of and disclosure concerning the transaction.<sup>2</sup> Also, the BMA requires the responsible agency to take into consideration, in its evaluation of any BMA application, the effectiveness of any insured depository institution in combating money-laundering activities.<sup>3</sup> Under 12 C.F.R. § 563e.29, OTS must consider the constituent savings associations' record of performance under the Community Reinvestment Act (CRA).

#### Capital

The Association is currently "well capitalized," and will remain "well capitalized" after the merger and the related capital infusion. Accordingly, we conclude that this approval standard is satisfied.

#### Managerial Resources

As the Association's regulator, OTS is familiar with the management of the Association. Upon consummation of the proposed merger, the Association's senior executive officers and board of directors will include several people from the Bank. OTS has reviewed the backgrounds of the new officers and directors, and has concluded that these individuals have experience that will bolster the Association's managerial resources. We conclude that managerial resources considerations are consistent with approval

#### Financial Resources and Future Prospects

The Association is projected to be profitable and "well capitalized" after the proposed transaction. The Bank will cease to exist as a separate entity after the merger. The Association's proposed business plan is acceptable. To help ensure the financial resources and future prospects of the Association are consistent with approval, we are imposing conditions 6, 7 and 8, which, respectively, require that the Association comply with its business plan and receive OTS non-objections for material variations from that plan, that the Association submit variance reports regarding the business plan to OTS, and that DMIC, DGI and DFSC enter into a capital maintenance agreement with respect to the Association prior to consummation of the transaction, in the form attached to this order.

Based on the foregoing, we conclude that the financial resources and future prospects of the Association and the Bank are consistent with approval, subject to the conditions.

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<sup>2</sup> 12 U.S.C. § 1828(c)(5)(B); 12 C.F.R. § 563.22(d) (2010).

<sup>3</sup> 12 U.S.C. § 1828(c)(11).

Competitive Impact

With respect to competitive factors, the relevant geographic area for the proposed merger is Lancaster County, Pennsylvania. The Bank has ten banking offices, all in Lancaster County, and the Association has three banking offices, all in Lancaster County. As of the last Deposit Market Share Report, June 30, 2010, the Association had a market share of 0.9 percent and ranked fourteenth. The Bank had a market share of 4.4 percent, and ranked sixth. As a result of the merger, the Herfindahl-Hirschman Index (HHI) would increase 7.9 points, from 1350.3 to 1358.2. Under the U.S. Department of Justice (DOJ) merger guidelines, mergers producing an increase in the HHI of less than 200 points in markets with a post-merger HHI of less than 1800 are unlikely to have adverse competitive effects. The DOJ has reviewed the transaction and has not objected to the merger. Based on the foregoing, OTS concludes that competitive considerations are consistent with approval.

Convenience and Needs of the Community

With respect to the convenience and needs of the community, the Association will continue its current operations, as well as the Bank's existing operations. Accordingly, we conclude that convenience and needs considerations are consistent with approval.

Community Reinvestment Act

As for the CRA, the Association and the Bank each has a "Satisfactory" CRA rating. OTS has received no comments objecting to the proposed merger. Accordingly, we conclude that approval of the BMA application is consistent with the CRA.

Conformity With Law; Anti-Money Laundering

As for conformance to law, regulation and supervisory policy, OTS's review of the BMA application did not indicate any violation of law or regulations, or non-compliance with supervisory policies, in connection with the proposed transaction. Based on the foregoing, OTS concludes that approval of the proposed transaction is not objectionable based on conformity of the proposed transaction to applicable law, regulation, and supervisory policies.

OTS must also review the constituent institutions' records of compliance with anti-money laundering statutes and regulations as part of the analysis of any BMA transaction. OTS has reviewed the Association's compliance record, which took no exceptions to the Association's compliance with the Bank Secrecy Act or any other anti-money laundering laws or regulations. Similarly, the OCC reviewed the Bank's compliance with such laws and did not object to the Bank's compliance. Therefore, we conclude that these criteria for approval under the BMA have been met.

Fairness and Disclosure

We are aware of no basis for objection to the merger resulting from fairness and disclosure issues. Appropriate publications have occurred, and disclosure materials relating to the proposed transaction have been filed with the appropriate regulators and have been provided to the Bank's stockholders. Accordingly, we are not aware of any basis for objection to the BMA application based on fairness.

