

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1999

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-15341

DONEGAL GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware

23-2424711

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

1195 River Road, Marietta, Pennsylvania

17547

(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code: (717) 426-1931

Securities registered pursuant to Section 12(b) of the Act: None.

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$1.00 par value

(Title of class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes X. No .
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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in

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definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

On March 15, 2000, the aggregate market value (based on the closing sales price on that date) of the voting stock held by non-affiliates of the Registrant was \$24,719,873.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date: 8,618,558 shares of Common Stock outstanding on March 15, 2000.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Registrant's annual report to stockholders for the fiscal year ended December 31, 1999 are incorporated by reference into Parts I, II and IV of this report.
2. Portions of the Registrant's proxy statement relating to the annual meeting of stockholders to be held April 20, 2000 are incorporated by reference into Part III of this report.

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PART I

Item 1. Business.

(a) General Development of Business.

Donegal Group Inc. is an insurance holding company formed in August 1986, which is headquartered in Pennsylvania and engages, through its subsidiaries, in the property and casualty insurance business in 19 mid-Atlantic and southeastern states. As used herein, "DGI" or the "Company" refers to Donegal Group Inc. and its insurance subsidiaries, Atlantic States Insurance Company ("Atlantic States"), Southern Insurance Company of Virginia ("Southern"), Delaware Atlantic Insurance Company ("Delaware Atlantic"), Pioneer Insurance Company ("Pioneer") and Southern Heritage Insurance Company ("Southern Heritage"). DGI is currently 61.8% owned by Donegal Mutual Insurance Company (the "Mutual Company"). DGI and its subsidiaries and the Mutual Company underwrite a broad line of personal and commercial coverages, consisting of private passenger and commercial automobile, homeowners, commercial multi-peril, workers' compensation and other lines of insurance.

The Company's strategy is to seek growth both internally and through acquisitions. Since the formation of the Company and Atlantic States in 1986, the Company has completed the following acquisitions:

Company Acquired	Year Acquired	Net Premiums Written Year Prior to Acquisition	Net Premiums Written Year Ended December 31, 1999
Southern Insurance Company of Virginia	1988	\$1,128,843	14,193,477
Delaware Atlantic Insurance Company	1995	2,824,398	3,813,812
Pioneer Insurance Company	1997	4,499,273	3,749,701
Southern Heritage Insurance Company	1998	32,002,540	17,422,801

The Company evaluates other acquisition candidates on a continuing basis. However, there can be no assurance as to whether or when the Company will effect any additional acquisitions.

Atlantic States, which DGI organized in September 1986, participates in an underwriting pool whereby it cedes to the Mutual Company the premiums, losses and loss expenses from all of its insurance business and assumes from the Mutual Company a specified portion of the pooled business, which also includes substantially all of the Mutual Company's property and casualty insurance business. Effective as of October 1, 1986, DGI entered into a pooling agreement with the Mutual Company whereby Atlantic States assumed 35% of the pooled business written or in force on or after October 1, 1986. Pursuant to amendments to the pooling agreement subsequent to October 1, 1986, the Mutual Company, which is solely responsible for any losses in the pooled business with dates of loss on or before the close of business on September 30, 1986, has increased the percentage of retrocessions of the pooled business to Atlantic States. Since January 1, 1996, 65% of the pooled business has been retroceded to Atlantic States. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7 hereof and Note 3 to the Consolidated Financial Statements incorporated by reference herein.

On December 29, 1988, DGI acquired all of the outstanding capital stock of Southern in exchange for a \$3,000,000 equity contribution to Southern. Since January 1, 1991, Southern has ceded to the Mutual Company 50% of its direct premiums written and 50% has been retained by Southern. Because the Mutual Company places substantially all of the business assumed from Southern in the pool, in which DGI has a 65% allocation, DGI's results of operations include approximately 80% of the business written by Southern. See Note 3 to the Consolidated Financial Statements incorporated by reference herein.

As of December 31, 1995, the Company acquired all of the outstanding capital stock of Delaware Atlantic pursuant to a Stock Purchase Agreement dated as of December 21, 1995 between the Company and the Mutual Company.

As of March 31, 1997, the Company acquired all of the outstanding capital stock of Pioneer pursuant to a Stock Purchase Agreement dated as of April 7, 1997 between the Company and the Mutual Company.

On November 17, 1998, DGI purchased all of the outstanding capital stock of Southern Heritage, a Georgia-domiciled property and casualty insurance company, from Southern Heritage Limited Partnership for a purchase price, as finally settled, of \$18,824,950 in cash.

The Mutual Company is currently a party to retrocessional reinsurance contracts with each of the Company's subsidiaries, Southern, Delaware Atlantic, Pioneer and Southern Heritage, whereby the Mutual Company reinsures each such subsidiary in respect of 100% of the net liability that may accrue to such subsidiary from its insurance operations and retrocedes 100% of the net liability back to such subsidiary, which such subsidiary assumes.

On March 19, 1999, the Mutual Company, the Company and Donegal Financial Services Corporation, a Delaware corporation formed by the Mutual Company and the Company in 1999 ("Donegal Financial" and together with the Mutual Company and the Company, the "Applicants"), filed an Application for Permission to Organize a Federal Stock Savings Bank and related holding company application with the Office of Thrift Supervision (the "OTS") pursuant to Section 10(e) of the Home Owners' Loan Act to organize a proposed de novo federal savings bank, to be known as Donegal Federal Savings Bank (the "Savings Bank"), the deposits of which will be insured by the Savings Association Insurance Fund of the Federal Deposit Insurance Corporation (the "FDIC"). An Application for Federal Deposit Insurance was filed on behalf of the Savings Bank with the FDIC on April 9, 1999. These applications currently remain under review by the OTS and the FDIC.

Unless otherwise stated, all information in this report gives retroactive effect to: (i) the four-for-three split of the Company's Common Stock effected through a stock dividend of one share of Common Stock for each three shares outstanding, which was paid on July 15, 1997 to stockholders of record on June 25, 1997, and (ii) the four-for-three split of the Company's

Common Stock effected through a stock dividend of one share of Common Stock for each three shares outstanding, which was paid on June 25, 1998 to stockholders of record on June 10, 1998.

(b) Financial Information about Industry Segments.

The Company has three segments, which consist of the investment function, the personal lines of insurance and the commercial lines of insurance. Financial information about these segments is set forth in Note 17 to the Consolidated Financial Statements incorporated by reference herein.

(c) Narrative Description of Business.

Relationship with the Mutual Company

DGI's operations are interrelated with the operations of the Mutual Company and, because of the percentage of the pooled business assumed by DGI, DGI's results of operations are dependent to a material extent upon the success of the Mutual Company. In addition, various reinsurance agreements exist between the Company and the Mutual Company. The Mutual Company is responsible for underwriting and marketing the pooled business and provides facilities, employees and services required to conduct the business of DGI on a cost-allocated basis. The Mutual Company owned 61.8% of DGI as of March 15, 2000.

Through the pool, DGI writes personal and commercial property and casualty insurance lines, including automobile, homeowners, commercial multi-peril, workers' compensation and other lines of business. The insurance agencies under contract with the Mutual Company serve as representatives for the pool participants.

The Mutual Company provides all personnel for the Company and certain of its insurance subsidiaries, including Atlantic States, Delaware Atlantic, Southern and Pioneer. Expenses are allocated to the Company, Delaware Atlantic, Southern and Pioneer according to a time allocation and estimated usage agreement, and to Atlantic States in relation to the relative participation of the Mutual Company and Atlantic States in the pooling agreement described herein. Expenses allocated to the Company under such agreement were \$27,466,898 in 1999.

The Mutual Company leases office equipment and automobiles from the Company, under a lease dated January 1, 1990. The Mutual Company made lease payments to the Company of \$819,474 in 1999.

Under the terms of the intercompany pooling agreement, Atlantic States cedes to the Mutual Company the premiums, losses and loss expenses on all of its insurance business. Substantially all of the Mutual Company's property and casualty insurance business written or in force on or after October 1, 1986 is included in the pooled business. Pursuant to amendments to the pooling agreement subsequent to October 1, 1986, the Mutual Company, which is solely responsible for any losses in the pooled business with dates of loss on or before the close

of business on September 30, 1986, has increased the percentage of retrocessions of the pooled business to Atlantic States. As most recently amended, effective as of January 1, 1996, 65% of the pooled business has been retroceded to Atlantic States. All premiums, losses, loss expenses and other underwriting expenses are prorated among the parties on the basis of their participation in the pool. The pooling agreement may be amended or terminated at the end of any calendar year by agreement of the parties. The allocations of pool participation percentages between the Mutual Company and Atlantic States are based on the pool participants' relative amounts of capital and surplus, expectations of future relative amounts of capital and surplus and the ability of the Company to raise capital for Atlantic States. The Company does not currently anticipate a further increase in Atlantic States' percentage of participation in the pool, nor does the Company intend to terminate the participation of Atlantic States in the pooling agreement.

The underwriting pool is intended to produce a more uniform and stable underwriting result from year to year for the participants in the pool than they would experience individually and to spread the risk of loss among all the participants. Each company participating in the pool has at its disposal the capacity of the entire pool, rather than being limited to policy exposures of a size commensurate with its own capital and surplus. The additional capacity exists because such policy exposures are spread among the pool participants, each of which has its own capital and surplus.

In addition to the underwriting pool, through the retrocessional reinsurance agreements with each of the Company's subsidiaries, Southern, Delaware Atlantic, Pioneer and Southern Heritage, the Mutual Company reinsures each such subsidiary in respect of 100% of the net liability that may accrue to such subsidiary from its insurance operations and retrocedes 100% of the net liability back to such subsidiary, which such subsidiary assumes.

On March 19, 1999, the Mutual Company, the Company and Donegal Financial filed an Application for Permission to Organize a Federal Stock Savings Bank and related holding company application with the OTS pursuant to Section 10(e) of the Home Owners' Loan Act to organize a proposed de novo federal savings bank, to be known as Donegal Federal Savings Bank, the deposits of which will be insured by the Savings Association Insurance Fund of the FDIC. An Application for Federal Deposit Insurance was filed on behalf of the Savings Bank with the FDIC on April 9, 1999. These applications currently remain under review by the OTS and the FDIC.

All of the Company's officers are officers of the Mutual Company, five of the Company's seven directors are directors of the Mutual Company and three of the Company's executive officers are directors of the Mutual Company. The Company and the Mutual Company maintain a Coordinating Committee, which consists of two outside directors from each of the Company and the Mutual Company, none of whom holds seats on both Boards, to review and evaluate the pooling agreement between the Company and the Mutual Company and to be responsible for matters involving actual or potential conflicts of interest between the Company and the Mutual Company. The decisions of the Coordinating Committee are binding on the

Company and the Mutual Company. The Company's Coordinating Committee members must conclude that intercompany transactions are fair and equitable to the Company. The purpose of this provision is to protect the interests of the stockholders of the Company other than the Mutual Company. The Coordinating Committee meets on an as-needed basis.

DGI's Business Strategy

DGI, in conjunction with the Mutual Company, has multiple strategies which the management of DGI believes have resulted in underwriting results that are favorable when compared to those of the property and casualty insurance industry in general over the past five years. The principal strategies comprise the following:

- o A regional company concept designed to provide the advantages of local marketing, underwriting and claims servicing with the economies of scale from centralized accounting, administrative, investment, data processing and other services.
- o An underwriting program and product mix designed to produce a Company-wide underwriting profit, i.e., a combined ratio of less than 100%, from careful risk selection and adequate pricing.
- o A goal of a closely balanced ratio between commercial business and personal business.
- o An agent selection process that focuses on appointing agencies with proven market strategies for the development of profitable business and an agent compensation plan providing for additional commissions based upon premium volume and profitability and the right to participate in the Company's Agency Stock Purchase Plan.
- o A continuing effort to attract and retain qualified employees who receive incentive compensation based upon historical results.
- o A goal of expanding operations in current and adjacent states.

Property and Casualty Insurance Products and Services

The following table indicates the percentage of DGI's net premiums written represented by commercial lines and by personal lines for the years ended December 31, 1999, 1998 and 1997:

	Year Ended December 31,		
	1999	1998	1997

Net Premiums Written:

Commercial.....	35.6%	38.2%	41.0%
Personal.....	64.4%	61.8%	59.0%

The commercial lines consist primarily of automobile, multi-peril and workers' compensation insurance. The personal lines consist primarily of automobile and homeowners insurance. These types of insurance are described in greater detail below:

Commercial

- o Commercial automobile -- policies that provide protection against liability for bodily injury and property damage arising from automobile accidents, and provide protection against loss from damage to automobiles owned by the insured.
- o Workers' compensation -- policies purchased by employers to provide benefits to employees for injuries sustained during employment. The extent of coverage is established by the workers' compensation laws of each state.
- o Commercial multi-peril -- policies that provide protection to businesses against many perils, usually combining liability and physical damage coverages.

Personal

- o Private passenger automobile -- policies that provide protection against liability for bodily injury and property damage arising from automobile accidents, and provide protection against loss from damage to automobiles owned by the insured.
- o Homeowners -- policies that provide coverage for damage to residences and their contents from a broad range of perils, including, fire, lightning, windstorm and theft. These policies also cover liability of the insured arising from injury to other persons or their property while on the insured's property and under other specified conditions.

The following table sets forth the combined ratios of DGI, prepared in accordance with generally accepted accounting principles and statutory accounting principles prescribed or permitted by state insurance authorities. The combined ratio is a traditional measure of underwriting profitability. When the combined ratio is under 100%, underwriting results are generally considered profitable. Conversely, when the combined ratio is over 100%, underwriting results are generally considered unprofitable. The combined ratio does not reflect investment income, federal income taxes or other non-operating income or expense. DGI's operating income depends on income from both underwriting operations and investments. DGI's combined ratio

	Year Ended December 31,		
	1999	1998	1997
	(dollars in thousands)		
Other	1,433	1,473	1,612
Total commercial	50,432	45,085	44,081
Personal:			
Automobile	60,716	46,609	38,989
Homeowners	25,573	21,737	19,939
Other	5,135	4,724	4,597
Total personal	91,424	73,070	63,525
Total business	\$141,856	\$118,155	\$107,606
Statutory Combined Ratios:			
Commercial:			
Automobile	113.8%	118.2%	89.9%
Workers' compensation	96.7	80.4	89.5
Commercial multi-peril	95.7	85.6	103.0
Other	80.6	71.1	57.7
Total commercial	100.0	91.3	93.5
Personal:			
Automobile	106.8	104.2	98.7
Homeowners	123.9	115.7	116.4
Other	87.1	91.2	87.6
Total personal	110.6	106.7	103.4
Total business	106.8%	100.8%	99.2%

Property and Casualty Underwriting

The underwriting department is responsible for the establishment of underwriting and risk selection guidelines and criteria for the various insurance products written by DGI. The underwriting department, in conjunction with the marketing representatives, works closely with DGI's independent agents to insure a comprehensive knowledge on the part of the agents of DGI's underwriting requirements and risk selection process.

DGI's underwriting and pricing strategy is designed to produce an underwriting profit resulting in a Company-wide combined ratio below 100%. DGI and the Mutual Company have a conservative underwriting philosophy, which, in the opinion of management, is one of the prime reasons for DGI's favorable loss ratios relative to the property and casualty insurance industry over the last five years, with the exception of 1999, when DGI's loss ratio was adversely impacted by restructuring charges.

The underwriting department has over time initiated risk inspection procedures and underwriting analyses on a per risk and class of business basis. It has also automated

underwriting processing utilizing technology such as bar coding. Management has established monitoring and auditing processes to verify compliance with underwriting requirements and procedures.

The underwriting department and the research and development department are responsible for the development of new insurance products and enhancements of existing products. Underwriting profitability is enhanced by the creation of niche products focused on classes of business which traditionally have provided underwriting profits.

Marketing

DGI's insurance products, together with the products of the Mutual Company and their respective subsidiaries, are marketed through approximately 3,300 independent insurance agents associated with approximately 1,200 insurance agencies. Business is written by either DGI or the Mutual Company depending upon geographic location, agency license and product. Management has developed an agency appointment procedure that focuses on appointing agencies with proven marketing strategies for the development of profitable business. DGI regularly evaluates its agency force and continues to strive to obtain and retain a significant position within each agency relative to the amount of business similar to that of DGI placed by the agency with other insurers. DGI and the Mutual Company have developed a successful contingent commission plan for agents under which additional commissions are payable based upon the volume of premiums produced and the profitability of the business of the agency written by DGI and the Mutual Company. Management believes the contingent commission program and the Company's Agency Stock Purchase Plan have enhanced the ability of DGI and the Mutual Company to write profitable business.

DGI has granted certain agents the authority to bind insurance within underwriting and pricing limits specified by DGI without the prior approval of DGI. However, DGI generally reviews all coverages placed by its agents and, subject to applicable insurance regulations, may cancel the coverage if it is inconsistent with DGI's guidelines.

DGI believes that its regional structure enables it to compete effectively with large national companies. This regional structure permits DGI to take advantage of its knowledge of local operating territories and the opportunity to form strong, long-term relationships with the agents that represent DGI and the Mutual Company.

DGI and the Mutual Company have developed comprehensive growth strategies for each of the commercial and personal lines of insurance business. DGI has focused on the small-to medium-sized commercial insurance markets, which have traditionally been a more stable and profitable segment of the property and casualty insurance business than the large commercial insurance markets, which have become increasingly competitive in the past several years. Commercial lines marketing is characterized by account selling, in which multiple lines of insurance are offered to a single policyholder.

DGI believes that competitive and comprehensive products targeted to selected classes of personal lines business, along with excellent service to agents and policyholders, provides a foundation for growth and profitability. As is customary in the industry, insureds are encouraged to place both their homeowners and personal automobile insurance with DGI or the Mutual Company and are offered a discount for doing so.

Claims

The claims department develops and implements policies and procedures for the establishment of claim reserves and the timely resolution and payment of claims. The management and staff of the claims department resolve policy coverage issues, manage and process reinsurance recoveries and handle salvage and subrogation matters.

Insurance claims are normally investigated and adjusted by internal claims adjusters and supervisory personnel. Independent adjusters are employed as needed to handle claims in territories in which the volume of claims is not sufficient to justify hiring internal claims adjusters. The litigation and personal injury sections manage all claims litigation, and all claims above \$25,000 require home office review and settlement authorization.

Field office staffs are supported by home office technical, litigation, material damage, subrogation and medical audit personnel who provide specialized claims support. An investigative unit attempts to prevent fraud and abuse and to control losses.

Liabilities for Losses and Loss Expenses

Liabilities for losses and loss expenses are estimates at a given point in time of what the insurer expects to pay to claimants, based on facts and circumstances then known, and it can be expected that the ultimate liability will exceed or be less than such estimates. Liabilities are based on estimates of future trends and claims severity, judicial theories of liability and other factors. However, during the loss adjustment period, additional facts regarding individual claims may become known, and consequently it often becomes necessary to refine and adjust the estimates of liability. Any adjustments are reflected in operating results in the year in which the changes are made.

DGI maintains liabilities for the eventual payment of losses and loss expenses with respect to both reported and unreported claims. Liabilities for loss expenses are intended to cover the ultimate costs of settling all losses, including investigation and litigation costs from such losses. The amount of liability for reported losses is primarily based upon a case-by-case evaluation of the type of risk involved and knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss. The amount of liability for unreported claims and loss expenses is determined on the basis of historical information by line of insurance. Inflation is implicitly provided for in the reserving function through analysis of costs, trends and reviews of historical reserving results. Liabilities are closely monitored and

are recomputed periodically by the Company and the Mutual Company using new information on reported claims and a variety of statistical techniques. Liabilities for losses are not discounted.

The establishment of appropriate liabilities is an inherently uncertain process, and there can be no assurance that the ultimate liability will not exceed DGI's loss and loss expense reserves and have an adverse effect on DGI's results of operations and financial condition. As is the case for virtually all property and casualty insurance companies, DGI has found it necessary in the past to revise estimated future liabilities for losses and loss expenses in non-material amounts, and further adjustments could be required in the future. However, on the basis of DGI's internal procedures, which analyze, among other things, DGI's experience with similar cases and historical trends such as reserving patterns, loss payments, pending levels of unpaid claims and product mix, as well as court decisions, economic conditions and public attitudes, management of DGI believes that adequate provision has been made for DGI's liability for losses and loss expenses.

Differences between liabilities reported in DGI's financial statements prepared on the basis of generally accepted accounting principles ("GAAP") and financial statements prepared on a statutory accounting basis result from reducing statutory liabilities for anticipated salvage and subrogation recoveries. These differences amounted to \$7,736,942, \$7,963,559 and \$6,155,467 at December 31, 1999, 1998 and 1997, respectively.

The following tables set forth a reconciliation of the beginning and ending net liability for unpaid losses and loss expenses for the periods indicated on a GAAP basis for the Company.

	Year Ended December 31,		
	1999	1998	1997
	(in thousands)		
Net liability for unpaid losses and loss expenses at beginning of year	\$ 93,863	\$ 77,474	\$ 75,428
Net liabilities of acquired company..	--	14,967	--
Net beginning balance as adjusted ...	\$ 93,863	\$ 92,441	\$ 75,428
Provision for net losses and loss expenses for claims incurred in the current year	99,659	75,463	69,040
Decrease in provision for estimated net losses and loss expenses for claims incurred in prior years	(454)	(2,296)	(1,384)
Total incurred	99,205	73,167	67,656
Net losses and loss payments for claims incurred during:			
The current year	58,906	44,389	39,133
Prior years	36,668	27,356	26,477
Total paid	95,574	71,745	65,610
Net liability for unpaid losses and loss expenses at end of year	\$ 97,494	\$ 93,863	\$ 77,474

The following table sets forth the development of the liability for net unpaid losses and loss expenses for DGI on a GAAP basis from 1989 to 1999, with supplemental loss data for 1999 and 1998.

"Net liability at end of year for unpaid losses and loss expenses" sets forth the estimated liability for net unpaid losses and loss expenses recorded at the balance sheet date for each of the indicated years. This liability represents the estimated amount of net losses and loss expenses for claims arising in the current and all prior years that are unpaid at the balance sheet date including losses incurred but not reported.

The "Liability reestimated as of" portion of the table shows the reestimated amount of the previously recorded liability based on experience for each succeeding year. The estimate is increased or decreased as payments are made and more information becomes known about

the severity of the remaining unpaid claims. For example, the 1990 liability has developed an excess after nine years, in that reestimated net losses and loss expenses are expected to be \$2.8 million less than the estimated liability initially established in 1990 of \$31.9 million.

The "Cumulative excess" shows the cumulative excess at December 31, 1999 of the liability estimate shown on the top line of the corresponding column. An excess in liability means that the liability established in prior years exceeded actual net losses and loss expenses or were reevaluated at less than the original amount. A deficiency in liability would mean that the liability established in prior years was less than actual net losses and loss expenses or were reevaluated at more than the original amount.

The "Cumulative amount of liability paid through" portion of the table shows the cumulative net losses and loss expense payments made in succeeding years for net losses incurred prior to the balance sheet date. For example, the 1990 column indicates that as of December 31, 1999 payments equal to \$28.9 million of the currently reestimated ultimate liability for net losses and loss expenses of \$29.1 million had been made.

	Year Ended December 31										
	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
	(in thousands)										
Net liability at end of year for unpaid losses and loss expenses.....	\$27,767	\$31,898	\$36,194	\$44,339	\$52,790	\$63,317	\$ 71,155	\$75,428	\$77,474	\$93,863	\$97,494
Net liability reestimated as of:...											
One year later.....	29,175	32,923	37,514	45,408	50,583	60,227	68,348	74,044	75,178	93,409	
Two years later.....	28,861	33,550	37,765	42,752	48,132	56,656	66,520	70,545	74,269		
Three years later....	28,545	32,803	35,446	40,693	44,956	54,571	63,187	68,788			
Four years later....	27,717	31,004	33,931	38,375	42,157	51,825	60,457				
Five years later....	26,759	30,041	32,907	37,096	41,050	50,493					
Six years later.....	26,180	29,595	32,234	36,682	40,572						
Seven years later...	25,971	29,417	31,976	36,730							
Eight years later....	25,828	29,175	31,685								
Nine years later....	25,904	29,058									
Ten years later.....	25,856										
Cumulative excess.....	\$(1,911)	\$(2,840)	\$(4,509)	\$(7,609)	\$(12,218)	\$(12,824)	\$(10,698)*	\$(6,640)	\$(3,205)	\$ (454)	
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====
Cumulative amount of liability paid through:											
One year later.....	\$11,401	\$13,003	\$13,519	\$16,579	\$16,126	\$19,401	\$23,479	\$26,477	\$27,356	\$36,668	
Two years later.....	17,421	19,795	20,942	24,546	25,393	30,354	37,078	40,384	46,143		
Three years later....	20,986	24,178	25,308	29,385	32,079	38,684	45,796	52,071			
Four years later....	23,268	26,413	27,826	32,925	36,726	43,655	51,771				
Five years later.....	24,331	27,439	29,605	34,757	39,122	46,331					
Six years later.....	24,909	28,157	30,719	35,739	40,440						
Seven years later....	25,280	28,627	31,173	36,518							
Eight years later....	25,599	28,841	31,412								
Nine years later.....	25,695	28,948									
Ten years later.....	25,753										

	Year Ended December 31							
	1992	1993	1994	1995	1996	1997	1998	1999
	(in thousands)							
Gross liability at end of year.....	\$57,777	\$70,093	\$88,484	\$98,894	\$114,622	\$118,112	\$141,409	\$149,979
Reinsurance recoverable.....	13,438	17,303	25,167	27,739	39,194	40,638	47,546	52,485
Net liability at end of year.....	44,339	52,790	63,317	71,155	75,428	77,474	93,863	97,494
Gross reestimated liability -- latest..	58,615	56,519	74,406	85,727	107,600	115,187	135,464	
Reestimated recoverable -- latest.....	21,885	15,947	23,913	25,270	38,812	40,918	42,055	
Net reestimated liability -- latest....	36,730	40,572	50,493	60,457	68,788	74,269	93,409	
Gross cumulative deficiency (excess)...	838	(13,574)	(14,078)	(13,167)	(7,022)	(2,925)	(5,945)	

Reinsurance

DGI and the Mutual Company use several different reinsurers, all of which have a Best rating of A- or better or, with respect to foreign reinsurers, have a financial condition which, in the opinion of management, is equivalent to a company with at least an A-rating.

The external reinsurance purchased by DGI and the Mutual Company includes "excess treaty reinsurance," under which losses are automatically reinsured over a set retention (\$250,000 for 1999), and "catastrophic reinsurance," under which the reinsured recovers 95% of an accumulation of many losses resulting from a single event, including natural disasters (for 1999, \$3,000,000 retention). DGI's principal reinsurance agreement in 1999, other than that with the Mutual Company, was an excess of loss treaty in which the reinsurers were Continental Casualty Company, Dorinco Reinsurance Company and Swiss Re America. Reinsurance is also purchased on an individual policy basis to reinsure losses that may occur from large risks, specific risk types or specific locations. The amount of coverage provided under each of these types of reinsurance depends upon the amount, nature, size and location of the risk being reinsured. For property insurance, excess of loss treaties provide for coverage up to \$1,000,000. For liability insurance, excess of loss treaties provide for coverage up to \$30,000,000. Property catastrophe contracts provide coverage up to \$70,000,000 resulting from one event. On both property and casualty insurance, DGI and the Mutual Company purchase facultative reinsurance to cover exposures from losses that exceed the limits provided by their respective treaty reinsurance. Atlantic States cedes to the Mutual Company all of its insurance business and assumes from the Mutual Company 65% of the Mutual Company's total pooled insurance business, including that assumed from Atlantic States and substantially all of the business assumed and retained by the Mutual Company from Southern and Delaware Atlantic. Atlantic States, Southern, Delaware Atlantic, Pioneer and Southern Heritage each have a catastrophe reinsurance agreement with the Mutual Company which limits the maximum liability under any one catastrophic occurrence to \$400,000, \$300,000, \$300,000, \$200,000 and \$400,000, respectively, and \$700,000 for a catastrophe involving more than one of the companies. The Mutual Company and Delaware Atlantic have an excess of loss reinsurance agreement in which the Mutual Company assumes up to \$200,000 of losses in excess of \$50,000 and a workers' compensation quota share agreement whereby Delaware Atlantic cedes 70% of that business. The Mutual Company and Pioneer have an excess of loss reinsurance agreement in which the Mutual Company assumes up to \$200,000 of losses in excess of \$50,000. The Mutual Company and Southern have an excess of loss reinsurance agreement in which the Mutual Company assumes up to \$25,000 of losses in excess of \$100,000 and a quota share agreement whereby Southern cedes 50% of its direct business less certain reinsurance to the Mutual Company. Southern, Delaware Atlantic, Pioneer and Southern Heritage each have retrocessional reinsurance agreements with the Mutual Company, under which they cede, and then assume back, 100% of their business net of other reinsurance.

Competition

The property and casualty insurance industry is highly competitive on the basis of both price and service. There are numerous companies competing for this business in the geographic areas where the Company operates, many of which are substantially larger and have greater financial resources than DGI, and no single company dominates. In addition, because the insurance products of DGI and the Mutual Company are marketed exclusively through independent insurance agencies, most of which represent more than one company, DGI faces competition to retain qualified independent agencies, as well as competition within agencies.

Investments

DGI's return on invested assets is an important element of its financial results. Currently, the investment objective is to maintain a widely diversified fixed maturities portfolio structured to maximize after-tax investment income while minimizing credit risk through investments in high quality instruments. At December 31, 1999, all debt securities were rated investment grade with the exception of three unrated obligations of \$878,000, and the investment portfolio did not contain any mortgage loans or any non-performing assets.

The following table shows the composition of the debt securities investment portfolio (at carrying value), excluding short-term investments, by rating as of December 31, 1999:

Rating(1)	December 31, 1999	
	Amount	Percent
	(dollars in thousands)	
U.S. Treasury and U.S. agency securities(2).....	\$111,574	47.3%
Aaa or AAA.....	66,696	28.2
Aa or AA.....	34,550	14.6
A.....	22,275	9.4
BBB.....	245	0.1
Not rated(3).....	878	0.4
Total.....	\$236,218	100%

-
- (1) Ratings assigned by Moody's Investors Services, Inc. or Standard & Poor's Corporation.
 - (2) Includes mortgage-backed securities of \$18.7 million.
 - (3) Represents one unrated obligation of The Lancaster County Hospital Authority Mennonite Home Project, one unrated obligation of Lakewood, Colorado and one unrated obligation of the Indianapolis, Indiana Economic Development Authority, all of which management of DGI believes to be equivalent to investment grade securities with respect to repayment risk.

DGI invests in both taxable and tax-exempt securities as part of its strategy to maximize after-tax income. Such strategy considers, among other factors, the alternative minimum tax. Tax-exempt securities made up approximately 37.3%, 34.1% and 34.3% of the total investment portfolio at December 31, 1999, 1998 and 1997, respectively.

The following table shows the classification of the investments (at carrying value) of DGI and its subsidiaries at December 31, 1999, 1998 and 1997.

	December 31,					
	1999		1998		1997	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(dollars in thousands)					
Fixed maturities(1):						
Held to maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 36,861	14.1%	\$ 32,891	12.9%	\$ 41,450	20.2%
Canadian government obligation	498	0.2	--	--	--	--
Obligations of states and political subdivisions	67,824	25.9	66,941	26.2	57,621	28.1
Corporate securities	15,819	6.1	9,131	3.6	7,250	3.5
Mortgage-backed securities	15,172	5.8	18,221	7.1	10,925	5.4
Total held to maturity	136,174	52.1	127,184	49.8	117,246	57.2
Available for sale:						
U.S. treasury securities and obligations of U.S. government corporations and agencies	61,205	23.4	55,439	21.8	40,197	19.6
Obligations of states and political subdivisions	20,223	7.7	19,957	7.8	12,762	6.2
Corporate securities	15,053	5.8	10,787	4.2	3,252	1.6
Mortgage-backed securities	3,563	1.4	4,342	1.7	1,520	0.8
Total available for sale	100,044	38.3	90,525	35.5	57,731	28.2
Total fixed maturities	236,218	90.4	217,709	85.3	174,977	85.4
Equity securities(2)	9,229	3.5	6,764	2.7	7,275	3.5
Short-term investments(3)	15,995	6.1	30,522	12.0	22,713	11.1
Total investments	\$261,442	100.0%	\$254,995	100.0%	\$204,965	100.0%
	=====	=====	=====	=====	=====	=====

-
- (1) Based on stated maturity dates with no prepayment assumptions. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

As shown above, the Company held investments in mortgage-backed securities having a carrying value of \$18.7 million at December 31, 1999. Included in these investments are collateralized mortgage obligations ("CMOs") with a carrying value of \$18.6 million at December 31, 1999. The Company has attempted to reduce the prepayment risks associated with mortgage-backed securities by investing approximately 99%, as of December 31, 1999, of the Company's holdings of CMOs in planned amortization and very accurately defined tranches. Such investments are designed to alleviate the risk of prepayment by providing predictable principal prepayment schedules within a designated range of prepayments. If principal is repaid earlier than originally anticipated, investment yields may decrease due to reinvestment of the proceeds at current interest rates (which may be lower) and capital gains or losses may be realized since the book value of securities purchased at premiums or discounts may be different from the prepayment amount.

Investment results of DGI and its subsidiaries for the years ended December 31, 1999, 1998 and 1997 are shown in the following table:

	Year Ended December 31,		
	1999	1998	1997

	(dollars in thousands)		
Invested assets(1)	\$264,293	\$208,304	\$202,283
Investment income(2)	13,224	11,998	11,507
Average yield	5.0%	5.6%	5.7%

-
- (1) Average of the aggregate invested amounts at the beginning and end of the period, including cash.
- (2) Investment income is net of investment expenses and does not include realized investment gains or losses or provision for income taxes.

A.M. Best Rating

In 1999, the A.M. Best rating of the Mutual Company, Atlantic States, Southern, Delaware Atlantic and Pioneer was "A", based upon their respective current financial conditions and historical statutory results of operations. Southern Heritage, which DGI acquired in November 1998, currently has a Best rating of B++. Management believes that this Best rating is an important factor in marketing DGI's products to its agents and customers. Best's ratings are industry ratings based on a comparative analysis of the financial condition and operating performance of insurance companies as determined by their publicly available reports. Best's classifications are A++ and A+ (Superior), A and A- (Excellent), B++ and B+ (Very Good), B and B- (Good), C++ and C+ (Fair), C and C- (Marginal), D (below minimum standards) and E and F (Liquidation). Best's ratings are based upon factors relevant to policyholders and are not directed toward the protection of investors. According to Best, an "excellent" rating is assigned

to those companies which, in Best's opinion, have achieved excellent overall performance when compared to the norms of the property and casualty insurance industry and have generally demonstrated a strong ability to meet policyholder and other contractual obligations.

Regulation

Insurance companies are subject to supervision and regulation in the states in which they transact business. Such supervision and regulation relates to numerous aspects of an insurance company's business and financial condition. The primary purpose of such supervision and regulation is the protection of policyholders. The extent of such regulation varies, but generally derives from state statutes which delegate regulatory, supervisory and administrative authority to state insurance departments. Accordingly, the authority of the state insurance departments includes the establishment of standards of solvency that must be met and maintained by insurers, the licensing to do business of insurers and agents, the nature of and limitations on investments, premium rates for property and casualty insurance, the provisions which insurers must make for current losses and future liabilities, the deposit of securities for the benefit of policyholders, the approval of policy forms, notice requirements for the cancellation of policies and the approval of certain changes in control. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to the financial condition of insurance companies.

In addition to state-imposed insurance laws and regulations, in December 1993 the National Association of Insurance Commissioners (the "NAIC") adopted a risk-based capital system for assessing the adequacy of statutory capital and surplus which augments the states' current fixed dollar minimum capital requirements for insurance companies. At December 31, 1999, DGI's insurance subsidiaries and the Mutual Company each exceeded the required levels of capital. There can be no assurance that the capital requirements applicable to DGI's insurance subsidiaries will not increase in the future.

The states in which Atlantic States (Pennsylvania, Maryland and Delaware), the Mutual Company (Pennsylvania, Ohio, Maryland, New York, Virginia, Delaware and North Carolina), Southern (Virginia and Pennsylvania), Delaware Atlantic (Delaware, Maryland and Pennsylvania), Pioneer (Ohio and Pennsylvania) and Southern Heritage (Alabama, Arkansas, Florida, Georgia, Illinois, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee and Virginia) do business have guaranty fund laws under which insurers doing business in such states can be assessed on the basis of premiums written by the insurer in that state in order to fund policyholder liabilities of insolvent insurance companies. Under these laws in general, an insurer is subject to assessment, depending upon its market share of a given line of business, to assist in the payment of policyholder claims against insolvent insurers. The Mutual Company, Atlantic States, Southern, Delaware Atlantic, Pioneer and Southern Heritage have made accruals for their portion of assessments related to such insolvencies based upon the most current information furnished by the guaranty associations. During 1998 and 1999, the Company received assessments totalling \$1.3 million and \$726,000, respectively, from the Pennsylvania Insurance Guaranty Association relating to the insolvency of two medical malpractice insurers. The impact of these involuntary programs on DGI was not material during 1997.

Most states have enacted legislation that regulates insurance holding company systems. Each insurance company in the holding company system is required to register with the insurance supervisory agency of its state of domicile and furnish information concerning the

operations of companies within the holding company system that may materially affect the operations, management or financial condition of the insurers within the system. Pursuant to these laws, the respective insurance departments may examine the Mutual Company, the Company and their respective insurance subsidiaries at any time, require disclosure of material transactions by the holding company and require prior notice or prior approval of certain transactions, such as "extraordinary dividends" from the insurance subsidiaries to the holding company.

All transactions within the holding company system affecting the Mutual Company and the Company's insurance subsidiaries must be fair and equitable. Approval of the applicable insurance commissioner is required prior to consummation of transactions affecting the control of an insurer. In some states, including Pennsylvania, the acquisition of 10% or more of the outstanding capital stock of an insurer or its holding company is presumed to be a change in control. Pursuant to an order issued in October 1998, the Pennsylvania Insurance Department has approved the Mutual Company's ownership of up to 65% of the outstanding Common Stock of DGI. These laws also require notice to the applicable insurance commissioner of certain material transactions between an insurer and any person in its holding company system and, in some states, certain of such transactions cannot be consummated without the prior approval of the applicable insurance commissioner.

The Company's insurance subsidiaries are restricted by the insurance laws of their respective states of domicile as to the amount of dividends or other distributions they may pay to the Company without the prior approval of the respective state regulatory authorities. Generally, the maximum amount that may be paid by an insurance subsidiary during any year after notice to, but without prior approval of, the insurance commissioners of these states is limited to a stated percentage of that subsidiary's statutory capital and surplus as of a certain date, or the net income or net investment income not including realized capital gains of the subsidiary for the preceding year. As of December 31, 1999, amounts available for payment of dividends in 2000 without the prior approval of the various insurance commissioners were \$6,851,802 from Atlantic States, \$184,285 from Southern, \$956,381 from Delaware Atlantic, \$567,793 from Pioneer and \$1,650,842 from Southern Heritage. See Note 12 to the Consolidated Financial Statements incorporated by reference herein.

The NAIC has adopted the Codification of Statutory Accounting Principles with an effective date of January 1, 2001. The codified principles are intended to provide a basis of accounting recognized and adhered to in the absence of conflict with, or silence of, state statutes and regulations. Various state laws and regulations of the Company's insurance subsidiaries' respective states of domicile may need to be amended for the codified principles to become effective. The effect of the codified principles on the statutory financial statements of the Company's insurance subsidiaries has not yet been determined.

The Mutual Company

The Mutual Company, which was organized in 1889, has a Best rating of A (Excellent). At December 31, 1999, the Mutual Company had admitted assets of \$148,080,589 and policyholders' surplus of \$61,409,896. At December 31, 1999, the Mutual Company had no debt and, of its total liabilities of \$86,670,693, reserves for net losses and loss expenses accounted for \$47,087,250 and unearned premiums accounted for \$24,921,293. Of the Mutual Company's investment portfolio of \$101,491,262 at December 31, 1999, investment-grade bonds accounted

for \$38,581,727, cash and short-term investments accounted for \$(546,117) and mortgages accounted for \$9,276,319. At December 31, 1999, the Mutual Company owned 5,252,326 shares of the Company's Common Stock, which were carried on the Mutual Company's books at \$43,909,448. The foregoing financial information is presented on the statutory basis of accounting.

Employees

As of December 31, 1999, the Mutual Company had 376 employees. The Mutual Company's employees provide a variety of services to DGI, Atlantic States, Delaware Atlantic, Southern and Pioneer, as well as to the Mutual Company and its subsidiaries. As of December 31, 1999, Southern Heritage had 27 employees.

Item 2. Properties.

DGI and Delaware Atlantic share headquarters with the Mutual Company's headquarters in a building owned by the Mutual Company. The Mutual Company charges DGI for an appropriate portion of the building expenses under an intercompany allocation agreement which is consistent with the terms of the pooling agreement. The headquarters of the Mutual Company has approximately 163,500 square feet of office space. Southern has a facility of approximately 10,000 square feet in Glen Allen, Virginia, which it owns. Pioneer has a facility of approximately 10,000 square feet in Greenville, Ohio, which it owns. Southern Heritage has a facility of approximately 14,000 square feet in Duluth, Georgia, which it leases.