Conclusion

Based on the application and the foregoing analysis, OTS concludes that the application satisfies the applicable approval standards, provided that the following conditions are complied with in a manner satisfactory to the Northeast Regional Director or his designee (Regional Director). Accordingly, the application is hereby approved, subject to the following conditions:

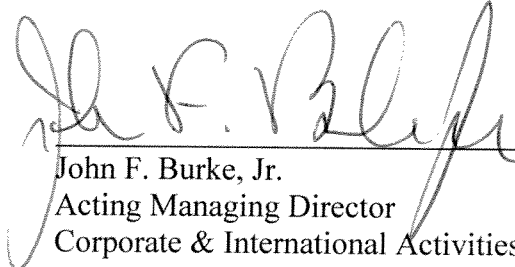
1. The Association and the Bank must receive all required regulatory approvals, and submit copies of all such approvals to the Regional Director, prior to consummation of the proposed transaction;
2. The proposed transactions must be consummated no earlier than 15 calendar days and no later than 120 calendar days from the date of this Order;
3. On the business day prior to the date of consummation of the proposed transactions, the chief financial officers of the Association and the Bank must certify in writing to the Regional Director that no material adverse changes have occurred with respect to the financial condition or operation of the Association, and the Bank, respectively, as disclosed in the applications. If additional information having a material adverse bearing on any feature of the applications is brought to the attention of the Association, the DFSC, DMIC, DGI, the Bank, UNFC, or OTS since the date of the financial statements submitted with the applications, the transactions must not be consummated unless the information is presented to the Regional Director, and the Regional Director provides written non-objection to the consummation of the transactions;
4. The Association must, within 5 calendar days after the effective date of the proposed transactions: (a) advise the Regional Director in writing of the effective date of the proposed transactions; and (b) advise the Regional Director in writing that the transactions were consummated in accordance with all applicable laws and regulations, the applications and this Order;
5. No later than 30 calendar days after the merger of the Bank with and into the Association, the Association must advise each accountholder whose withdrawable accounts in the Association would increase above \$250,000 as a result of the

transaction, or whose uninsured balance would increase as a result of the merger, of the effect of the transaction on deposit insurance coverage, and submit a copy of such notice to the Regional Director;

6. For three years following the date of consummation of the proposed transactions, the Association must operate within the parameters of its modified three-year business plan. The Association must submit any proposed major deviations or material changes from the plan for the prior, written non-objection of the Regional Director. The request for change must be submitted no later than 60 calendar days prior to the desired implementation date;
7. For three years following the date of consummation of the proposed transactions, the Association must submit to the Regional Director within 45 calendar days after the end of each calendar quarter, a business plan variance report detailing the Association's compliance with the business plan and an explanation of any deviations; and
8. The proposed transaction is consummated upon the effective date of a Capital Maintenance Agreement executed by DMIC, DGI, DFSC, Province Bank, and OTS, in the form attached hereto.

The Regional Director may, for good cause, extend any time period herein for up to 120 days.

By order of the Director of the Office of Thrift Supervision, or his designee, effective March 16, 2011.

  
John F. Burke, Jr.  
Acting Managing Director  
Corporate & International Activities

## CAPITAL MAINTENANCE AGREEMENT

THIS CAPITAL MAINTENANCE AGREEMENT (this "Agreement") is entered into, and is effective as of, the \_\_\_\_ day of \_\_\_\_\_, 2011 (the "Effective Date"), by and among PROVINCE BANK FSB ("Province"), a federal savings association with its home office in Marietta, Pennsylvania, DONEGAL FINANCIAL SERVICES CORPORATION ("DFSC"), a Delaware corporation with its principal place of business in Marietta, Pennsylvania, DONEGAL MUTUAL INSURANCE COMPANY, a Pennsylvania-domiciled mutual insurance company ("DMIC"), DONEGAL GROUP INC. ("DGI"), a Delaware business corporation, and the OFFICE OF THRIFT SUPERVISION (the "OTS").

### RECITALS

WHEREAS, Province is a wholly owned subsidiary of DFSC;

WHEREAS, DFSC is wholly owned by DMIC and DGI;

WHEREAS, DMIC, DGI, DFSC and Province have determined that it is in the best interests of both DFSC and Province to ensure that Province is able to continue to operate safely and soundly and in accordance with all applicable laws, regulations and regulatory requirements, as a going concern;

WHEREAS, in order to meet all regulatory capital requirements and carry out its business plans, Province may need additional capital from time to time;

WHEREAS, the OTS seeks to ensure that Province complies with all its capital requirements and that Province operates in a safe and sound manner;

WHEREAS, DFSC may realize the benefits of contributions to the equity capital of Province through continued ownership of an equity interest in Province; and

WHEREAS, DMIC and DGI may realize the benefits of contributions to the equity capital of Province through continued ownership of an equity interest in DFSC.