Item 3. Legal Proceedings.

DGI is a party to numerous lawsuits arising in the ordinary course of its insurance business. DGI believes that the resolution of these lawsuits will not have a material adverse effect on its financial condition or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders.

No matter was submitted to a vote of holders of the Company's Common Stock during the fourth quarter of 1999.

Executive Officers of the Company

Name	Age	Position
Donald H. Nikolaus	57	President and Chief Executive Officer since 1981
Ralph G. Spontak	47	Senior Vice President since 1991; Chief Financial Officer and Vice President since 1983; Secretary since 1988
Cyril J. Greenya	55	Senior Vice President - Commercial Underwriting since 1997; Vice President - Commercial Underwriting for five years prior thereto; Manager - Commercial Underwriting for nine years prior thereto

Frank J. Wood	66	Senior Vice President - Marketing since 1997; Vice President - Marketing for nine years prior thereto; Manager - Marketing for one year prior thereto
James B. Price	64	Senior Vice President - Claims since 1997; Vice President - Claims for 25 years prior thereto
Robert G. Shenk	47	Senior Vice President - Claims since 1997; Vice President - Claims for five years prior thereto
William H. Shupert	73	Senior Vice President - Underwriting since 1991; Vice President - Underwriting for 18 years prior thereto
Daniel J. Wagner	39	Treasurer since 1993; Controller for five years prior thereto

PART II

Item 5. Market for the Registrant's Common Equity and Related

Stockholder Matters.

The response to this Item is incorporated in part by reference to page 31 of the Company's Annual Report to Stockholders for the year ended December 31, 1999, which is included as Exhibit (13) to this Form 10-K Report. As of March 15, 2000, the Company had approximately 622 holders of record of its Common Stock. The Company declared dividends of \$.36 per share in 1999 and \$.3375 per share in 1998.

Item 6. Selected Financial Data.

The response to this Item is incorporated by reference to page 29 of the Company's Annual Report to Stockholders for the year ended December 31, 1999, which is included as Exhibit (13) to this Form 10-K Report.

Item 7. Management's Discussion and Analysis of Financial

Condition and Results of Operations.

The response to this Item is incorporated by reference to pages 10 through 12 of the Company's Annual Report to Stockholders for the year ended December 31, 1999, which is included as Exhibit (13) to this Form 10-K Report.

Item 8. Financial Statements and Supplementary Data.

The response to this Item is incorporated by reference to pages 13 through 28 of the Company's Annual Report to Stockholders for the year ended December 31, 1999, which is included as Exhibit (13) to this Form 10-K Report.

Item 9. Changes in and Disagreements with Accountants on

Accounting and Financial Disclosure.

None.

PART III

Item 10. Directors and Executive Officers of the Registrant.

The response to this Item with respect to the Company's directors is incorporated by reference to pages 8 through 10 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 20, 2000. The response to this Item with respect to the Company's executive officers is incorporated by reference to Part I of this Form 10-K Report.

Item 11. Executive Compensation.

The response to this Item is incorporated by reference to pages 11 through 14 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 20, 2000, except for the Compensation Committee Report and the Performance Graph, which are not incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The response to this Item is incorporated by reference to pages 3 through 5 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 20, 2000.

Item 13. Certain Relationships and Related Transactions.

The response to this Item is incorporated by reference to pages 3 through 7 and page 16 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 20, 2000.

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a) Financial statements, financial statement schedules and exhibits filed:

(1) Consolidated Financial Statements

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Report of Independent Auditors.....	28
Donegal Group Inc. and Subsidiaries:	
Consolidated Balance Sheets as of December 31, 1999 and 1998.....	13
Consolidated Statements of Income for the three years ended December 31, 1999, 1998 and 1997	14
Consolidated Statements of Stockholders' Equity for the three years ended December 31, 1999, 1998 and 1997.....	15
Consolidated Statements of Cash Flows for the three years ended December 31, 1999, 1998 and 1997.....	16
Notes to Consolidated Financial Statements.....	17-28

(2) Financial Statement Schedules

	Page

Donegal Group Inc. and Subsidiaries:	
Independent Auditors' Consent and Report on Schedules.....	Exhibit 23
Schedule I. Summary of Investments - Other than Investments in Related Parties.....	33
Schedule II. Condensed Financial Information of Parent Company.....	34
Schedule III. Supplementary Insurance Information.....	37
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Schedule VI. Supplemental Insurance Information Concerning Property and Casualty Subsidiaries...	40

All other schedules have been omitted since they are not required, not applicable or the information is included in the financial statements or notes thereto.

 * Refers to the respective page of Donegal Group Inc.'s 1999 Annual Report to Stockholders. The Consolidated Financial Statements and Notes to Consolidated Financial Statements and Auditor's Report thereon on pages 13 through 28 are incorporated herein by reference. With the exception of the portions of such Annual Report specifically incorporated by reference in this Item and Items 5, 6, 7 and 8 hereof, such Annual Report shall not be deemed filed as part of this Form 10-K Report or otherwise subject to the liabilities of Section 18 of the Securities Exchange Act of 1934.

(3) Exhibits

Exhibit No. -----	Description of Exhibits -----	Reference -----
(3)(i)	Certificate of Incorporation of Registrant, as amended	filed herewith
(3)(ii)	Amended and Restated By-laws of Registrant	(a)
(4)	Form of Registrant's Common Stock Certificate	(b)
Management Contracts and Compensatory Plans or Arrangements -----		
(10)(A)	Donegal Mutual Insurance Company Money Purchase Pension Plan and Trust dated March 12, 1985	(b)
(10)(B)	Donegal Mutual Insurance Company Profit Sharing Plan and Trust dated March 12, 1985	(b)
(10)(C)	Donegal Group Inc. Key Executive Incentive Bonus Plan dated September 29, 1986	(e)
(10)(D)	Donegal Group Inc. Employee Stock Purchase Plan, as amended	(e)
(10)(E)	Donegal Group Inc. Equity Incentive Plan, as amended	(e)
(10)(F)	Donegal Group Inc. Agency Stock Purchase Plan	(1)
(10)(G)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan	(d)

- (10)(H) Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan for Directors (k)
- (10)(I) Donegal Group Inc. Executive Restoration Plan (c)
- (10)(J) Donegal Mutual Insurance Company 401(k) Plan filed herewith
- (10)(K) Amendment No. 1 effective January 1, 2000 to Donegal Mutual Insurance Company 401(k) Plan filed herewith

Other Material Contracts

- (10)(L) Tax Sharing Agreement dated September 29, 1986 between Donegal Group Inc. and Atlantic States Insurance Company (b)
- (10)(M) Services Allocation Agreement dated September 29, 1986 between Donegal Mutual Insurance Company, Donegal Group Inc. and Atlantic States Insurance Company (b)
- (10)(N) Proportional Reinsurance Agreement dated September 29, 1986 between Donegal Mutual Insurance Company and Atlantic States Insurance Company (b)
- (10)(O) Amendment dated October 1, 1988 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company (f)
- (10)(P) Multi-Line Excess of Loss Reinsurance Agreement effective January 1, 1993 between Donegal Mutual Insurance Company, Southern Insurance Company of Virginia, Atlantic States Insurance Company and Pioneer Mutual Insurance Company, and Christiana General Insurance Corporation of New York, Cologne Reinsurance Company of America, Continental Casualty Company, Employers Reinsurance Corporation and Munich American Reinsurance Company (h)

- (10)(Q) Amendment dated July 16, 1992 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company (g)
- (10)(R) Amendment dated as of December 21, 1995 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company (i)
- (10)(S) Stock Purchase Agreement dated as of December 21, 1995 between Donegal Mutual Insurance Company and Donegal Group Inc. (i)
- (10)(T) Donegal Group Inc. 1996 Employee Stock Purchase Plan (j)
- (10)(U) Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Pioneer Insurance Company (c)
- (10)(V) Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Delaware American Insurance Company (c)
- (10)(W) Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Southern Insurance Company of Virginia (c)
- (10)(X) Reinsurance and Retrocession Agreement effective January 1, 2000 between Donegal Mutual Insurance Company and Southern Heritage Insurance Company filed herewith
- (10)(Y) Property Catastrophe Excess of Loss Reinsurance Agreement effective January 1, 2000 between Donegal Mutual Insurance Company and Southern Heritage Insurance Company filed herewith
- (10)(Z) Stock Purchase Agreement dated as of May 14, 1998 between Donegal Group Inc. and Southern Heritage Limited Partnership (m)

- | | | |
|----------|---|----------------|
| (10)(AA) | Amendment dated November 17, 1998 to Stock Purchase Agreement dated as of May 14, 1998 between Donegal Group Inc. and Southern Heritage Limited Partnership | (m) |
| (10)(BB) | Amended and Restated Credit Agreement dated as of July 27, 1998 among Donegal Group Inc., the banks and other financial institutions from time to time party thereto and Fleet National Bank, as Agent | (m) |
| (10)(CC) | First Amendment and Waiver to the Amended and Restated Credit Agreement dated as of December 31, 1999 | filed herewith |
| (13) | 1999 Annual Report to Stockholders (electronic filing contains only those portions incorporated by reference into this Form 10-K report) | filed herewith |
| (20) | Proxy Statement relating to the Annual Meeting of Stockholders to be held on April 20, 2000, provided, however, that the Compensation Committee Report and the Performance Graph shall not be deemed filed as part of this Form 10-K Report | (n) |
| (21) | Subsidiaries of Registrant | filed herewith |
| (23) | Consent of Independent Auditors | filed herewith |
| (27) | Financial Data Schedule | filed herewith |

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- (a) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-Q Report for the quarter ended September 30, 1998.
 - (b) Such exhibit is hereby incorporated by reference to the like-described exhibits in Registrant's Form S-1 Registration Statement No. 33-8533 declared effective October 29, 1986.
 - (c) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1996.
 - (d) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1998.

- (e) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1986.
- (f) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1988.
- (g) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1992.
- (h) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 33-67346 declared effective September 29, 1993.
- (i) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated December 21, 1995.
- (j) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-8 Registration Statement No. 333-1287 filed February 29, 1996.
- (k) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1997.
- (l) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 333-06787 declared effective August 1, 1996.
- (m) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated November 17, 1998.
- (n) Such exhibit is hereby incorporated by reference to the Registrant's definitive proxy statement filed March 24, 2000.

(b) Reports on Form 8-K:

None.

DONEGAL GROUP INC. AND SUBSIDIARIES
SCHEDULE I - SUMMARY OF INVESTMENTS
OTHER THAN INVESTMENTS IN RELATED PARTIES

(\$ in thousands)

December 31, 1999

	Cost	Fair Value	Amount at Which Shown in the Balance Sheet
	-----	-----	-----
Fixed Maturities:			
Held to maturity:			
United States government and governmental agencies and authorities including obligations of states and political subdivisions	\$104,684	\$103,312	\$104,684
Canadian government obligation	498	490	498
All other corporate bonds	15,819	15,253	15,819
Mortgage-backed securities	15,173	14,941	15,173
Total fixed maturities held to maturity	----- 136,174	----- 133,996	----- 136,174
Available for sale:			
United States government and governmental agencies and authorities including obligations of states and political subdivisions	84,171	81,428	81,428
All other corporate bonds	15,472	15,053	15,053
Mortgage-backed securities	3,777	3,563	3,563
Total fixed maturities available for sale	----- 103,420	----- 100,044	----- 100,044
Total fixed maturities	----- 239,594	----- 234,040	----- 236,218
Equity Securities:			
Preferred stocks			
Public utilities	125	115	115
Banks	3,959	3,413	3,413
Industrial and miscellaneous	1,488	1,302	1,302
Total preferred stocks	----- 5,572	----- 4,830	----- 4,830
Common stocks			
Public utilities	131	63	63
Banks and insurance companies	733	1,271	1,271
Industrial and miscellaneous	2,608	3,065	3,065
Total common stocks	----- 3,472	----- 4,399	----- 4,399
Total equity securities	----- 9,044	----- 9,229	----- 9,229
Short-term investments	15,995	15,995	15,995
Total investments	----- \$264,633 =====	----- \$259,264 =====	----- \$261,442 =====

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE II - CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY

Condensed Balance Sheets
(\$ in thousands)

December 31, 1999 and 1998

ASSETS	1999	1998
	-----	-----
Investment in subsidiaries (equity method)	\$ 138,702	\$ 134,441
Cash	371	599
Property and equipment	2,232	2,276
Other	750	2,124
	-----	-----
Total assets	\$ 142,055	\$ 139,440
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	1999	1998
	-----	-----
Cash dividends declared to stockholders	\$ 761	\$ 708
Line of credit	37,000	37,500
Other	879	601
	-----	-----
Total liabilities	38,640	38,809
	=====	=====
Stockholders' equity		
Preferred stock, \$1.00 par value, authorized 2,000,000 shares, none issued	--	--
Common stock, \$1.00 par value, authorized 20,000,000 shares, issued 8,574,210 and 8,325,221 shares and outstanding 8,451,922 and 8,202,933 shares	8,574	8,325
Class A Common Stock, \$1.00 par value, authorized 15,000,000 shares, none issued	--	--
Additional paid-in capital	43,537	41,271
Accumulated other comprehensive income (loss)	(2,074)	1,316
Retained earnings, including equity in undistributed net income of subsidiaries (72,539 and 64,922)	54,270	50,611
Treasury stock, at cost	(892)	(892)
	-----	-----
Total stockholders' equity	103,415	100,631
	-----	-----
Total liabilities and stockholders' equity	\$ 142,055	\$ 139,440
	=====	=====

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE II - CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY

(Continued)

Condensed Statements of Income
(\$ in thousands)

Years ended December 31, 1999, 1998 and 1997

	1999	1998	1997
	-----	-----	-----
Revenues			
Dividends-subsiary	\$ 820	\$ 1,000	\$ 950
Lease income	819	754	643
Investment income	46	22	15
Total revenues	----- 1,685	----- 1,776	----- 1,608
Expenses			
Operating expenses	938	718	643
Interest	2,463	1,293	1,022
Total expenses	----- 3,401	----- 2,011	----- 1,665
Loss before income tax benefit and equity in undistributed net income of subsidiaries	(1,716)	(235)	(57)
Income tax benefit	(807)	(413)	(346)
Income (loss) before equity in undistributed net income of subsidiaries	----- (909)	----- 178	----- 289
Equity in undistributed net income of subsidiaries	7,566	8,840	10,352
Net income	----- \$ 6,657 =====	----- \$ 9,018 =====	----- \$ 10,641 =====

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE II - CONDENSED INFORMATION OF PARENT COMPANY

Condensed Statements of Cash Flows
(\$ in thousands)

Years ended December 31, 1999, 1998 and 1997

	1999	1998	1997
	-----	-----	-----
Cash flows from operating activities:			
Net income	\$ 6,657	\$ 9,018	\$ 10,641
	-----	-----	-----
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiaries	(7,566)	(8,840)	(10,352)
Other	2,365	(921)	382
	-----	-----	-----
Net adjustments	(5,201)	(9,761)	(9,970)
	-----	-----	-----
Net cash provided by (used in) operating activities	1,456	(743)	671
	-----	-----	-----
Cash flows from investing activities:			
Net purchase of property and equipment	(426)	(564)	(1,251)
Capital contribution to subsidiaries	--	(2,000)	--
Sale of subsidiary	100	--	--
Acquisition of Southern Heritage	--	(18,028)	--
Other	(426)	(5,613)	4
	-----	-----	-----
Net cash used in investing activities	(752)	(26,205)	(1,247)
	-----	-----	-----
Cash flows from financing activities:			
Cash dividends paid	(2,946)	(2,664)	(2,252)
Issuance of common stock	2,514	1,481	1,131
Line of credit, net	(500)	27,000	2,000
	-----	-----	-----
Net cash provided by (used in) financing activities	(932)	26,817	879
	-----	-----	-----
Net change in cash	(228)	(131)	303
Cash beginning	599	730	427
	-----	-----	-----
Cash ending	\$ 371	\$ 599	\$ 730
	=====	=====	=====

DONEGAL GROUP INC. AND SUBSIDIARIES
SCHEDULE III - SUPPLEMENTARY INSURANCE INFORMATION

(\$ in thousands)

Years Ended December 31, 1999, 1998 and 1997

Segment	Net Earned Premiums	Net Investment Income	Net Losses and Loss Expenses	Amortization of Deferred Policy Acquisition Costs	Other Underwriting Expenses	Net Premiums Written
	-----	-----	-----	-----	-----	-----
Year Ended December 31, 1999						

Personal Lines	\$ 96,167	\$ --	\$67,582	\$16,448	\$ 19,801	\$ 91,424
Commercial Lines	47,707	--	31,623	8,160	8,234	50,432
Investments	--	13,224	--	--	--	--
	-----	-----	-----	-----	-----	-----
	\$143,874	\$13,224	\$99,205	\$24,608	\$ 28,035	\$141,856
	=====	=====	=====	=====	=====	=====
Year Ended December 31, 1998						

Personal Lines	\$ 71,676	\$ --	\$49,141	\$12,614	\$ 14,052	\$ 73,070
Commercial Lines	44,493	--	24,026	6,876	7,660	45,084
Investments	--	11,998	--	--	--	--
	-----	-----	-----	-----	-----	-----
	\$116,169	\$11,998	\$73,167	\$19,490	\$ 21,712	\$118,154
	=====	=====	=====	=====	=====	=====
Year Ended December 31, 1997						

Personal Lines	\$ 61,600	\$ --	\$41,074	\$11,578	\$ 10,564	\$ 63,525
Commercial Lines	45,702	--	26,583	7,118	6,495	44,081
Investments	--	11,507	--	--	--	--
	-----	-----	-----	-----	-----	-----
	\$107,302	\$11,507	\$67,657	\$18,696	\$ 17,059	\$107,606
	=====	=====	=====	=====	=====	=====

(continued)

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE III - SUPPLEMENTARY INSURANCE INFORMATION, CONTINUED

 (\$ in thousands)

Segment	At December 31,			
	Deferred Policy Acquisition Costs	Liability for Losses and Loss Expenses	Unearned Premiums	Other Policy Claims and Benefits Payable
1999				

Personal Lines	\$ 6,936	\$ 79,085	\$60,886	\$ --
Commercial Lines	4,267	70,894	36,771	--
Investments	--	--	--	--
	-----	-----	-----	-----
	\$ 11,203	\$149,979	\$97,657	\$ --
	=====	=====	=====	=====
1998				

Personal Lines	\$ 7,648	\$ 77,482	\$63,916	\$ --
Commercial Lines	3,686	63,927	30,807	--
Investments	--	--	--	--
	-----	-----	-----	-----
	\$ 11,334	\$141,409	\$94,723	\$ --
	=====	=====	=====	=====

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE IV - REINSURANCE

	Gross Amount	Ceded to Other Companies	Assumed from Other Companies	Net Amount	Percentage Assumed to Net
	-----	-----	-----	-----	-----
Year Ended December 31, 1999					

Property and casualty premiums	\$91,996,926	\$67,487,819	\$119,364,863	\$143,873,970	83%
	=====	=====	=====	=====	===
Year Ended December 31, 1998					

Property and casualty premiums	\$61,173,134	\$56,338,098	\$111,333,956	\$116,168,992	96%
	=====	=====	=====	=====	===
Year Ended December 31, 1997					

Property and casualty premiums	\$51,753,477	\$51,753,477	\$107,302,168	\$107,302,168	100%
	=====	=====	=====	=====	===

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE VI - SUPPLEMENTARY INSURANCE INFORMATION
 CONCERNING PROPERTY AND CASUALTY SUBSIDIARIES

	Deferred Policy Acquisition Costs	Liability for Losses and Loss Expenses	Discount, if any, Deducted from Reserves	Unearned Premiums
	-----	-----	-----	-----
At December 31,				
1999	\$11,203,302 =====	\$149,979,141 =====	\$ --- =====	\$97,657,020 =====
1998	\$11,334,301 =====	\$141,409,008 =====	\$ --- =====	\$94,722,785 =====

(continued)

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE VI - SUPPLEMENTARY INSURANCE INFORMATION
 CONCERNING PROPERTY AND CASUALTY SUBSIDIARIES, CONTINUED

Years ended December 31, 1999, 1998 and 1997

	Net Earned Premiums	Investment Income	Losses and Loss Expenses Related to		Amortization of Deferred Policy Acquisition Costs	Net Paid Losses and Loss Expenses	Net Premiums Written
			Current Year	Prior Years			
Year Ended December 31, 1999	\$143,873,970	\$13,223,537	\$99,659,002	\$ (454,000)	\$24,608,000	\$95,574,426	\$141,856,479
Year Ended December 31, 1998	\$116,168,992	\$11,997,661	\$75,463,085	\$(2,296,000)	\$19,490,000	\$71,744,736	\$118,153,817
Year Ended December 31, 1997	\$107,302,168	\$11,492,012	\$69,040,518	\$(1,384,000)	\$18,696,000	\$65,610,249	\$107,604,989

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DONEGAL GROUP INC.

Date: March 29, 2000

By: /s/ Donald H. Nikolaus

Donald H. Nikolaus, President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Signature -----	Title -----	Date ----
/s/ Donald H. Nikolaus ----- Donald H. Nikolaus	President and a Director (principal executive officer)	March 29, 2000
/s/ Ralph G. Spontak ----- Ralph G. Spontak	Senior Vice President and Secretary (principal financial and accounting officer)	March 29, 2000
/s/ Robert S. Bolinger ----- Robert S. Bolinger	Director	March 29, 2000
----- Thomas J. Finley	Director	March __, 2000
/s/ Patricia A. Gilmartin ----- Patricia A. Gilmartin	Director	March 29, 2000
/s/ Philip H. Glatfelter, II ----- Philip H. Glatfelter, II	Director	March 29, 2000
/s/ C. Edwin Ireland ----- C. Edwin Ireland	Director	March 29, 2000
/s/ R. Richard Sherbahn ----- R. Richard Sherbahn	Director	March 29, 2000

EXHIBIT INDEX

(Pursuant to Item 601 of Regulation S-K)

Exhibit No. -----	Description of Exhibits -----	Reference -----
(3)(i)	Certificate of Incorporation of Registrant, as amended	filed herewith
(3)(ii)	Amended and Restated By-laws of Registrant	(a)
(4)	Form of Registrant's Common Stock Certificate	(b)
Management Contracts and Compensatory Plans or Arrangements		
(10)(A)	Donegal Mutual Insurance Company Money Purchase Pension Plan and Trust dated March 12, 1985	(b)
(10)(B)	Donegal Mutual Insurance Company Profit Sharing Plan and Trust dated March 12, 1985	(b)
(10)(C)	Donegal Group Inc. Key Executive Incentive Bonus Plan dated September 29, 1986	(e)
(10)(D)	Donegal Group Inc. Employee Stock Purchase Plan, as amended	(e)
(10)(E)	Donegal Group Inc. Equity Incentive Plan, as amended	(e)
(10)(F)	Donegal Group Inc. Agency Stock Purchase Plan	(l)
(10)(G)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan	(d)
(10)(H)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan for Directors	(k)
(10)(I)	Donegal Group Inc. Executive Restoration Plan	(c)

- (10)(J) Donegal Mutual Insurance Company 401(k) Plan filed herewith
- (10)(K) Amendment No. 1 effective January 1, 2000 to Donegal Mutual Insurance Company 401(k) Plan filed herewith
- Other Material Contracts
- (10)(L) Tax Sharing Agreement dated September 29, 1986 between Donegal Group Inc. and Atlantic States Insurance Company (b)
- (10)(M) Services Allocation Agreement dated September 29, 1986 between Donegal Mutual Insurance Company, Donegal Group Inc. and Atlantic States Insurance Company (b)
- (10)(N) Proportional Reinsurance Agreement dated September 29, 1986 between Donegal Mutual Insurance Company and Atlantic States Insurance Company (b)
- (10)(O) Amendment dated October 1, 1988 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company (f)
- (10)(P) Multi-Line Excess of Loss Reinsurance Agreement effective January 1, 1993 between Donegal Mutual Insurance Company, Southern Insurance Company of Virginia, Atlantic States Insurance Company and Pioneer Mutual Insurance Company, and Christiana General Insurance Corporation of New York, Cologne Reinsurance Company of America, Continental Casualty Company, Employers Reinsurance Corporation and Munich American Reinsurance Company (h)
- (10)(Q) Amendment dated July 16, 1992 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company (g)

- (10)(R) Amendment dated as of December 21, 1995 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company (i)
- (10)(S) Stock Purchase Agreement dated as of December 21, 1995 between Donegal Mutual Insurance Company and Donegal Group Inc. (i)
- (10)(T) Donegal Group Inc. 1996 Employee Stock Purchase Plan (j)
- (10)(U) Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Pioneer Insurance Company (c)
- (10)(V) Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Delaware American Insurance Company (c)
- (10)(W) Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Southern Insurance Company of Virginia (c)
- (10)(X) Reinsurance and Retrocession Agreement effective January 1, 2000 between Donegal Mutual Insurance Company and Southern Heritage Insurance Company filed herewith
- (10)(Y) Property Catastrophe Excess of Loss Reinsurance Agreement effective January 1, 2000 between Donegal Mutual Insurance Company and Southern Heritage Insurance Company filed herewith
- (10)(Z) Stock Purchase Agreement dated as of May 14, 1998 between Donegal Group Inc. and Southern Heritage Limited Partnership (m)
- (10)(AA) Amendment dated November 17, 1998 to Stock Purchase Agreement dated as of May 14, 1998 between Donegal Group Inc. and Southern Heritage Limited Partnership (m)

- (10)(BB) Amended and Restated Credit Agreement dated as of July 27, 1998 (m)
among Donegal Group Inc., the banks and other financial
institutions from time to time party thereto and Fleet National
Bank, as Agent
- (10)(CC) First Amendment and Waiver to the Amended and Restated Credit Agreement dated as of December 31, 1999 filed herewith
- (13) 1999 Annual Report to Stockholders (electronic filing contains only those portions incorporated by reference into this Form 10-K report) filed herewith
- (20) Proxy Statement relating to the Annual Meeting of Stockholders to be held on April 20, 2000, provided, however, that the Compensation Committee Report and the Performance Graph shall not be deemed filed as part of this Form 10-K Report (n)
- (21) Subsidiaries of Registrant filed herewith
- (23) Consent of Independent Auditors filed herewith
- (27) Financial Data Schedule filed herewith

-
- (a) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-Q Report for the quarter ended September 30, 1998.
- (b) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-1 Registration Statement No. 33-8533 declared effective October 29, 1986.
- (c) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1996.
- (d) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1998.
- (e) Such exhibit is hereby incorporated by reference to the like-described exhibits in Registrant's Form 10-K Report for the year ended December 31, 1986.

- (f) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1988.
- (g) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1992.
- (h) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 33-67346 declared effective September 29, 1993.
- (i) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated December 21, 1995.
- (j) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-8 Registration Statement No. 333-1287 filed February 29, 1996.
- (k) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1997.
- (l) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 333-06787 declared effective August 1, 1996.
- (m) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated November 17, 1998.
- (n) Such exhibit is hereby incorporated by reference to the Registrant's definitive proxy statement filed March 24, 2000.

CERTIFICATE OF INCORPORATION

OF

DONEGAL GROUP INC.

1. The name of the Corporation is Donegal Group Inc.
2. The address of its registered office is 1220 Market Street Building, Wilmington, County of New Castle, Delaware 19801. The name of its registered agent at such address is Wilmington Corporate Services, Inc.
3. The nature of the business to be conducted or promoted is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of the State of Delaware.
4. (a) The aggregate number of shares which the Corporation shall have authority to issue is: Ten Million (10,000,000) shares of Common Stock of the par value of One Dollar (\$1.00) per share (the "Common Stock") and One Million (1,000,000) shares of Series Preferred Stock of the par value of One Dollar (\$1.00) per share (the "Preferred Stock").

(b) The Preferred Stock may be issued from time to time by the Board of Directors as herein provided in one or more series. The designations, relative rights, preferences and limitations of the Preferred Stock, and particularly of the shares of each series thereof, may, to the extent permitted by law, be similar to or may differ from those of any other series. The Board of Directors of the Corporation is hereby expressly granted authority, subject to the provisions of this Article Four, to issue from time to time Preferred Stock in one or more series and to fix from time to time before issuance thereof, by filing a certificate pursuant to the General Corporation Law, the number of shares in each such series and all designations, relative rights (including the right, to the extent permitted by law, to convert into shares of any class or into shares of any series of any class), preferences and limitations of the shares in each such series, including, but without limiting the generality of the foregoing, the following:

1

- (i) The number of shares to constitute such series (which number may at any time, or from time to time, be increased or decreased by the Board of Directors, notwithstanding that shares of the series may be outstanding at the time of such increase or decrease, unless the Board of Directors shall have otherwise provided in creating such series) and the distinctive designation thereof;
- (ii) The dividend rate on the shares of such series, whether or not dividends on the shares of such series shall be cumulative and the date or dates, if any, from which dividends thereon shall be cumulative;
- (iii) Whether or not the shares of such series shall be redeemable, and, if redeemable, the date or dates upon or after which they shall be redeemable and the amount or amounts per share (which shall be, in the case of each share, not less than its preference upon involuntary liquidation, plus an amount equal to all dividends thereon accrued and unpaid, whether or not earned or declared) payable thereon in the case of the redemption thereof, which amount may vary at different redemption dates or otherwise as permitted by law;
- (iv) The right, if any, of holders of shares of such series to convert the same into, or exchange the same for, Common Stock or other stock as permitted by law, and the terms and conditions of such conversion or exchange, as well as provisions for adjustment of the conversion rate in such events as the Board of Directors shall determine;
- (v) The amount per share payable on the shares of such series upon the voluntary and involuntary liquidation, dissolution or winding up of the Corporation;

- (vi) Whether the holders of shares of such series shall have voting power, full or limited, in addition to the voting powers provided by law, and, in case additional voting powers are accorded, to fix the extent thereof; and
- (vii) Generally to fix the other rights and privileges and any qualifications, limitations or restrictions of such rights and

privileges of such series, provided, however, that no such rights, privileges, qualifications, limitations or restrictions shall be in conflict with the Certificate of Incorporation of the Corporation or with the resolution or resolutions adopted by the Board of Directors providing for the issue of any series of which there are shares then outstanding.

- (c) All shares of Preferred Stock of the same Series shall be identical in all respects, except that shares of any one series issued at different times may differ as to the dates, if any, from which dividends thereon may accumulate. All shares of Preferred Stock of all series shall be of equal rank and shall be identical in all respects, except that to the extent not otherwise limited in this Article Four any series may differ from any other series with respect to any one or more of the designations, relative rights, preferences and limitations described or referred to in subparagraphs (b) (i) to (vii) inclusive of this Article Four.
- (d) Dividends on the outstanding Preferred Stock of each series shall be declared and paid or set apart for payment before any dividends shall be declared and paid or set apart for payment on the Common Stock with respect to the same quarterly dividend period. Dividends on any shares of Preferred Stock shall be cumulative only if and to the extent set forth in a certificate filed pursuant to law. After dividends on all shares of Preferred Stock (including cumulative dividends if and to the extent any such shares shall be entitled thereto) shall have been declared and paid or set apart for payment with respect to any quarterly dividend period, then and not otherwise as long as any shares of Preferred Stock shall remain outstanding, dividends may be declared and paid or set apart for payment with respect to the same quarterly dividend period on the Common Stock out of the assets or funds of the Corporation legally available therefor.
- (e) All shares of Preferred Stock of all series shall be of equal rank, preference and priority as to dividends irrespective of whether or not the rates of dividends to which the particular series of Preferred Stock shall be entitled shall be the same

and when the stated dividends are not paid in full, the shares of all series of Preferred Stock shall share ratably in the payment thereof in accordance with the sums which would be payable on such shares if all dividends were paid in full, provided, however, that any two or more series of Preferred Stock may differ from each other as to the existence and extent of the right to cumulative dividends, as aforesaid.

(f) Except as otherwise specifically provided in the certificate filed pursuant to law with respect to any series of Preferred Stock or as otherwise provided by law, the Preferred Stock shall not have any right to vote for the election of directors or for any other purpose and the Common Stock shall have the exclusive right to vote for the election of directors and for all other purposes. Each holder of Common Stock shall be entitled to one vote for each share thereof held. In all instances in which voting rights are granted to Preferred Stock or any series thereof, such Preferred Stock or series shall vote with the Common Stock as a single class, except with respect to any vote for the approval of any merger, consolidation, liquidation or dissolution of the Corporation and except as otherwise provided in the certificate filed pursuant to law with respect to any series of Preferred Stock or as otherwise provided by law.

(g) In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, each series of Preferred Stock shall have preference and priority over the Common Stock for payment of the amount to which each outstanding series of Preferred Stock shall be entitled in accordance with the provisions thereof and each holder of Preferred Stock shall be entitled to be paid in full such amount, or have a sum sufficient for the payment in full set aside, before any payments shall be made to the holders of the Common Stock. If, upon liquidation, dissolution or winding up of the Corporation, the assets of the Corporation or the proceeds thereof, distributable among the holders of the shares of all series of Preferred Stock shall be insufficient to pay in full the preferential amount aforesaid, then such assets, or the proceeds thereof, shall be distributed

among such holders ratably in accordance with the respective amounts which would be payable if all amounts payable thereon were paid in full. After the holders of the Preferred Stock of each series shall have been paid in full the amounts to which they respectively shall be entitled, or a sum sufficient for the payment in full set aside, the remaining net assets of the Corporation shall be distributed pro rata to the holders of the Common Stock in accordance with their respective rights and interests, to the exclusion of the holders of Preferred Stock. A consolidation or merger of the Corporation with or into another corporation or corporations, or a sale, whether for cash, shares of stock, securities or properties, of all or substantially all of the assets of the Corporation, shall not be deemed or construed to be a liquidation, dissolution or winding up of the Corporation within the meaning of this Article Four.

(h) In the event that Preferred Stock of any series shall be made redeemable as provided in subparagraph (b)(iii) of this Article Four, the Corporation, at the option of the Board of Directors, may redeem at any time or times, and from time to time, all or any part of any one or more series of Preferred Stock outstanding by paying for each share the then applicable redemption price fixed by the Board of Directors as provided herein, plus an amount equal to accrued and unpaid dividends to the date fixed for redemption, upon such notice and terms as may be specifically provided in the certificate filed pursuant to law with respect to such series of Preferred Stock.

5. The Corporation shall have the power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Corporation) by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in

connection with such action, suit or proceeding if he acted in good faith and in a manner reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceedings, had no reasonable cause to believe his conduct was unlawful. The termination of any action, upon a plea of nolo contendere or equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

6. The directors of the Corporation shall incur no personal liability to the Corporation or its stockholders for monetary damages for any breach of the fiduciary duty as a director; provided, however, that the directors of the Corporation shall continue to be subject to liability (i) for any breach of their duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the General Corporation Law of the State of Delaware, or (iv) for any transaction from which the directors derived an improper benefit.
7. The business and affairs of the Corporation shall be managed by or under the direction of the Board of Directors, the number of members of which shall be set forth in the By-laws of the Corporation. The Directors need not be elected by ballot unless required by the By-laws of the Corporation.
8. In the furtherance and not in limitation of the objects, purposes and powers conferred by the laws of the State of Delaware, the Board of Directors is expressly authorized to make, amend and repeal the By-laws, to fix the amount to be reserved as working capital, and to authorize and cause to be executed mortgages and liens without limit as to the amount, upon the property and franchise of this corporation.
9. The Corporation is to have perpetual existence.
10. Meetings of the stockholders may be held within or without the State of Delaware, as the By-laws may provide. The books of the

Corporation may be kept, subject to any provisions contained in the statutes, outside the State of Delaware at such place or places as may be designated from time to time by the Board of Directors or in the By-laws of the Corporation. Elections of directors need not be by written ballot unless the By-laws of the Corporation shall so provide.

11. The Corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred upon stockholders herein are granted subject to this reservation.
12. The name and address of the Incorporator is John L. Olsen, Esquire, c/o Duane, Morris & Heckscher, 1220 Market Street Building, P.O. Box 195, Wilmington, Delaware 19899.
13. The powers of Incorporator shall terminate upon the election of directors.

I, THE UNDERSIGNED, being the Incorporator, for the purpose of forming a corporation under the laws of the State of Delaware, do make, file and record this Certificate of Incorporation, and do hereby certify that this is my act and deed and the facts herein stated are true; and accordingly, have hereunto set my hand and seal this 26th day of August, 1986.

/s/ John L. Olsen
------(SEAL)
John L. Olsen, Incorporator

CERTIFICATE OF AMENDMENT
OF
CERTIFICATE OF INCORPORATION
OF
DONEGAL GROUP INC.

UNDER SECTION 242 OF THE GENERAL CORPORATION
LAW OF THE STATE OF DELAWARE

Donegal Group Inc., a corporation organized and existing under and by
virtue of the General Corporation Law of the State of Delaware,

DOES HEREBY CERTIFY THAT:

FIRST: The Board of Directors of Donegal Group Inc. (the
"Corporation"), at a meeting of the Board of Directors held on March 16, 1998
pursuant to notice duly given, duly adopted the following resolution setting
forth a proposed amendment of the Certificate of Incorporation of the
Corporation, declaring such amendment to be advisable and calling for a meeting
of the stockholders of said Corporation for consideration thereof. The
resolution setting forth the proposed amendment is as follows:

RESOLVED, that Article 4(a) of the Certificate of
Incorporation of Donegal Group Inc. is hereby amended and
restated to provide in full as follows:

"4.(a) The aggregate number of shares which the
Corporation shall have authority to issue is: Fifteen
Million shares of Common Stock of the par value of
One Dollar (\$1.00) per share (the "Common Stock") and
One Million shares of Series Preferred Stock of the
par value of One Dollar (\$1.00) per share (the
"Preferred Stock")."

SECOND: Thereafter, pursuant to a resolution of the Board of Directors,
at the annual meeting of the stockholders of the Corporation held on April 16,
1998, the holders of a majority of the outstanding shares entitled to vote
thereon voted in favor of the approval and adoption of the amendment.

THIRD: Such amendment was duly adopted in accordance with the
provisions of Section 242 of the General Corporation Law of the State of
Delaware.

IN WITNESS WHEREOF, said Corporation has caused this Certificate of Amendment to be signed by Donegal H. Nikolaus, its President and Chief Executive Officer, and Ralph G. Spontak, its Senior Vice President, Chief Financial Officer and Secretary, this 20th day of April, 1998.

(SEAL)

DONEGAL GROUP INC.

By: /s/ Donald H. Nikolaus

Donald H. Nikolaus
President and Chief Executive Officer

ATTEST:

By: /s/ Ralph G. Spontak

Ralph G. Spontak,
Senior Vice President,
Chief Financial Officer and Secretary

CERTIFICATE OF AMENDMENT
OF
CERTIFICATE OF INCORPORATION
OF
DONEGAL GROUP INC.

UNDER SECTION 242 OF THE GENERAL CORPORATION
LAW OF THE STATE OF DELAWARE

Donegal Group Inc., a corporation organized and existing under and by
virtue of the General Corporation Law of the State of Delaware,

DOES HEREBY CERTIFY THAT:

FIRST: The Board of Directors of Donegal Group Inc. (the "Corporation"), at a meeting of the Board of Directors held on March 18, 1999 pursuant to notice duly given, duly adopted the following resolutions setting forth a proposed amendment of the Certificate of Incorporation of the Corporation, declaring such amendment to be advisable and calling for a meeting of the stockholders of said Corporation for consideration thereof. The resolutions setting forth the proposed amendment are as follows:

WHEREAS, the Board of Directors declares it advisable to amend Article 4 of the Corporation's Certificate of Incorporation to (i) increase the number of authorized shares of capital stock from 16,000,000 shares, consisting of 1,000,000 shares of Series Preferred Stock and 15,000,000 shares of Common Stock, to 37,000,000 shares, consisting of 2,000,000 shares of Series Preferred Stock, 20,000,000 shares of Common Stock and 15,000,000 shares of Class A Common Stock and (ii) restate in its entirety Article 4 of the Corporation's Certificate of Incorporation as so amended; it is

RESOLVED, that Article 4 of the Certificate of Incorporation of Donegal Group Inc. is hereby amended and restated to provide in full as set forth on Exhibit A hereto; and

FURTHER RESOLVED, that the amendment to and restatement of Article 4 of the Certificate of Incorporation shall be submitted to the stockholders of the Corporation for approval in accordance with the applicable provisions of the Delaware General Corporation Law.

SECOND: Thereafter, pursuant to a resolution of the Board of Directors, at the annual meeting of the stockholders of the Corporation held on April 15, 1999, the holders of a majority of the outstanding shares entitled to vote thereon voted in favor of the approval and adoption of the amendment.

THIRD: Such amendment was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Amendment to be signed by Donald H. Nikolaus, its President and Chief Executive Officer, and Ralph G. Spontak, its Senior Vice President, Chief Financial Officer and Secretary, this 15th day of April, 1999.

(SEAL)

DONEGAL GROUP INC.