NOW, THEREFORE, in consideration of the foregoing premises, the OTS, DFSC, DMIC, DGI and Province do hereby agree as follows:

## ARTICLES

### 1. CONSTRUCTION OF AGREEMENT.

A. This Agreement is a "written agreement" entered into with an agency within the meaning and for the purposes of Section 8 of the Federal Deposit Insurance Act, as amended (12 USC § 1818).

B. This Agreement shall not be construed as a "written agreement, order, capital directive or prompt corrective action directive" issued by the OTS requiring Province "to meet and maintain a specific capital level" for purposes of 12 CFR § 565.4.

### 2. CAPITAL ASSURANCES.

A. During the term of this Agreement and except as otherwise provided in this Agreement, DMIC, DGI and DFSC commit and promise to make such capital contributions in the combined aggregate maximum amount that would not exceed \$20.0 million, as may be necessary from time to time to ensure that Province has sufficient "core capital" and "supplementary capital", as computed in accordance with the rules and regulations of the OTS at 12 CFR Part 567 ("Capital"), so that Province maintains capital ratios of 8% for Tier I Capital to Average Total Assets, 9.5% for Tier I Capital to Risk-Based Assets, and 12% for Total Capital to Risk-Based Assets (the "Minimum Capital Requirement").

B. DMIC, DGI and DFSC agree that if, at any time, Province's Capital level falls below the Minimum Capital Requirement (a "Capital Deficiency"), then DMIC, DGI and DFSC will, within thirty (30) calendar days of receiving written notification from either Province or the OTS of a Capital Deficiency, contribute additional Capital in cash, in an amount sufficient to cause Province's Capital to meet the Minimum Capital Requirement; provided, that such time period for compliance may be extended by the appropriate Regional Director of the OTS in the sole discretion of the OTS. In the event DMIC, DGI and DFSC receive notice of a Capital Deficiency, their obligations to contribute such additional Capital shall be joint and several.

C. During the term of this Agreement, without the prior written approval or non-objection of the OTS, Province commits and promises not to make a "capital distribution" (as defined at 12 CFR § 563.141) if, (i) following such capital distribution, Province's Capital would be less than the amount of Province's Capital on the later of the Effective Date or the date on which Union National Community Bank ("UNCB") merges with and into Province, (ii) following such capital distribution, Province's Capital would be less than the Minimum Capital Requirement, or (iii) the amount of capital distributions in any calendar year would exceed Province's net income for that year to date plus retained net income for the preceding two years.

3. TERM AND TERMINATION OF AGREEMENT.

A. The term of this Agreement shall commence on the Effective Date and shall terminate (i) when DFSC no longer has control as defined in this Agreement of Province, (ii) upon the conversion of Province to another form of depository institution charter other than a "savings association" within the meaning of Section 2(4) of the Home Owners' Loan Act, as amended (the "HOLA"), (iii) with the written consent of the parties hereto or (iv) as of the fifth anniversary of the Effective Date, provided, however, that if Province does not satisfy the Minimum Capital Requirement as of such fifth anniversary, the term of this Agreement shall automatically be extended for one additional year without any action on the part of DMIC, DGI, DFSC, Province or the OTS. For purposes of this Agreement, "control" shall have the meaning set forth at Section 10(a)(2) of the HOLA (12 USC § 1467a(a)(2)), and 12 CFR § 574.4, notwithstanding Sections 10(a)(1)(D)(ii) and 10(t) of the HOLA (12 USC §§ 1467a(a)(1)(D)(ii) and 1467a(t)) and 12 CFR §§ 574.2(q)(3) and 574.3(c)(1)(iii). Without limiting the generality of the foregoing, for the avoidance of doubt, DFSC shall be deemed to control Province if the OTS may presume that DFSC controls Province pursuant to 12 CFR § 574.4(b), unless the OTS shall have accepted a rebuttal of control submission made by DFSC using the standards set forth in 12 CFR § 574.4(e) to establish an absence of such control.