ATTEST:

By: /s/ Donald H. Nikolaus

Donald H. Nikolaus,
President and Chief
Executive Officer

By: /s/ Ralph G. Spontak

Ralph G. Spontak,
Senior Vice President, Chief
Financial Officer and Secretary

EXHIBIT A

4. The aggregate number of shares of stock which the Corporation shall have authority to issue is 37,000,000 shares, consisting of (i) 20,000,000 shares of Common Stock (the "Common Stock"), par value \$1.00 per share, (ii) 15,000,000 shares of Class A Common Stock (the "Class A Common Stock"), par value \$.01 per share, and (iii) 2,000,000 shares of Series Preferred Stock (the "Preferred Stock"), par value \$.01 per share.

(a) The Class A Common Stock may be issued from time to time by the Board of Directors as herein provided in one or more series. The designations, relative rights (including voting rights), preferences, limitations and restrictions of the Class A Common Stock, and particularly of the shares of each series thereof, may, to the extent permitted by law, be similar to or may differ from those of any other series. The Board of Directors of the Corporation is hereby expressly granted authority, subject to the provisions of this Article 4, to issue from time to time Class A Common Stock in one or more series and to fix from time to time before issuance thereof, by filing a certificate of designations pursuant to the General Corporation Law of the State of Delaware (the "GCL"), the number of shares in each such series and all designations, relative rights (including the right, to the extent permitted by law, to convert into shares of any class or into shares of any series of any class), preferences, qualifications, limitations and restrictions of the shares in each such series. Notwithstanding anything to the contrary set forth above, the powers, preferences and rights, and the qualifications, limitations and restrictions, of the Common Stock and the Class A Common Stock shall be subject to the following:

(i) Except as otherwise required by law or as otherwise provided in this Certificate of Incorporation or in a certificate of designations filed pursuant to the GCL with respect to any series of Class A Common Stock, each share of Common Stock and each share of Class A Common Stock shall be of equal rank and shall have identical powers, preferences, qualifications, limitations, restrictions and other rights, including rights in liquidation. All shares of Class A Common Stock of the same series shall be identical in all respects.

(ii) Each holder of Common Stock shall be entitled to one vote for each share of Common Stock held. Except as otherwise specifically provided in the certificate of designations filed pursuant to the GCL with respect to any series of Class A Common Stock or as otherwise provided by law, the Class A Common Stock shall not have any right to vote for the election of directors or for any other purpose and the Common Stock and, to the extent

provided in a certificate of designations filed pursuant to the GCL with respect to any series of Preferred Stock, the Preferred Stock shall have the exclusive right to vote for the election of directors and for all other purposes. In all instances in which voting rights are granted to the Class A Common Stock or any series thereof, the Class A Common Stock or series thereof shall vote with the Common Stock and, to the extent provided in a certificate of designations filed pursuant to the GCL with respect to any series of Preferred Stock, the Preferred Stock as a single class, except as otherwise provided in the certificate of designations filed pursuant to the GCL with respect to any series of Class A Common Stock or as otherwise provided by law.

(iii) Each share of Common Stock and each share of Class A Common Stock shall be equal in respect of rights to dividends and distributions, except that (A) a dividend or distribution in cash or property on a share of Class A Common Stock may be greater than a dividend or distribution in cash or property on a share of Common Stock and (B) dividends or other distributions payable on the Common Stock and the Class A Common Stock in shares of capital stock shall be made to all holders of Common Stock and Class A Common Stock and may be made (1) in shares of Common Stock to the holders of Common Stock and in shares of Class A Common Stock to the holders of Class A Common Stock, (2) in shares of Class A Common Stock to the holders of Common Stock and to the holders of Class A Common Stock or (3) in any other authorized class or series of capital stock to the holders of Common Stock and to the holders of Class A Common Stock.

(iv) Except to the extent provided in paragraph (a)(iii) of this Article 4, the Corporation shall not split, divide or combine the shares of the Common Stock or the Class A Common Stock unless, at the same time, the Corporation splits, divides or combines, as the case may be, the shares of both the Common Stock and the Class A Common Stock in the same proportion and manner.

(v) The number of authorized shares of Common Stock and the number of authorized shares of Class A Common Stock may be increased or decreased (but not below the number of shares then outstanding) by the affirmative vote of the holders of a majority of the voting power of the stock of the Corporation entitled to vote irrespective of any other voting requirements set forth in Section 242(b)(2) of the GCL, but subject in all events to compliance with the requirements of this Article 4.

(b) The Preferred Stock may be issued from time to time by the Board of Directors of the Corporation as herein provided in one or more series. The designations, relative rights (including

voting rights), preferences, limitations and restrictions of the Preferred Stock, and particularly of the shares of each series thereof, may, to the extent permitted by law, be similar to or may differ from those of any other series. The Board of Directors of the Corporation is hereby expressly granted authority, subject to the provisions of this Article 4, to issue from time to time Preferred Stock in one or more series and to fix from time to time before issuance thereof, by filing a certificate of designations pursuant to the GCL, the number of shares in each such series and all designations, relative rights (including the right, to the extent permitted by law, to convert into shares of any class or into shares of any series of any class), preferences, limitations and restrictions of the shares in each such series. Notwithstanding anything to the contrary set forth above, the powers, preferences and rights, and the qualifications, limitations and restrictions, of the Preferred Stock shall be subject to the following:

(i) The number of authorized shares of the Preferred Stock may be increased or decreased (but not below the number of shares then outstanding) by the affirmative vote of the holders of a majority of the voting power of the stock of the Corporation entitled to vote irrespective of any other voting requirements set forth in Section 242(b)(2) of the GCL, but subject in all events to compliance with the requirements of this Article 4.

(ii) All shares of Preferred Stock of the same series shall be identical in all respects, except that shares of any one series issued at different times may differ as to the dates, if any, from which dividends thereon, if any, may accumulate. All shares of Preferred Stock of all series shall be of equal rank and shall be identical in all respects, except that, to the extent not otherwise limited in this Article 4, any series may differ from any other series with respect to any one or more of the designations, relative rights, preferences, limitations and restrictions set forth in a certificate of designations filed under the GCL with respect to any series.

(iii) Except as otherwise specifically provided in the certificate of designations filed pursuant to the GCL with respect to any series of Preferred Stock or as otherwise provided by law, the Preferred Stock shall not have any right to vote for the election of directors or for any other purpose and the Common Stock and, to the extent provided in a certificate of designations filed pursuant to the GCL with respect to any series of Class A Common Stock, the Class A Common Stock shall have the exclusive right to vote for the election of directors and for all other purposes. In all instances in which voting rights are granted to the Preferred Stock or any series thereof, such Preferred Stock or series thereof shall vote with the Common Stock and, to the extent provided in a certificate of designations filed pursuant to the GCL with respect to any series of Class A Common Stock, the Class A Common Stock as a single class,

except as otherwise provided in the certificate of designations filed pursuant to the GCL with respect to any series of Preferred Stock or as otherwise provided by law.

(c) In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, each series of Preferred Stock shall have preference and priority over the Common Stock and the Class A Common Stock for payment of the amount to which each outstanding series of Preferred Stock shall be entitled in accordance with the provisions thereof and each holder of Preferred Stock shall be entitled to be paid in full such amount, or have a sum sufficient for the payment in full set aside, before any payments shall be made to the holders of the Common Stock and the Class A Common Stock. After the holders of the Preferred Stock of each series shall have been paid in full the amounts to which they respectively shall be entitled, or a sum sufficient for the payment in full set aside, the remaining net assets of the Corporation shall be distributed pro rata to the holders of the Common Stock and the Class A Common Stock in accordance with their respective rights and interests, to the exclusion of the holders of Preferred Stock. A consolidation or merger of the Corporation with or into another corporation or corporations, or a sale, whether for cash, shares of stock, securities or properties, of all or substantially all of the assets of the Corporation, shall not be deemed or construed to be a liquidation, dissolution or winding up of the Corporation within the meaning of this Article 4.

(Effective January 1, 1998)

Issue Date:
May 1, 1998

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ARTICLE I

DEFINITIONS

Whenever used herein, the following words shall have the meaning set forth below, unless otherwise clearly required by the context.

1.1 Parties

(a) "Employer" means Donegal Mutual Insurance Company, a Pennsylvania corporation, and any successor.

(b) "Plan Committee" or "Committee" means the Committee established by the Employer to administer the Plan as set forth in Article VII hereof.

(c) "Trustee" means the corporation, individual or individuals appointed by the Employer to hold and administer the assets of the Trust.

(d) "Employee" means any individual employed by the Employer or an Affiliated Employer, except that such term shall not include: (i) any leased Employee as defined in Section 414(n)(2) and (ii) any employee who is hired as a temporary employee and whose employment is to be of limited duration generally not in excess of six (6) months.

(e) "Participant" means an Employee who has satisfied the eligibility requirements and has entered the plan as provided in Article II.

(f) "Beneficiary" or "Designated Beneficiary" means a person or persons (natural or otherwise) designated by a Participant to receive any death benefit payable under this plan. If there is no such designation, or if the designated person or persons predecease the Participant, Beneficiary shall mean the surviving spouse, surviving children, surviving parents or estate of the Participant, in the order listed.

(g) "Plan" means the Donegal Mutual Insurance Company 401(k) Plan as set forth herein and as it may be amended in the future.

(h) "Trust" or "Trust Agreement" means the Donegal Mutual Insurance Company 401(k) Plan Trust established by the Employer.

(i) "Affiliated Employer" means the Employer, and any trade or business (whether or not incorporated) which is under common control (as defined in Section 414(c) of the Code) with the Employer; an organization (whether or not incorporated) which is a member of an affiliated service group (as defined in Section 414(m) of the Code) which includes the Employer; and any other entity required to be aggregated with the Employer pursuant to regulations under Section 414(o) of the Code.

(j) 'Highly Compensated Employee' means an Employee who performs services during the determination year and is described in one or more of the following groups:

1. An Employee who is a 5% owner, as defined in Section

416(i)(1)(A)(iii), at anytime during the determination year or the preceding year.

2. An Employee who received compensation during the preceding year in excess of \$80,000 (indexed in accordance with IRC Section 415(d)).

3. If the Employer so elects, an Employee who is in the top paid group during the preceding year as such term is defined in IRC Section 414(q).

For purposes of this paragraph:

(1) Compensation is compensation within the meaning of IRC Section 415(c)(3), including elective or salary reduction contributions to a cafeteria plan, cash or deferred arrangement or tax-sheltered annuity, and

(2) Employers aggregated under IRC Sections (415)(b), (c), (m), or (o) are treated as a single employer.

(3) Highly Compensated Employee includes a former employee who was separated from service for the Employer prior to the determination year and was a Highly Compensated Employee for the year of the termination or for any determination year in or after the date on which he attains age 55.

(k) "Non-Highly Compensated Employee" means an Employee of the Employer who is not a Highly Compensated Employee.

1.2 Important Dates

(a) "Effective Date" means January 1, 1998, the date on which the provisions of the Plan became effective.

(b) "Plan Year" means the calendar year.

(c) "Anniversary Date" means the last day of each Plan Year after the Effective Date.

(d) "Limitation Year" means the Plan Year.

1.3 Service and Compensation

(a) "Hour of Service" means:

(1) Each hour for which an Employee is paid, or entitled to payment, for the performance of duties for the Employer. These hours shall be credited to the Employee for the computation period in which the duties are performed; and

(2) Each hour for which an Employee is paid, or entitled to payment, by the Employer on account of a period of time during which no duties are performed (irrespective of whether the employment relationship has terminated) due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. No more than 501 Hours of Service shall be credited under this paragraph for any single continuous period (whether or not such period occurs in a single computation period). Hours under this paragraph shall be calculated and credited pursuant to Section 2530,200(b)2 of the Department of Labor Regulations which are incorporated herein by reference; and

(3) Each hour for which back pay, irrespective of mitigation of damages, is either awarded or agreed to by the Employer. The same Hours of Service shall not be credited both under paragraph (1) or paragraph (2), as the case may be, and under this paragraph (3). These hours shall be credited to the Employee for the computation period or periods to which the award or agreement pertains rather than the computation period in which the award, agreement or payment is made.

(4) For absences beginning on or after the first day of the Plan Year, solely for purposes of determining whether a One-Year Break in Service for participation and vesting purposes has occurred in a Plan Year (or other computation period), an Employee who is on Maternity or Paternity Leave shall receive credit for the Hours of Service which would otherwise have been credited to such Employee but for such absence, or in any case in which such Hours cannot be determined, 8 Hours of Service per day of such absence. No more than 501 Hours of Service shall be credited under this paragraph for any single absence due to Maternity or Paternity Leave. The Hours of Service credited under this paragraph shall be credited only (i) in the Plan Year (or other computation period) in which the absence begins if the crediting is necessary to prevent a One-Year Break in Service in that period, or (ii) in any other case, in the immediately following Plan Year (or other computation period).

(b) "One-Year Break in Service" means a Plan Year during which an Employee fails to complete at least 500 Hours of Service. For purposes of Section 2.1, the relevant eligibility computation period shall be substituted for the Plan Year.

(c) "Years of Service" means

(1) For purposes of eligibility to participate, as provided in Section 2.1.

(2) Years of Service credited prior to a period of consecutive One-Year Breaks in Service shall not be credited if the number of consecutive One-Year Breaks in Service during such period before the Employee earns any vested benefit in Employer contributions under the Plan equals or exceeds the greater of (A) five (5), or (B) the aggregate number of Years of Service before such period.

(3) An Employee's Years of Service shall include Years of Service with

the Employer and with other businesses under common control which includes the Employer and with other members of an affiliated service group which includes the Employer.

(d) "Compensation" means the total taxable compensation paid to an Employee by the Employer during the Plan Year except as hereinafter provided. Any bonus, payments under any Employee incentive plan, disability payments, taxable fringe benefits, non-taxable fringe benefits, amounts realized from the exercise of stock options, or when restricted stock (or property) held by the Employee either becomes freely transferrable or is no longer subject to a substantial risk of forfeiture, and amounts realized from the sale, exchange or other disposition of stock options shall not be considered compensation. The foregoing notwithstanding, compensation shall include any elective contributions made by the Employer that are not includable in the Employee's gross income under Code Sections 125, 402(g)(3), 402(h), 403(b) or any compensation deferred under Code Section 457(b).

Compensation shall include all compensation (as defined above) which is actually paid to the Employee during the applicable Plan Year, including the Plan Year in which the Employee becomes a Participant. Compensation shall be limited for all purposes to \$160,000 as adjusted from time to time in accordance with Code Section 401(a)(17).

(e) "Authorized Leave of Absence" means any absence authorized by the Employer under the Employer's standard personnel practices provided that all persons under similar circumstances must be treated alike in the granting of such Authorized Leaves of Absence and provided further that the Employee returns within the period of authorized absence. In the event of absence due to service in the Armed Forces of the United States, (1) such absence shall be considered an Authorized Leave of Absence provided that the Employee returns to employment with the Employer within the period provided by law, and (2) credit for Hours of Service shall be given to the extent required by law.

(f) "Employment Commencement Date" means the first day on which an Employee completes an Hour of Service for the Employer.

(g) "Maternity or Paternity Leave" means an absence from work:

- (1) By reason of pregnancy of the Participant;
- (2) By reason of the birth of a child of the Participant;
- (3) By reason of the placement of a child with the Participant in connection with the adoption of such child by the Participant; or
- (4) For purposes of caring for such child, for a period beginning immediately after such birth or placement.

In approving such leave, the Plan Committee may require the Participant to furnish such timely information as it may reasonably require to establish that the reason for the absence from work is for one of the reasons set forth above and the number of days for which there was such absence.

1.4 Miscellaneous

(a) "Disability" means a condition which renders a Participant unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of a long, continued and indefinite duration. The Plan Committee may require such proof of Disability as it deems necessary, and may require a Participant to be examined by a physician of its own choosing.

(b) "Participant's Elective Deferral" or "Participant's Elective Contribution" means as to each Participant the amount of the Participant's salary reduction election made pursuant to Section 3.4 during the Plan Year by the Employee and allocated to the Participant's Elective Deferral Account.

(c) "Employer Matching Contribution" means any contribution to the Plan made by the Employer for the Plan Year and allocated to a Participant's Employer Matching Contribution Account by reason of the Participant's Elective Deferrals.

(d) "ERISA" means Public Law No. 93-406, the Employees Retirement Income Security Act of 1974, as amended from time to time.

(e) "Code" or "IRC" means the Internal Revenue Code of 1986 and amendments thereto.

(f) "Forfeiture" means that portion of a Participant's account that is not vested and occurs on the earlier of:

(1) The distribution of the entire vested portion of a Participant's account, or

(2) The last day of the Plan Year in which the Participant incurs five consecutive one year breaks in service.

(g) USERRA Compliance. Notwithstanding any provision of this Plan to the contrary, contributions, benefits and service credit with respect to qualified military service will be provided in accordance with Section 414 (u) of the Code.

1.5 Construction. Words used herein in the masculine include the feminine, in the singular include the plural and in the plural include the singular, unless the context indicates otherwise.

ARTICLE II

PARTICIPATION

2.1 Eligibility for Participation. Each Employee who is employed by the Employer on the Effective Date shall eligible to become a Participant as of that date. Each other Employee shall be eligible to become a Participant as of the first day of the month immediately succeeding

the month in which the Employee commences employment with the Employer. An Employee becomes a Participant by filing with the Plan Committee a salary reduction election in accordance with Section 3.4 hereof in the form prescribed by the Committee.

2.2 Continuing Participation.

(a) The Participant shall continue to be a Participant until he incurs a One-Year Break in Service. Participation shall cease as of the last day of the Plan Year during which such event occurs.

(b) During a period of Authorized Leave of Absence, an Employee shall not be deemed to have incurred a One-Year Break in Service. In the event that an Employee is laid off, such layoff shall be treated as an Authorized Leave of Absence, to the extent that the Employer's personnel policies so provide, or in the absence of any such policies, for a period of one year from the date of layoff.

2.3 Reemployment After Termination of Employment. Upon the reemployment of any Employee who was a Participant such Employee again shall become a Participant on the first day of the month coincident with or next following his completion of at least one Hour of Service. All of an Employee's Years of Service with the Employer shall be credited except Years of Service which are disregarded under Section 1.3(c)(2).

ARTICLE III

CONTRIBUTIONS

3.1 Employer's Matching Contribution. The Employer shall contribute annually on behalf of each Participant in the employ of the Employer on the Anniversary Date an amount equal to twenty-five percent (25%) of each Participant's Elective Deferrals for the Plan Year but not in excess of two percent (2%) of the Participant's Compensation for the Plan Year ("Matching Contribution"). The requirement that a Participant be employed by the Employer on the Anniversary Date shall be waived if the employment of the Participant terminated during the Plan Year because of retirement, disability or death.

3.2 Payment of Employer Matching Contributions. The Employer shall pay its matching contribution to the Plan within thirty (30) days of the end of each calendar quarter and under all circumstances the Employer's matching contribution must be paid not later than the last date, including extensions thereof for filing its income tax return for the Plan Year with respect to which the matching contribution is made.

3.3 Return of Contributions. In no event shall any Employer Contributions revert to or be recoverable by the Employer, unless:

(a) the contribution is made by reason of a mistake of fact, in which case it shall be returned within one (1) year after the payment of the contribution, or,

(b) the contribution is conditioned upon qualification of the Plan under Section 401 of the Code and if the Plan does not initially so qualify, it shall be returned to the Employer within one (1) year after the date of denial of qualification.

All contributions are conditioned upon the deductibility of the contribution under Section 404 of the Code. To the extent the deduction is disallowed, the contribution shall be returned within one (1) year after the disallowance of the deduction.

3.4 Participant's Salary Reduction Election.

(a) Each Participant may make an Elective Contribution to the Plan and to the extent he elects to reduce or forego an increase in his Compensation, the amount by which his Compensation is reduced shall be treated as the Participant's Elective Contribution and be allocated to that Participant's Elective Account. The amount of the Elective Contribution may not be less than 1% nor more than 8% of the Participant's Compensation as elected by the Participant in units of one percentage point on forms provided by the Plan Committee, which may limit the amount of a Participant's Elective Contribution at any time, if it determines that such limitation is necessary to satisfy the requirements of IRC Section 401(k).

(b) The balance in each Participant's Elective Account shall be fully vested at all times and shall not be subject to forfeiture for any reason.

(c) A Participant may not make withdrawals from his Elective Account prior to his attaining age 59-1/2, except in the event of disability, retirement, termination of employment or hardship as provided in Section 3.5. Distributions made pursuant to this Section shall be deemed to be made as of the last day of the preceding accounting quarter and the Participant's Elective Account shall be reduced accordingly.

(d) The Employer shall pay all Participants' Elective Contributions accumulated through payroll deduction to the Trustee with reasonable promptness and in all events before the end of the succeeding month following such payroll deductions.

(e) A Participant may change or terminate his deferral election as provided in subparagraph (a) by giving thirty (30) days' written notice of such change or termination to the Plan Committee or its designee and such change or termination shall be effective as of the first pay period coincident with or next following the expiration of said thirty (30)-day period. A Participant who has terminated or not commenced making Elective Contributions pursuant to paragraph (a) above may commence or reinstate his deferral election upon thirty (30) days' written notice to the Plan Committee or its designee and the Participant's Elective Contributions shall commence with the first pay period commencing on or after the expiration of the thirty (30)-day period.

(f) A Participant who has taken a hardship distribution as provided in Section 3.5 hereof shall have his salary reduction election terminated as of the date of the hardship distribution and shall not be eligible to reinstate that election until after the first anniversary date of that distribution. Additionally, the Participant's Elective Contributions for the taxable year immediately following the taxable year of the hardship distribution may not exceed the applicable

limit on Elective Deferrals under Code Section 402(g) less the Participant's Elective Contributions for the year in which the Participant received the hardship distribution.

3.5 Participant Withdrawals.

(a) Participant's Elective Deferral Account. A Participant may not withdraw any amount attributable to his Elective Deferrals prior to the Participant's retirement, death, disability, separation from service or attainment of age 59-1/2 except in the case of hardship as provided herein. Upon application to the Plan Committee for a withdrawal based on hardship, the Plan Committee shall make a determination of the existence of hardship. If the Plan Committee determines that a hardship exists with respect to the Participant, the Participant may withdraw up to 100 percent of his vested interest in the Participant's Elective Deferral Account, but not in excess of the amount requested by the Participant in his initial application. Withdrawal of amounts less than the total amount in the Participant's Elective Deferral Account shall be in units of \$1,000 with a minimum withdrawal of \$1,000. The Plan Committee shall implement the foregoing by such rules, regulations, forms and procedures as to which the Plan Committee seems appropriate, provided always that participants similarly situated be treated uniformly. Hardship withdrawals may be made from Participant's Elective Deferrals only, excluding withdrawal of any income earned by Participant's Elective Deferrals.

(b) Participant's Employer Matching Contribution Account. A Participant may not withdraw any amount attributable to his Employer Matching Contribution Account prior to the Participant's retirement, death, disability, separation from service, or attainment of age 59-1/2.

(c) Hardship Provisions. A distribution because of hardship will be made only if the Participant has an immediate and heavy financial need which may not be satisfied from other assets of the Participant. A distribution is deemed to be on account of an immediate and heavy financial need only if the distribution is for:

1. Expenses for medical care described in Section 213(d) of the Code previously incurred by the Participant, the Participant's spouse or any dependents of the Participant or necessary for those persons to obtain medical care described in Section 213(d);
2. Costs directly related to the purchase of a principal residence for the Participant (excluding mortgage payments);
3. Payment of tuition, related educational fees, and room and board expenses for the next twelve (12) months of post-secondary education for the Participant or the Participant's spouse, children or dependents; or
4. Payments necessary to prevent the eviction of a Participant from the Participant's principal residence or foreclosure on the mortgage of that residence.

(d) A distribution is deemed necessary to satisfy an immediate and heavy financial need of a Participant if all of the following are satisfied:

1. The distribution is not in excess of the amount of the immediate and heavy financial need of the Participant which may include amounts necessary to pay the federal, state or local income taxes and penalties reasonably anticipated as a result of the distribution.

2. The Participant has obtained all distributions other than hardship distributions and all non-taxable (at the time of the loan) loans currently available under all Plans maintained by the Employer.

3. The Plan and all other plans maintained by the Employer limit the Participant's elective contributions for the next taxable year to the applicable limit under Section 402(g) of the Code for that year minus the Employee's elective contributions for the year of the hardship distribution.

4. The Participant is prohibited under the terms of the Plan or an otherwise legally enforceable agreement from making elective contributions and Employee contributions to the Plan and all other plans maintained by the Employer for at least twelve (12) months after receipt of the hardship distribution.

3.6 Limitations on Participant's Salary Reduction Election or Elective Deferrals.

(a) Maximum Amount of Elective Deferrals. No Employee shall be permitted to have Elective Deferrals made under this Plan during any calendar year in excess of \$7,000.00 multiplied by the Adjustment Factor for such year as provided by the Secretary of the Treasury.

(b) Average Actual Deferral Percentages.

(1) The Average Actual Deferral Percentage for Eligible Participants who are Highly Compensated Employees for the Plan Year shall not exceed the Average Actual Deferral Percentage for Eligible Participants who are Non-Highly Compensated Employees for the Plan Year multiplied by 1.25; or

(2) The Average Actual Deferral Percentage for Eligible Participants who are Highly Compensated Employees for the Plan Year shall not exceed the Average Actual Deferral Percentage for Eligible Participants who are Non-Highly Compensated Employees for the Plan Year multiplied by 2, provided that the Average Actual Deferral Percentage for Eligible Participants who are Highly Compensated Employees does not exceed the Average Actual Deferral Percentage for Eligible Participants who are Non-Highly Compensated Employees by more than two (2) percentage points, or such lesser amount as the Secretary of the Treasury shall prescribe to prevent the multiple use of this alternative limitation with respect to any Highly Compensated Employee.

(c) Definitions. For purposes of this Section 3.6 the following definitions shall be used:

(1) "Actual Deferral Percentage" ("ADP") shall mean the ratio (expressed as a percentage), of Elective Deferrals on behalf of each Eligible Participant for the Plan Year to such Eligible Participant's Compensation for the Plan Year. For this purpose, Elective Deferrals shall be taken into account only to the extent they relate to Compensation that either will be received by the Participant in the Plan Year, but for the deferral election, or which is attributable to services performed by the Participant in the Plan Year and will be received by the Participant within 2 1/2 months after the close of the Plan Year but for the deferral election. Further, Elective Deferrals shall be taken into account only if they are allocated to the Participant's Account within the Plan Year to which they relate. An Elective Deferral is considered allocated within the Plan Year if the allocation is not contingent upon the Participant's performance of services or continued participation in the Plan after the allocation date and the Elective Deferral is actually paid to the trust not later than 12 months after the Plan Year to which the contribution relates.

(2) "Average Actual Deferral Percentage" shall mean the average (expressed as a percentage) of the Actual Deferral Percentage of all Eligible Participants as a group.

(3) "Eligible Participant" shall mean any Employee of the Employer who is otherwise authorized under the terms of the Plan to have Elective Deferrals allocated to his account for the Plan Year.

(4) "Excess Contributions" are defined in IRC Section 401(k)(8)(b) and are determined and distributed as provided in Section 3.10 hereof.

(d) Special Rules.

(1) For purposes of this Section 3.6, the Actual Deferral Percentage for any Eligible Participant who is a Highly Compensated Employee for the Plan Year and who is eligible to have Elective Deferrals allocated to his account under two or more Plans or arrangements described in Section 401(k) of the Code that are maintained by the Employer or an Affiliated Employer shall be determined as if all such Elective Deferrals were made under a single arrangement.

(2) For purposes of distributing Excess Contributions, the amount of Excess Contributions that may be distributed to a Highly Compensated Employee for a Plan Year shall be reduced by the amount of excess deferrals previously distributed to the Highly Compensated Employee for his or her taxable year ending with or within such Plan Year.

(3) A Participant's Elective Contributions which are returned as provided in (c)(4) above shall not be taken into account in determining the amount of Matching Contributions to be made for the Participant's benefit for the year. To the extent Matching Contributions have already been made with respect to the Elective Contributions, such Matching Contributions shall be distributed to the Participant at the same time as the Elective Contributions are returned or recharacterized, provided however, that to the extent the Participant does not have a vested interest in such Matching Contributions, the Participant shall forfeit such Matching

Contributions.

(4) For purposes of determining the ADP for the Non Highly Compensated Employees for any determination year, the Plan shall rely on look-back year data. For this purpose, determination year means the Plan Year with respect to which the ADP or ACP is being calculated and look-back means the Plan Year immediately preceding the determination year.

3.7 Limitations on Employee Contributions and Matching Employer Contributions.

(a) Contribution Percentage. The Average Contribution Percentage ("ACP") for Eligible Participants who are Highly Compensated Employees for the Plan Year shall not exceed the Average Contribution Percentage for Eligible Participants who are Nonhighly Compensated Employees for the Plan Year multiplied by 1.25; or

The Average Contribution Percentage for Eligible Participants who are Highly Compensated Employees for the Plan Year shall not exceed the Average Contribution Percentage for Eligible Participants who are Nonhighly Compensated Employees the Plan Year multiplied by 2, provided that the Average Contribution Percentage for Eligible Participants who are Highly Compensated Employees does not exceed the Average Contribution Percentage for Eligible Participants who are Nonhighly Compensated Employees by more than two (2) percentage points or such lesser amount as the Secretary of the Treasury shall prescribe to prevent the multiple use of this alternative limitation with respect to any Highly Compensated Employee.

(b) Definitions. For purposes of this Section 3.7 the following definitions shall apply.

(1) "Average Contribution Percentage" shall mean the average (expressed as a percentage) of the Contribution Percentages of the Eligible Participants in a group.

(2) "Contribution Percentage" shall mean the ratio (expressed as a percentage), of the sum of the Employee Contributions and Matching Contributions made on behalf of each Eligible Participant for the Plan Year to such Eligible Participant's Compensation for the Plan Year.

(3) "Eligible Participant" shall mean any employee of the Employer who is otherwise authorized under the terms of the plan to have Employee Contributions or Matching Contributions allocated to his account for the Plan Year.

(c) Special Rules.

(1) For purposes of this section 3.7, the Contribution Percentage for any Eligible Participant who is a Highly Compensated Employee for the Plan Year and who is eligible to receive Matching contributions, or Elective Deferrals allocated to his account under two or more plans described in Section 401(a) of the Code or arrangements described in Section 401(k) of the Code that are maintained by the Employer or an Affiliated Employer shall be

determined as if all such contributions and Elective Deferrals were made under a single plan.

(2) In the event that this plan satisfies the requirements of Section 410(b) of the Code only if aggregated with one or more other plans, or if one or more other plans satisfy the requirements of Section 410(b) of the Code only if aggregated with this plan, then this Section 3.7 shall be applied by determining the Contribution Percentages of Eligible Participants as if all such plans were a single plan.

(d) Excess Aggregate Contributions.

(i) Excess Aggregate Contributions for a Highly-Compensated Employee will be determined by reducing the Actual Contribution Ratio (ACR) of the Highly-Compensated Employee with the highest ACR to the extent necessary to satisfy the Actual Contribution Percentage ("ACP") test or to cause such ratio to equal the ACR of the Highly-Compensated Employee with the next highest ratio. This process will be repeated until the ACP test is satisfied. In no event will Excess Aggregate Contributions remain unallocated or be allocated to a suspense account for allocation in the future Plan Year. The amount of the Excess Aggregate Contributions shall be distributed first to the Highly-Compensated Employee with the highest dollar amounts of Matching Contributions or Elective Contributions taken into account in computing the ACP in an amount equal to the lesser of such total Excess Aggregate Contributions or the amount necessary to cause the amount of such Employee's Matching Contributions to equal the amount of the Matching Contributions taken into account in computing the ACP of the Highly Compensated Employee with the next highest dollar amount of Matching Contributions taking into account in computing the ACP. This process will be repeated until the aggregate amount required to be distributed is so distributed. Income on such Excess Aggregate Contributions shall be distributed in accordance with the applicable Treasury Regulations. Distribution of Excess Aggregate Contributions will be made after the close of the Plan Year to which the contributions relate but within twelve months after the close of such Plan Year. Such distributions shall be treated as Employer contributions for purposes of Code Sections 401(a)(4), 404 and 415. Notwithstanding the foregoing, to the extent a Participant receives a distribution of Excess Aggregate Contributions which relate to Matching Contributions in which the Participant does not have a vested interest, such portion of the Excess Aggregate Contribution shall be forfeited.

(ii) The amount of Excess Aggregate Contributions for a Plan Year will be determined only after first determining the Excess Contributions that are treated as Employee contributions because of recharacterization for the Plan Year.

3.8 Limitations on Contributions and Benefits.

(a) Definition of Annual Additions. For purposes of the Plan, "Annual Addition" shall mean the amounts allocated to a Participant's account during the limitation year that constitute:

- (1) Employer Contributions,
- (2) Employee Contributions,
- (3) Forfeitures, and

(4) Amounts described in Sections 415(l)(1) and 419A(d)(2) of the Code.

(b) Maximum Annual Addition. The maximum annual addition that may be contributed or allocated to a Participant's account under the Plan for any limitation year shall not exceed the lesser of

(1) the Defined Contribution Dollar Limitation, or

(2) Twenty-five (25%) percent of the Participant's compensation, within the meaning of Section 415(c)(3) of the Code for the Limitation Year.

(c) Special Rules. The compensation limitation referred to in subsection (b)(2) shall not apply to:

(1) Any contribution for medical benefits (within the meaning of Section 419A(f)(2) of the Code) after separation from service which is otherwise treated as an Annual Addition, or

(2) Any amount otherwise treated as an Annual Addition under Section 415(l)(1) of the Code.

(d) Definitions. For purposes of Section 3.8,

(1) Defined Contribution Dollar Limitation means \$30,000.00 or, if greater, 1/4 of the defined benefit dollar limitation set forth in Section 415(b)(1) of the Code as in effect for the Limitation Year.

(2) Limitation Year means the calendar year.

(e) Limitations if Participant in More Than One Plan. The foregoing limitations of this Section 3.8 shall apply to the Annual Additions to this Plan and all Annual Additions made to all other defined contribution plans whether terminated or ever maintained by the Employer or a Related Employer in which the Participant is or was a Participant.

(f) Overall Limitation on Defined Benefit and Defined Contribution Plan Benefits. The sum of a Participant's defined benefit plan fraction and his defined contribution plan fraction shall not exceed 1.0. This limitation shall be applied in accordance with the following provisions specified in the following subparagraphs.

(1) A Participant's defined benefit plan fraction is the projected annual benefit of the Participant under all defined benefit plans (whether terminated or not) ever maintained by the Employer or by Related Employers divided by the lesser of

(a) the product of 1.25 multiplied by the dollar limitation in effect from time to time under Section 415(b)(1)(A) of the Code, or

(b) the product of 1.4 multiplied by the amount that may be taken into account under Section 415(b)(1)(B) of the Code with respect to such individual for such year.

All such amounts shall be determined as of the close of the Limitation Year, with such applicable adjustments and reductions as are required under Section 415(b) of the Code. Notwithstanding the above, if the Participant was a Participant as of the first day of the first Limitation Year beginning after December 31, 1986, in one or more defined benefit plans maintained by the Employer that were in existence on May 6, 1986, the denominator of the fraction may not be less than 125 percent of the sum of the annual benefits under such plans that the Participant had accrued as of the close of the Last Limitation Year beginning before January 1, 1987, disregarding any changes in the terms and conditions of the plans after May 5, 1986. The preceding sentence shall only apply if the defined benefit plans individually and in the aggregate satisfied the requirements of Section 415 of the Code for all Limitation Years beginning before January 1, 1987.

(2) A Participant's defined contribution plan fraction is the sum of the Annual Additions to the Participant's account under the Plan and all other defined contribution plans (whether terminated or not) ever maintained by the Employer or by Related Employers as of the close of the Limitation Year, divided by the lesser of:

(a) the sum of the product of 1.25 multiplied by the dollar limitation in effect under Section 415(c)(1)(A) of the Code (determined without regard to subsection (c)(6) thereof) for such year and each prior year of service with the Employer or Related Employers, or

(b) the sum of the product of 1.4 multiplied by the amount that may be taken into account under Section 415(c)(1)(B) (or subsection (c)(7), if applicable) of the Code for such year and each prior year of service with the Employer or Related Employers.

All such amounts shall be determined as of the close of the Limitation Year and with such applicable limits and adjustments as are required under Section 415(b) of the Code. Notwithstanding the above, if the Employee was a Participant as of the first day of the first Limitation Year beginning after December 31, 1986, in one or more defined benefit contribution plans maintained by the Employer that were in existence on May 6, 1986, the numerator of this fraction will be adjusted if the sum of this fraction and the defined benefit fraction would otherwise exceed 1.0 under the terms of the Plan. Under the adjustment, an amount, equal to the product of the excess of the sum of the fractions over 1.0 times the denominator of this fraction, will be permanently subtracted from the numerator of this fraction. The adjustment is calculated using the fractions as they would be computed as of the end of the last Limitation Year beginning before January 1, 1987, and disregarding any changes in the terms and conditions of the plans made after May 6, 1986, but using the Section 415 limitation applicable to the first Limitation Year beginning on or after January 1, 1987.

(3) For purposes of applying the limitations of this Section 3.8, the amount of any nondeductible Employee Contributions credited for the Limitation Year under any defined benefit plan maintained by the Employer or by any Related Employer shall be treated as an

Annual Addition for the benefit of the Participant under a qualified defined contribution plan.

(g) Source of Benefit Reduction Necessary to Meet Annual Addition Limitation. If as a result of the foregoing, a Participant's defined contribution plan Annual Additions will exceed the limitations of this Section, the required reduction in such Additions shall be made first to the Donegal Mutual Insurance Company Profit Sharing Plan Annual Additions and, if necessary, then to the Annual Additions with respect to a Participant made to this Plan, proceeding first through forfeitures allocated to the Participant's Employer Matching Contribution account, then the Employer's Matching Contribution for the Plan Year and then to the return of the Elective Contributions of a Participant for the Plan Year. Any reduction in Employer Matching Contributions or forfeitures that would otherwise have been allocated to the Participant under this Plan in order to meet the above limitations shall be treated as a forfeiture and used to reduce the Employer Matching Contribution otherwise required.

3.9 Distribution of Excess Deferrals.

(a) In General. Notwithstanding any other provision of the Plan, Excess Deferral Amounts for any Plan Year and the income allocable thereto shall be distributed no later than April 15 of the next succeeding year to Participants who claim such Allocable Excess Deferral Amounts for the calendar year.

(b) Definitions. For purposes of this Section 3.9, "Excess Deferral Amount" means the amount of Elective Deferrals for a calendar year that the Participant allocates to this Plan pursuant to the claim procedure set forth in Section 3.9(c).

(c) Claims. The Participant's claim shall be in writing and be submitted to the Plan Committee no later than March 1 of the next succeeding year. It shall specify the Participant's Excess Deferral Amount for the preceding calendar year and be accompanied by the Participant's written statement that if such amounts are not distributed, such Excess Deferral Amount, when added to amounts deferred under other plans or arrangements described in Section 401(k), 408(k) or 403(b) of the Code, will exceed the limit imposed on the Participant by Section 402(g) of the Code for the year in which the deferral occurred.

(d) Maximum Distribution Amount. The Excess Deferral Amount distributed to a Participant with respect to a calendar year shall be adjusted for income and, if there is a loss allocable to the Excess Deferral, shall in no event be less than the lesser of the Participant's account under the Plan or the Participant's Elective Deferrals for the Plan Year.

3.10 Excess Contributions.

(a) In General. Excess Contributions as defined in IRC Section 401(k)(8)(B) and the income allocable thereto (as provided in paragraph (c) hereof) shall be distributed no later than the March 15th of the next succeeding Plan Year to the Highly-Compensated Employees as provided herein. The amount of Excess Contributions to be distributed shall be determined by reducing the Elective Deferral amount of the Highly Compensated Employee having the highest Elective Deferral amount for such year to the higher of (1), the level at which the ADP test is passed by the Plan without the reduction of the ADP of any other Highly Compensated

Employees or (2) the ADP of the Highly Compensated Employee having the next highest Elective Deferral amount. If this process does not satisfy the ADP test for the Plan, this process as described in the preceding sentence shall be repeated at the progressively descending elective deferral amount levels amount Highly Compensated Employees until the ADP test is satisfied, or until the aggregate of excess Elective Deferral amounts has been refunded, whichever is the first to occur. All excess contributions must be corrected by the close of the Plan Year following the Plan Year for which they were made.

(b) Election to Treat As Employee Contributions. Any amount required to be distributed to a Participant by paragraph (a) hereof shall, at the election of the Participant and to the extent provided in Treasury Regulations, be retained in the Plan as a Voluntary Employee Contribution and treated as an amount distributed to the Participant and then contributed as such a Voluntary Employee Contribution. Any excess contributions recharacterized as Employee Contributions pursuant to the preceding sentence shall nevertheless remain subject to the same nonforfeitability requirements and distribution limitations as apply to Elective Contributions.

(c) Excess Aggregate Contributions. Excess Aggregate Contributions in the amount allocable thereto (as provided in paragraph (d) hereof shall be distributed no later than the March 15th of the next succeeding Plan Year to the Highly-Compensated Participants on the basis of the respective portions of such amounts attributable to each of such Participants. Excess Aggregate Contributions means the amount described in Section 401(m)(6)(B) of the Code.