B. During the term of this Agreement, without obtaining the prior written approval or non-objection of the OTS, DFSC may not transfer or dispose of voting stock or other securities of Province if such transaction would cause DFSC to no longer control Province and, consequently, result in the termination of this Agreement.

4. REQUIRED APPROVALS. DMIC, DGI, DFSC and Province will not execute this Agreement unless and until all approvals which may be required for DMIC, DGI, DFSC and Province to enter into this Agreement have been received.

5. MODIFICATION OR AMENDMENT OF AGREEMENT. This Agreement may be modified or amended only by the mutual written consent of DMIC, DGI, DFSC and Province and with the prior written approval or non-objection of the OTS.

6. ASSIGNABILITY OF AGREEMENT. This Agreement shall not be assigned without the written consent of DMIC, DGI, DFSC and Province and the prior written approval or non-objection of the OTS.

7. SUCCESSORS IN INTEREST. This Agreement shall remain in full force and effect against any successors in interest to DMIC, DGI and DFSC and shall inure to the benefit of any regulatory successor of the OTS.



8. NOTICES. All notices or other communications required hereunder shall be in writing and shall be made by facsimile transmission, with a copy sent via overnight courier to the following persons, addressed as follows:

If to DFSC, to:

Donegal Financial Services Corporation  
1195 River Road  
Marietta, PA 17547  
Facsimile: 717-426-7009  
Attn: Donald H. Nikolaus, Chairman of the Board

If to Province, to:

Province Bank FSB  
1205 River Road  
Marietta, PA 17547  
Facsimile: 717-426-1297  
Attn: Donald H. Nikolaus, Chairman of the Board

If to DMIC, to:

Donegal Mutual Insurance Company  
1195 River Road  
Marietta, PA 17547  
Facsimile: 717-426-7009  
Attn: Donald H. Nikolaus, President and Chief Executive Officer

If to DGI, to:

Donegal Group Inc.  
1195 River Road  
Marietta, PA 17547  
Facsimile: 717-426-7009  
Attn: Donald H. Nikolaus, President and Chief Executive Officer

If to the OTS, to:

Office of Thrift Supervision  
Department of the Treasury  
Harborside Financial Center, Plaza 5  
Jersey City, New Jersey 07311  
Facsimile: (201) 4 13-7543  
Attn: Michael Finn, Regional Director

Such notice or communication shall be deemed to have been given or made as of the date that the notice or communication was sent via facsimile transmission.

9. COMMITMENT TO THE OTS. The undertakings of DMIC, DGI and DFSC in this Capital Agreement constitute a commitment by DMIC, DGI and DFSC to the OTS (and any regulatory successors) that DMIC, DGI and DFSC will maintain the Capital of Province as provided in this Agreement, and such commitment is intended to be a commitment to maintain the capital of an insured depository institution made to a Federal depository institutions regulatory agency for purposes of Title 11 of the United States Code.

10. ENTIRE AGREEMENT. This Agreement constitutes the entire agreement among the parties with respect to the subject matter hereof, and all prior agreements, arrangements, and negotiations between the parties, whether oral or written, with respect to this Agreement are deemed to be merged herein.

11. GOVERNING LAW. To the extent that Federal law does not control, this Agreement shall be governed, construed and controlled by the laws of the Commonwealth of Pennsylvania without reference to conflicts of laws principles thereof that would otherwise result in the application of the laws of another jurisdiction.

12. SEVERABILITY. If any portion of this Agreement shall be held by a court of competent jurisdiction to be invalid or inoperative, then, so far as is reasonable and possible, the remainder of this Agreement shall be considered valid and operative, and effect will be given to the intent manifested by the portion held invalid or inoperative.

IN WITNESS WHEREOF, the parties have executed this Agreement.

DONEGAL FINANCIAL SERVICES CORPORATION

By: \_\_\_\_\_  
Donald H. Nikolaus, Chairman of the Board

PROVINCE BANK FSB

By: \_\_\_\_\_  
Donald H. Nikolaus, Chairman of the Board

DONEGAL MUTUAL INSURANCE COMPANY

By: \_\_\_\_\_  
Donald H. Nikolaus, President and Chief Executive  
Officer

DONEGAL GROUP INC.

By: \_\_\_\_\_  
Donald H. Nikolaus, President and Chief Executive  
Officer

OFFICE OF THRIFT SUPERVISION

By: \_\_\_\_\_  
Michael E. Finn, Northeast Regional Director