The foregoing notwithstanding, the amount of Excess Contributions to be distributed shall be reduced by Excess Deferrals (ss.3.9) previously distributed for the taxable year ending in the same Plan Year and Excess Deferrals to be distributed for a taxable year will be reduced by Excess Contributions previously distributed or recharacterized for the Plan Year beginning in such taxable year.

(d) Determination of Income. The income allocable to Excess Contributions and Excess Aggregate Contributions shall be determined by computing both the income for the Plan Year with respect to which the excess amounts relate and the income for the period between the end of that year and the date of distribution ("the gap"). The income allocable to such excess amounts will be equal to the sum of the income allocable to the Participant's account containing the excess amounts for the applicable year and the income allocable to such account for the gap period multiplied by a fraction, the numerator of which is the excess amount and the denominator of which is the closing balance as of the end of the applicable year. Until provided otherwise by Treasury Regulations, such distribution shall be made without reduction for net losses.

(e) Limitations on Multiple Use of Alternative Limitation. The alternative method of compliance with IRC Sections 401(k) and 401(m) shall be limited as provided in Treas. Reg. Section 1.401(m)-(2)(b). In the event a multiple use of the alternative limitation occurs, correction of such use with respect to the affected Highly-Compensated Employees shall be accomplished by reducing the Actual Deferral Percentage of the Highly-Compensated Employees and such reduction shall be treated as an Excess Contribution subject to the provisions of this Section 3.10.

3.11 Employee Rollover Contributions.

(a) An Employee eligible to participate in the Plan, whether or not a Participant, may transfer to the Plan within the time period and in the manner prescribed in paragraph (c) below and pursuant to procedures promulgated by the Plan Committee, a rollover amount as defined in paragraph (b) below, provided that such rollover amount shall be subject in all respects to this section 3.11. The rollover amount shall be credited to a Rollover Account maintained for that Employee/Participant. That Account shall share in the income allocations of the trust fund as provided in section 4.3(d) hereof, but it shall not share in Employer contributions nor any other allocations under section 4.3. Upon the termination of the Participant's employment with the Employer, for whatever reason, the total balance in the Rollover Account shall be distributed in the same manner as the balances in the Participant's other accounts in accordance with Article V hereof.

(b) For purposes of this section, rollover amount means as to any Employee, an "eligible rollover distribution" as defined in Section 402(c)(4) of the Code.

(c) Rollover amounts must be transferred to this Plan on or before the sixtieth (60th) day following the Employee's receipt of the rollover amount. The Employee may authorize the Plan Committee to obtain the rollover amount from the transferor plan directly. As a condition precedent to being permitted to transfer a rollover amount to the Plan, the Employee shall comply with such requirements and complete such forms as the Plan Committee reasonably believes are necessary to insure that any amount it authorizes the Trustee to accept constitutes a rollover amount as defined in Section 402(c)(4) of the Code.

(d) The foregoing notwithstanding, in determining whether the distribution to be received as a rollover is being received from a qualified plan, the Plan Committee shall be entitled to rely on the representations of the Employee as provided in the Treasury Regulations that the distributing plan is a qualified plan. Regardless of whether it is ultimately determined that such distributing plan is or is not a qualified plan, the acceptance of such contribution shall not be a grounds for disqualification of the Plan. Nevertheless, if the Plan Committee determines at any time that any amount accepted as a rollover amount pursuant to this section, for whatever reason, was not eligible for such classification or otherwise did not qualify as a rollover amount, the Committee shall direct the Trustees to pay to the Employee/Participant or his designated beneficiary the total amount accepted as a rollover amount plus all earnings and increments in value thereon from the date of acceptance to the date of such distribution. The Plan Committee shall authorize the Trustees or other payor to withhold from such distribution any taxes as required by law and to submit such information documents to the taxing authorities as required by law.

(e) Under all circumstances and at all times the Employee/Participant shall be 100% vested in the balance of the Employee's Rollover Account.

3.12 Direct Rollovers Permitted

(a) Notwithstanding any provision of the Plan to the contrary that would otherwise limit a distributee's election under this Section, a distributee may elect, at the time and in the manner prescribed by the Committee, to have any portion of an eligible

rollover distribution paid directly to an eligible retirement plan specified by the distributee in a direct rollover.

(b) Definitions.

1. Eligible rollover distribution: An eligible rollover distribution is any distribution of all or any portion of the balance to the credit of the distributee, except that an eligible rollover distribution does not include: any distribution that is one of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the distributee or the joint lives (or joint life expectancies) of the distributee and the distributee's designated beneficiary, or for a specified period of ten years or more; any distribution to the extent such distribution is required under Section 401(a)(9) of the Code; and the portion of any distribution that is not includible in gross income (determined without regard to the exclusion for net unrealized appreciation with respect to employer securities).

2. Eligible retirement plan: An eligible retirement plan is an individual retirement account described in Section 408(a) of the Code, an individual retirement annuity described in Section 408(b) of the Code, an annuity plan described in Section 403(a) of the Code, or a qualified trust described in Section 401(a) of the Code, that accepts the distributee's eligible rollover distribution. However, in the case of an eligible rollover distribution to the surviving spouse, an eligible retirement plan is an individual retirement account or individual retirement annuity.

3. Distributee: A distributee includes an Employee or former Employee. In addition, the Employee's or former Employee's surviving spouse and the Employee's or former Employee's spouse or former spouse who is the alternate payee under a qualified domestic relations order, as defined in Section 414(p) of the Code, are distributees with regard to the interest of the spouse or former spouse.

4. Direct rollover: A direct rollover is a payment by the Plan to the eligible retirement plan specified by the distributee.

3.13 Reemployment after Distribution. If any former Participant shall be re-employed by the Employer before incurring five consecutive 1 year Breaks in Service, and such former Participant had received a distribution of his entire vested interest prior to his re-employment, his forfeited account shall be reinstated only if he repays the full amount distributed to him before the earlier of five years after (1) the first date on which the Participant is subsequently re-employed by the Employer, or (2) the close of the first of five consecutive 1 year Breaks in Service commencing after the distribution. If a distribution occurs for any reason other than a separation from service, the time for repayment may not end earlier than five years after the date of separation. In the event the former Participant does repay the full amount distributed to him, the undistributed portion of the Participant's Account must be restored in full, unadjusted by any gains or losses occurring subsequent to the Anniversary Date coinciding with or preceding his

termination. The source for such reinstatement shall first be any forfeitures occurring during the year. If such source is insufficient, then the Employer shall contribute an amount which is sufficient to restore any such forfeited Account. Additionally, the Employer shall establish a separate account for the Participant's interest in the Plan at the time of the distribution and at any time during which the Participant's vested percentage in that account can increase that vested portion will equal or exceed an amount determined by applying the following formula where "x" equals the amount: $x = P (ab + (r \times d) - (r \times d))$. "P" is the vested percentage; "ab" is the account balance; "d" is the amount of the distribution; and "r" is the ratio of the account balance at the relevant time to the account balance after the distribution.

ARTICLE IV

PARTICIPANTS' ACCOUNTS

4.1 Individual Accounts. The Plan Committee shall establish and maintain for each Participant (or Beneficiary of a deceased Participant) an Elective Deferral Account and Employer Matching Contribution Account. Credits and charges shall be made to each such Account in the manner hereinafter described. The maintenance of Accounts is for accounting purposes only, and a segregation of the assets of the Trust to each Account shall not be required.

4.2 Valuation of the Trust. The Trust shall be valued by the Trustees on the Anniversary Date in each Plan Year. Such valuation shall be made on the basis of the fair market value of all property held in Trust. Any contribution made on account of a particular Plan Year but received by the Trustees after the end of such Plan Year shall be treated as having been made on the Anniversary Date.

4.3 Adjustments and Allocations to Accounts. At the end of each Plan Year, the Accounts of each Participant (or Beneficiary of a deceased Participant) shall be adjusted in the following order:

(a) decreased by any amounts distributed to or for the benefit of the Participant (or Beneficiary of a deceased Participant);

(b) increased by the contributions made by or on behalf of the Participant to his account not previously so allocated;

(c) increased by the Employer's Matching Contribution which shall be allocated to each Participant's Employer Matching Contribution Account, provided that no allocation shall be made to the account of a Participant unless that Participant is in the employ of the Employer on the last day of the year, except as provided in Section 3.1; and

(d) increased by the income of the Trust in proportion to the account balances in each such account on the last day of each calendar quarter in proportion to the balances of all such accounts on the same day prior to the income allocation provided herein.

(e) The foregoing notwithstanding, if as a result of a reasonable error in estimating a Participant's Plan Compensation, or a reasonable error in determining the amount of a Participant's Elective Deferrals, the annual additions for a Participant for a particular Plan Year would cause the limitations of Code Section 415 applicable to that Participant for that Plan Year to be exceeded, such excess amounts shall not be deemed to be annual additions to that Participant's account and shall not increase that Participant's account, but rather shall be removed from that Participant's account and be used to reduce the Employer contributions for the next Limitation Year (Plan Year) and succeeding Limitation Years, if necessary, for that Participant if that Participant is covered by the Plan as of the end of the Limitation Year. If the Participant is not covered by the Plan as of the end of the Limitation Year, then such excess must be held unallocated in a suspense account for that Limitation Year and allocated and reallocated in the next Limitation Year to all remaining Participants and such excess amounts must be used to reduce the Employer contributions for such Limitation Years. No such excess amounts may be distributed to Participants or former participants.

4.4 Combined Limitations.

(a) In the event any Participant in this Plan is a participant under any other Defined Contribution Plan maintained by the Employer (whether or not terminated), the total amount of Annual Additions to such Participant's Accounts for any Limitation Year from all such Defined Contribution Plans shall not exceed the limitations set forth in Section 3.8. Any reduction shall be made first from the Employer's profit sharing plan or plans and then from the Employer's other defined contribution plans. If it is determined that as a result of the limitations set forth in this Section, the Annual Additions to a Participant's account in this Plan must be reduced, such reduction shall be accomplished in accordance with the provisions of Section 3.10.

(b) In the event that any Participant under this Plan is a participant under one or more Defined Benefit Plans maintained by the Employer (whether or not terminated), then for any Limitation Year the sum of the Defined Benefit Plan Fraction for such Limitation Year and the Defined Contribution Plan Fraction for such Limitation Year shall not exceed one (1.0). If it is determined that, as a result of the limitations set forth in this Section 4.4, the Annual Additions under this Plan must be reduced, such reduction shall be accomplished in accordance with the provisions of Section 3.10.

(c) Definitions Relating to Annual Addition Limitations: For purposes of Section 4.4, the following definitions shall apply:

(1) "Retirement Plan" means a Plan maintained by the Employer which is (A) a profit sharing, or pension plan described in Section 401(a) of the Code, (B) an annuity plan or annuity contract described in Sections 403(a) or 403(b) of the Code, (C) a qualified bond purchase plan described in Section 405(a) of the Code, or (D) an individual retirement account, individual retirement annuity or retirement bond described in Sections 408(a), 408(b) or 409 of the Code.

(2) "Defined Contribution Plan" means a Retirement Plan which provides for an individual account for each Participant and for benefits based solely on the amount contributed to the Participant's account, and any income, expense, gains and losses, and any

forfeitures of accounts of other participants which may be allocated to such participant's account.

(3) "Defined Benefit Plan" means any Retirement Plan which does not meet the definition of a Defined Contribution Plan.

(4) "Defined Benefit Plan Fraction", for any Limitation Year means a fraction (A) the numerator of which is the projected annual benefit of the Participant (the annual benefit to which such Participant would be entitled under the terms of the Defined Benefit Plan on the assumptions that he continues employment until his normal retirement age as determined under the terms of such Defined Benefit Plan, that his compensation continues at the same rate as in effect in the Limitation Year under consideration until the date of his normal retirement age and that all other relevant factors used to determine benefits under such Defined Benefit Plan remain constant as of the current Limitation Year for all future Limitation Years) under all Defined Benefit Plans maintained by the Employer, determined as of the close of the Limitation Year, and (B) the denominator of which is the lesser of (i) the product of 1.25 multiplied by the dollar limitation in effect under subsection (b)(1)(A) of Section 415 of the Code for such Limitation Year, or (ii) the product of 1.4 multiplied by 100% of the Participant's average compensation for his high three Limitation Years.

(5) "Defined Contribution Plan Fraction" for any Limitation Year shall mean a fraction (A) the numerator of which is the sum of the Annual Additions to the Participant's accounts under all Defined contribution Plans maintained by the Employer in such Limitation Year, and (B) the denominator of which is the sum of the lesser of the following amounts determined for such Limitation Year and for each prior Limitation Year of service with the Employer: (i) the product of 1.25 multiplied by the dollar limitation in effect under subsection (c)(1)(A) of Section 415 of the Code for such Limitation Year (without regard to subsection (c)(6) thereof), or (ii) the product of 1.4 multiplied by 25% of the Participant's Limitation Year Compensation.

(6) "Limitation Year" shall mean the Plan Year.

(7) "Limitation Year Compensation" shall mean compensation as defined in Section 1.3(d) of the Plan.

(8) "Employer" means the employer that adopts this Plan, and all members of a controlled group of corporations (as defined in Section 414(b) of the Code as modified by Section 415(h), all commonly controlled trades or businesses (as defined in Section 414(c) of the Code as modified by Section 415(h) or affiliated Service groups (as defined in Section 414(m) of the Code) of which the adopting employer is a part.

4.5 Self-Directed Accounts.

(a) Each Participant shall direct the Trustees as to how all or any portion of the Participant's Account shall be invested in accordance with such rules and regulations that permit a Participant the opportunity to exercise control over the assets in his individual account and provide an opportunity to choose, from a broad range of investments, the manner in which

some or all of such assets are invested. The Trustees shall implement such Participant instructions except as provided in paragraph (c) below. All rules and regulations shall be applied consistently and uniformly to all Participants similarly situated.

(b) The Trustees shall make available to each Participant the opportunity to choose from at least three diversified categories of investments (including look-through investments) and to transfer all or any portion of the Participant's Account between and among such investments no less frequently than quarterly annually. In addition to investment directions which may be given pursuant to paragraph (d) below, a Participant may invest in any of the look-through investment vehicles as selected by the Trustees. All of the information concerning such investments shall be made available to a Participant upon request to the Trustees by distribution of the prospectuses and other information concerning such look-through investments as is provided to the Trustees.

(c) The Trustees shall not honor investment directions which, if implemented would not be in accordance with the Plan documents to the extent the Plan documents are consistent with Title I of ERISA; would cause the Plan to maintain an indicia of ownership of any Plan assets outside of the United States; would jeopardize the Plan's tax qualified status under the Internal Revenue Code; would result in a prohibited transaction as described in ERISA Section 406, or in IRC Section 4975; could result in a loss in excess of the Participant's Account balance; or, would generate income taxable to the Plan.

(d) In addition to the look-through investment vehicles available to the Participant under paragraph (b) above, a Participant may select any other investment, subject to the limitations of paragraph (c) and subject to the Participant bearing the expenses of carrying out the Participant's instructions in purchasing such investments, all of which shall be detailed in writing by the Trustees to the Participant to the extent known and, if there are expenses which are unknown that fact shall be in writing on forms supplied by the Trustees and shall be signed by the Participant and witnessed by a Trustee.

(e) Under no circumstances shall the ability of a Participant to direct the investment of the amounts credited to his Account be interpreted to allow the Participant to invest such Accounts directly or to ever take possession of all or any portion of his Account, except as specifically provided by this Plan. All funds while held in the Trust are part of the trust fund and are managed exclusively by the Trustees subject to this Section 4.5.

(f) It is specifically intended that the Plan qualify as an ERISA 404(c) Plan. The Plan Committee is the identified plan fiduciary to accept Participant's investment choices and to distribute such investment information. The Plan Committee may designate all or a portion of this responsibility to others provided such designation is communicated in writing to the Participants. To the extent the Plan does qualify as an ERISA 404(c) Plan, with respect to each Participant the Plan fiduciaries may be relieved of liability for any losses which are the direct and necessary result of investment choices made by the Participant or the Participant's beneficiary. A Participant may change the allocation of his contribution and account balances at least once in any three months. Each Participant shall have the opportunity to give investment instructions to the Plan Committee or its designee and will obtain written confirmation of such instructions. Under no circumstances is any person, including any member of the Plan Committee, or any employee of

the Employer, authorized to distribute to a Participant information concerning any investment that is not contained in a prospectus or otherwise made available pursuant to all applicable laws regulating the sale and investment of securities and other property.

ARTICLE V

PAYMENT OF BENEFITS

5.1 Vesting and Forfeitures.

(a) Elective Deferral Account - A Participant shall be 100% vested at all times in the amounts held in this account.

(b) Employer Matching Contribution Account - A Participant will be 100% vested in the amounts held in this account after the completion of three (3) Years of Service:

(c) Except as provided above, for purposes of this Plan, the word "Accounts" shall mean both a Participant's Elective Deferral Account and the Employer Matching Contribution Account.

(d) All forfeitures arising under this Plan shall be applied to the restoration of any accounts of Participants who are reemployed during the Plan Year as required by this Plan and forfeitures remaining, if any, will be applied toward the Employer's Matching Contribution for the Plan Year in which the forfeitures occurred. If there are any forfeitures remaining unapplied after the application of the preceding sentence, they will be applied to the Matching Contribution accounts of the Participants remaining in the Plan in proportion to their compensation for that Plan Year.

5.2 Retirement. A Participant shall reach Normal Retirement Age upon attaining age 65 and Early Retirement Age upon attaining age 55 and may retire as of the first day of the month coincident with or following his attainment of such ages as the Participant elects, which day shall be called the Participant's Retirement Date. A Participant shall have a nonforfeitable right to the balances in his Accounts upon attainment of Early or Normal Retirement Age. A Participant may remain actively employed by the Employer after his Normal Retirement Date, subject to any written mandatory retirement policy of the Employer. He shall continue to be a Participant in the Plan as long he remains so employed by the Employer, and he may retire or be retired in accordance with any such written mandatory retirement policy of the Employer, as of the first day of any month after his Normal Retirement Date. A Participant who retires under this section shall be entitled to distribution of his entire Accounts balance at the time and in the manner provided by Section 5.8.

5.3 Age 59-1/2. Upon attainment of age 59-1/2, a Participant may request a distribution of all or any portion of the vested portion of his Accounts attributable to contributions made pursuant to Sections 3.1, 3.4, and 3.11. Such distribution may be made even though the Participant has not terminated employment and continues as a Participant in the Plan thereafter. A Participant requesting a distribution under this Section shall be entitled to distribution at the

time and in the manner provided by Section 5.8.

5.4 Disability. A Participant who is determined by the Employer to be disabled as defined in Section 1.4(a) hereof, shall be considered to have taken disability retirement as of the first day of the month following the month in which the Employer makes such determination. The Employer may require the Participant to submit to medical examinations for the purpose of verifying the Participant's disability. A Participant who becomes disabled shall have a 100% nonforfeitable right to the balances in his Accounts and shall be entitled to distribution of his Accounts at the time and in the manner provided by Section 5.8.

5.5 Death. In the event of a Participant's death prior to his termination of employment with the Employer, the balances in such Participant's Accounts shall become fully vested and payable to the Participant's beneficiary as designated under the Plan. Distribution of such balances shall be made at the time and in the manner provided by Section 5.8. Unless otherwise elected in the manner prescribed in this Section, the Beneficiary of any death benefit payable hereunder shall be the Participant's spouse. The Participant may designate a Beneficiary other than his or her spouse only if:

- (a) The Participant's spouse has consented to the Beneficiary Designation. Such consent must be in writing and must be witnessed by a representative of the Plan Committee or notarized. The consent will be valid only as to the spouse who signed it; or
- (b) The Participant establishes to the satisfaction of the Plan Committee that he or she has no spouse; or
- (c) The Participant's spouse cannot be located; or
- (d) Because of other circumstances under which no spousal consent is required in accordance with applicable regulations under the Code or ERISA.

5.6 Termination of Employment Prior to Retirement, Disability or Death. A Participant who terminates employment with the Employer and who is not entitled to distribution of his account balance under any previous section of this Article V, shall be entitled to distribution of the vested balances in his Accounts at the time and in the manner provided by Section 5.8.

5.7 Limitation on Distributions. Except as provided in Section 5.8, no distributions shall be made to a Participant from his Accounts until such Participant's retirement, attainment of age 59-1/2, death, disability, other termination of employment or due to hardship as provided herein.

The Plan Administrator shall not permit a distribution of any benefit prior to the Participant's Normal or Early Retirement Age where the present value of the non-forfeitable accrued benefit (taking into account benefits derived from both Employer and Employee contributions) is in excess of \$5,000 without the consent of the Participant's spouse. The Plan Administrator must obtain the written consent of the Participant and where applicable the Participant's spouse not more than 90 days before the commencement of the distribution of any part of an accrued benefit hereunder.

5.8 Distribution upon Retirement, Disability, Death or Other Termination of Employment.

(a) Time and Manner of Distribution. Upon a Participant's retirement, attainment of age 59-1/2 (if a distribution is requested at that time pursuant to the provisions of Section 5.3), disability, death, or other termination of employment, there shall be distributed to the Participant, or to his Beneficiary in the case of death, the vested balances in the Participant's Accounts as of the Accounting Date immediately preceding the date of such separation from employment, plus any contributions credited or to be credited to his Accounts subsequent to such Accounting Date, in a lump sum, to be distributed as soon as practicable after such separation from employment (and in the case of an age 59-1/2 in-service distribution as soon as practical after the written request is received by the Plan Committee) unless elected otherwise by the Participant or the Participant's surviving spouse. For purposes of this Section 5.8 "Accounting Date" means a date on which the Trustee values the Investment Funds and makes allocations to Accounts pursuant to Article IV. Notwithstanding the foregoing, a Participant who has separated from employment may elect, pursuant to Plan Committee rules, to defer such lump sum distribution to any subsequent date, subject to the restrictions contained in subsection (b) hereof. The Accounting Date for such deferred lump sum distribution shall be the Accounting Date which immediately precedes the date of distribution elected by the Participant. An election to defer a distribution may be changed no more frequently than annually and shall be irrevocable upon the death of the Participant.

If a Participant (or Beneficiary) entitled to receive a distribution under this Section 5.8 should die prior to the time he has received the full distribution to which he is entitled, then the amount credited to his Accounts as of the Accounting Date for the month in which the death occurs shall be distributed to the deceased Participant's Beneficiary or to the estate of the Beneficiary in the case of the Beneficiary's death. The provisions of this Section 5.8 shall apply to all benefits payable to a Participant derived from both Employer and non-deductible Employee Contributions. If a distribution is considered to have commenced in accordance with the Treasury Regulations before the Participant's death, the remaining interest of the Participant will be distributed at least as rapidly as under the method of distribution being used as of the date of the Participant's death. Additionally, distributions under this Plan will be made in accordance with the requirement of the Treasury Regulations under Section 401(a)(9), including the minimum distribution incidental benefit requirements of Section 1.401(a)(9)-2 of the proposed Regulations.

(b) Restrictions. Distributions are subject to the following restrictions where applicable:

(1) No Participant (or Beneficiary) may elect a distribution date which is earlier than 60 days following the date on which the Participant's Accounts are to be valued.

(2) Each Participant's Accounts balances must be distributed to him in full no later than the April 1st following the calendar year in which he attains age 70-1/2; provided however, if Participant dies before his entire Accounts balances have been distributed, or if distribution has commenced to the Participant's surviving spouse who dies before the entire Account balances have been distributed then the entire remaining Account balances must be distributed to the Participant's designated Beneficiary within five years of the Participant's death

(or the death of his surviving spouse). The foregoing notwithstanding, a Participant other than a five (5%) percent owner shall not be required to accept a distribution regardless of age prior to the termination of his employment with the Employer.

(3) Notwithstanding (2) above or any other provision herein to the contrary, in no event shall distribution of a Participant's Accounts be made later than the sixtieth (60th) day after the close of the Plan Year in which occurs the latest of the following events:

(a) The attainment by the Participant of age 65;

(b) In the case of a Plan Participant who commences participation in the Plan within five (5) years before attaining age 65, the fifth anniversary of the time the Plan Participant commences participation in the Plan;

(c) In the case of a Plan Participant not described in paragraph (b) above, the tenth anniversary of the Plan Year in which the Participant joined the Plan as a Participant;

(d) The termination of the Participant's service with the Employer; or

(e) The date specified by the Participant in his election made pursuant to subsection (a) hereof.

5.9 Distributions of \$5,000 or Less. Upon the termination of a Participant's employment with the Employer, prior to a Participant's annuity starting date, the Plan Committee shall make an immediate total distribution of the vested value of the account of the Participant if the present value of such account to the extent vested (calculated using an interest rate not greater than the PBGC rate) is \$5,000 or less and, at no time prior to the termination of the Participant's employment, ever exceeded \$5,000.00. Such amount shall be paid to the Participant, or if the Participant is then deceased, to the Participant's designated beneficiary; provided, however, if the distribution provided hereunder is less than the total amount of the Participant's account at the time of the distribution and if the Participant is reemployed within the five (5) year period commencing on such termination, the Participant shall have repayment rights with respect to such distribution identical to those provided in Section 3.13 hereof.

5.10 Additional Distribution Restrictions. Notwithstanding anything else contained in this Plan, amounts attributable to Elective Deferrals may not be distributed earlier than the occurrence of one of the following events:

(1) the Participant's retirement, death or disability or separation from service;

(2) the termination of this Plan without the establishment or maintenance of another defined contribution plan (other than an ESOP or SEP);

(3) the Participant's attainment of age 59 1/2 or hardship as provided

herein;

(4) the sale or disposition by the Employer to an unrelated corporation of substantially all of its assets, but only with respect to Employees who continue employment with the acquiring corporation and the acquiring corporation does not maintain the Plan after the disposition; and

(5) the sale or other disposition by the Employer of its interest in a subsidiary to an unrelated entity but only with respect to Employees who continue employment with the subsidiary and the acquiring entity does not maintain the Plan after the disposition.

Clauses, 2, 4, and 5 apply only if the distribution is in the form of a lump sum and clauses 4 and 5 apply only if the transferor corporation continues to maintain the Plan.

ARTICLE VI

FIDUCIARY RESPONSIBILITY

6.1 Named Fiduciary. The Employer shall be the "named fiduciary" referred to in Section 402(a) of ERISA with respect to the management, operation and administration of the Plan and is also responsible for making contributions provided for under Section 3.1. The "Plan Administrator" as defined in Section 414(g) of the Code and Section 3(16) of ERISA is the Plan Committee as established by Article VIII hereof.

6.2 Allocation of Fiduciary Responsibility. Each fiduciary, whether named herein or otherwise, shall only have the individual responsibility for exercising the functions and responsibilities assigned or allocated to such fiduciary hereunder. Unless otherwise specifically provided herein, no fiduciary responsibility shall be shared by two or more fiduciaries. Where one fiduciary follows the directions of another fiduciary, who has the fiduciary responsibility for such action, then the fiduciary following such direction shall not be deemed a fiduciary hereunder in taking such action.

6.3 Service in More than One Capacity. Any person, or group of persons, may serve in more than one fiduciary capacity with respect to this Plan.

6.4 Employment of Advisers. A fiduciary may engage accountants, attorneys, actuaries or such other advisers as it deems necessary or advisable to properly carry out its duties under this Plan. The functions of any such persons designated by the fiduciary shall be limited to the specific services and duties for which they are engaged, and such persons shall have no other duties, obligations or responsibilities under the Plan.

6.5 Compensation of Fiduciaries and Advisers. The fees, expenses and costs charged or incurred by any fiduciary or any adviser hereunder may be paid in whole or in part by the Employer, and any such fees, expenses or costs not paid by the Employer shall be paid out of the

Trust; provided that such compensation or reimbursement is reasonable under the circumstances; and provided further that no person who already receives full-time pay from an Employer whose employees are Participants in the Plan shall receive any compensation from the Trust, except for reimbursement of expenses properly and actually incurred.

6.6 Liability of Fiduciaries. Each fiduciary, and each adviser to any fiduciary, shall be free from all liability for any act or conduct in carrying out its responsibilities under this Plan, except for acts of willful misconduct or gross negligence; provided, however, that the foregoing shall not relieve any such fiduciary or adviser from any responsibility or liability that it may have pursuant to ERISA.

ARTICLE VII

PLAN ADMINISTRATION

7.1 Plan Committee. A Plan Committee consisting of at least two officers of the Employer shall be the Plan Administrator. The Plan Committee may appoint one member authorized to sign any reports required by ERISA in representation of all members. Members of the Plan Committee shall serve until their resignation or dismissal by the Employer and vacancies shall be filled in the same manner as the original appointments. The Employer may dismiss any member of the Plan Committee at any time with or without cause.

7.2 Duties and Powers of the Plan Committee. The Plan Committee shall have such duties and powers as may be necessary to discharge its duties hereunder, including, but not limited to, the following:

- (a) To construe and interpret the Plan and Trust.
- (b) To decide all questions of the eligibility of Employees to become Participants under the Plan.
- (c) To determine the amount, manner and time of payment of benefits under the Plan.
- (d) To authorize and direct all disbursements by the Trustee from the Trust.
- (e) To prescribe procedures to be followed by Participants or Beneficiaries for filing applications for benefits.
- (f) To prepare and distribute to Participants information explaining the Plan.
- (g) To make and publish rules for the regulation of the Plan which are not inconsistent with the terms of the Plan or with ERISA.
- (h) To designate one or more of its members to assume responsibility for any of its functions or to delegate to individuals not members of the Committee any administrative,

clerical or other nondiscretionary duties provided always in such delegation, the Committee shall alone remain responsible for decisions affecting the rights of Participants and their beneficiaries.

(i) To take any action required to take self corrective measures as required by the Internal Revenue Service or the Department of Labor to preserve the tax qualified status of the Plan, to correct errors in fiduciary conduct or such other action to maintain the Plan in compliance with all applicable laws.

The Plan Committee shall have no power to add to, subtract from or modify any of the terms of the Plan, or to modify any benefits provided by the Plan, or to waive or fail to apply any requirements for eligibility for a benefit under the Plan. All policies, rules, interpretations and decisions of the Plan Committee shall be uniformly and consistently applied in a nondiscriminatory manner to all Participants in similar circumstances. The Plan Committee shall be entitled to rely upon information furnished by a Participant or Beneficiary in carrying out its duties hereunder.

7.3 Claims Procedure. The Plan Committee shall make all determinations as to the right of any person to a benefit under this Plan. If a claim is denied by the Plan Committee, it shall give written notice to the claimant setting forth (a) the specific reason or reasons for the denial, (b) the specific reference to pertinent Plan provisions on which the denial is based, (c) a description of any additional material or information necessary for the claimant to perfect the claim and an explanation of why such material or information is necessary, and (d) an explanation of the claim review procedure, in accordance with this Section.

Within sixty days after the receipt by the claimant of a written notice of denial of a claim, or such later time as may be deemed reasonable taking into account the nature of the benefit subject to the claim and any other attendant circumstances, the claimant may file a written request with the Plan Committee that it conduct a full and fair review of the denial of the claim for benefits. If such review is requested, the claimant or his duly authorized representative may (a) request a review upon written application, (b) review pertinent documents, and (c) submit issues and comments in writing.

The Plan Committee shall issue a written decision on the claim within sixty days after the receipt of the aforesaid request for review, except that if there are special circumstances (such as the need to hold a hearing) which require an extension of time for processing the claim, the aforesaid sixty day period shall be extended to one hundred twenty days. In the event of such extension, written notice of the extension shall be furnished to the claimant prior to the commencement of the extension. Any decision on review shall be in writing, and shall be written in a manner calculated to be understood by the claimant, shall include the specific reason or reasons for the decision, and shall contain specific reference to pertinent Plan provisions upon which the decision is based.

The foregoing notwithstanding, the Plan Committee shall be responsible for maintaining records of Participants' service, account balances, vesting and other matters relating to amount of benefits under the Plan. The Plan Committee shall also be responsible for filing such reports, and making such disclosure to Participants as may be required by ERISA and the Code.

7.4 Records and Reports. The Plan Committee shall be responsible for maintaining

records of Participants' service, account balances, vesting and other matters relating to amount of benefits under the Plan. The Plan Committee shall also be responsible for filing such reports, and making such disclosures to Participants as may be required by ERISA and the Code.

7.5 Application and Forms for Benefits. The Plan Committee may require a Participant to complete and file with the Committee an application for a benefit, or any other forms approved by the Committee, and to furnish all pertinent information requested by the Plan Committee. The Plan Committee may rely on all such information so furnished.

ARTICLE VIII

AMENDMENT, MERGER AND TERMINATION OF THE PLAN

8.1 Amendment and Termination.

(a) General. The Employer intends to continue this Plan and the payment of contributions hereunder indefinitely, but such continuance is not assumed as a contractual obligation, and the Employer expressly reserves the right to discontinue contributions to the Plan or to terminate the Plan at any time, as to its Employees without the consent of any other party. Any amendment may be made retroactive by its terms, but no such amendment shall cause any part of the Trust to be used for, or diverted to, any purpose other than the exclusive benefit of Participants or their Beneficiaries; provided, however, the Employer may make any amendment it determines necessary or desirable, with or without retroactive effect, to qualify or maintain the Plan as a qualified plan within the meaning of Section 401(a) of the Code, and to qualify or maintain the Trust as tax exempt under Section 501(a) of the Code, and the regulations issued thereunder.

(b) Limitations on Amendment.

(1) If the Plan's vesting schedule is amended or the Plan is amended in any way that directly or indirectly affects the computation of a Participant's nonforfeitable percentage, or if the Plan is deemed amended by an automatic change to or from a top-heavy vesting schedule, each Participant with at least three years of service with the Employer may elect, within a reasonable period after the adoption of the amendment or change to have the Participant's nonforfeitability percentage computed under the Plan without regard to such amendment or change. The period during which the election may be made shall commence with the date the amendment is adopted or deemed to be made and shall end on the latest of:

(i) Sixty (60) days after the amendment is adopted

(ii) Sixty (60) days after the amendment becomes effective or

(iii) Sixty (60) days after the Participant is issued written notice of the amendment by the Plan Committee.

(2) No amendment to the Plan shall be effective to the extent it has the effect of decreasing a Participant's accrued benefit. Notwithstanding the preceding sentence, a Participant's account balance may be reduced to the extent permitted under Section 412(c)(8) of the Code. For purposes of this section, a Plan amendment which has the effect of decreasing a Participant's account balance or eliminating an optional form of benefit with respect to benefits attributable to service before the amendment shall be treated as reducing an accrued benefit. Furthermore, no amendment of the Plan shall have the effect of decreasing a Participant's vested interest determined without regard to such amendment as of the later of the date such amendment is adopted or the date it becomes effective.

8.2 Action by Employer. Any action by the Employer under this Plan may be taken by means of a writing signed by an authorized officer.

8.3 Effect of Termination. Upon termination of the Plan, the accounts of all Participants or Beneficiaries affected thereby shall become fully vested and nonforfeitable, and the Plan Committee shall, after payment of expenses properly chargeable to the Fund, allocate any unallocated assets in the Fund to the accounts of such Participants or Beneficiaries pursuant to the rules set forth in Article IV hereof. In making such final allocation, the Plan Committee may, if it determines that a termination of the Plan has occurred prior to the date of formal action by the Employer, reverse any forfeitures of accounts of Participants which have occurred in the interim.

8.4 Partial Termination. Upon termination of the Plan with respect to a group of Participants which constitutes a partial termination of the Plan under the Code, the accounts of such group of Participants shall become fully vested and non-forfeitable.

8.5 Manner of Distribution. In the event of termination or partial termination of the Plan, the Plan Committee shall direct the Trustee either (a) to make distribution of benefits to Participants or their Beneficiaries affected by such termination or partial termination pursuant to Section 5.8, or (b) to retain such benefits for distribution upon the occurrence of one of the events set forth in Article V hereof.

To the extent that no discrimination in value results, any distribution after termination or partial termination of the Plan may be made, in whole or in part, in cash, in securities or other assets in kind, or in nontransferable annuity contracts, as the Plan Committee and the Trustee may determine. All non-cash distributions shall be valued at fair market value at the date of distribution.

8.6 Merger. In the event of any merger or consolidation of the Plan with, or transfer in whole or in part of the assets and liabilities of the Fund to another trust fund held under any other plan of deferred compensation maintained or to be established for the benefit of all or some of the Participants in this Plan, the assets of the Fund applicable to such Participants shall be transferred to the other trust fund only if:

(a) Each Participant would (if either this Plan or the other plan then terminated) receive a benefit immediately after the merger, consolidation or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation or transfer (if this Plan had then terminated).

(b) A writing signed by the authorized partner of the Employer under this Plan, or of any new or successor employer of the affected Participants, shall authorize such transfer of assets, and, in the case of the new or successor employer of the affected Participants, its resolutions shall include an assumption of liabilities with respect to such Participants' inclusion in the new employer's plan, and

(c) Such other plan and trust are qualified under Sections 401(a) and 501(a) of the Internal Revenue Code.

8.7 Successor Employer. In the event of the dissolution, merger, consolidation or reorganization of the Employer, provision may be made by which the Plan and Trust will be continued by the successor; and, in that event, such successor shall be substituted for the Employer under the Plan. The substitution of the successor shall constitute an assumption of Plan liabilities by the successor and the successor shall have all of the powers, duties and responsibilities of the Employer under the Plan.

ARTICLE IX

TOP-HEAVY PROVISIONS AND DEFINITIONS

9.1 Top-Heavy Plan Definitions.

(a) "Top-Heavy Plan" means a plan which, as of the Determination Date (1) the Present Value of Accrued Benefits of Key Employees and (2) the aggregate of the Accounts of Key Employees under the plan exceeds sixty percent (60%) of the Present Value of Accrued Benefits and the aggregate of the Accounts of all employees under such plan. The determination of whether a plan is top-heavy shall be made after aggregating all other plans of the Employer or any of its affiliates which are part of a Required Aggregation Group and after aggregating any other plan of the Employer or any of its affiliates which is part of the Permissive Aggregation Group, if such permissive aggregation thereby eliminates the top-heavy status of any plan within such Permissive Aggregation Group. A plan is a "Super Top-Heavy Plan" if, as of the Determination Date, the plan would meet the test specified above for being a Top-Heavy Plan if ninety percent (90%) were substituted for sixty percent (60%) in each place it appears in this subsection.

(b) "Determination Date" means, for purposes of determining whether a plan is a Top-Heavy Plan for a particular Plan Year, the last day of the preceding Plan Year (or, in the case of the first Plan Year of a plan, the last day of the first Plan Year).

(c) "Valuation Date" means, for purposes of determining the value of Accounts under this Section, the same date as the Determination Date.

(d) "Key Employee" means any Employee or former Employee (including a Beneficiary of such Employee) who at any time during the Plan Year of Determination, or during any of the four (4) preceding Plan Years, is:

(1) An officer of the Employer having annual Compensation for such Plan Year which is in excess of 50% of the dollar limit in effect under Section 415(b)(1)(A) for the calendar year in which such Plan Year ends;

(2) An owner of (or considered as owning within the meaning of Section 318) both more than an one-half percent interest as well as one of the ten largest interests in the Employer and having annual compensation greater than the dollar limit in effect under Section 415(c)(1)(A) for the Plan Year;

(3) A 5% owner of the Employer; or

(4) A 1% owner of the Employer whose annual compensation is more than \$150,000.

For purposes of determining 5% and 1% owners, the aggregation rules and the rules of subsections (b), (c) and (m) of Section 414 of the Code do not apply.

(e) "Non-Key Employee" means any Employee or former Employee (including a Beneficiary of such Employee) who is not a Key Employee.

(f) "Account" means the value of all accounts (as defined in Sections 1.4(b), (c) and (d) under the Plan as of the Valuation Date, including all employer contributions paid or payable to such Account and all employee contributions actually paid to such Account, except as follows:

(1) The value of each Account shall be increased by the aggregate distributions made with respect to an Employee under the Plan during the five (5) year period ending on the Determination Date.

(2) In the case of a profit sharing plan, the value of each Account shall not include any employer contribution actually made after the Determination Date, except in the case of the first Plan Year each account shall include such contributions that are allocated to the Account as of a date within the first Plan Year.

(3) The value of an Account maintained for voluntary deductible Employee contributions (if any) shall not be included.

(4) The value of an Account maintained for rollover contributions (if any) shall not be included if the rollover contribution was initiated by the Employee and was not made from a plan maintained by the Employer (or by an employer required to be aggregated with

the Employer under Sections 414(b), (c) or (m) of the Code).

(5) The value of an Account maintained for an Employee who is a Non-Key Employee with respect to a plan for any Plan Year who was a Key Employee with respect to a plan for any prior Plan Year shall not be included.

(6) If an individual has not performed any services for any employer maintaining the Plan at any time during the five (5) year period ending on the Determination Date, the value of the Account of such individual shall not be included.

(g) "Required Aggregation Group" means (1) each qualified plan of the Employer or any of its affiliates in which at least one Key Employee participates, including for this purpose any terminated plan that covered a Key Employee maintained by the Employer within the five year period ending on the Determination Date, and (2) any other qualified plan of the Employer or any of its affiliates which enables a plan described in (1) to meet the requirements of Sections 401(a)(4) or 410 of the Code.

(h) "Permissive Aggregation Group" means the Required Aggregation Group of plans plus any other plan or plans of the Employer or any of its affiliates which, when considered as a group with the Required Aggregation Group would continue to satisfy the requirements of Sections 401(a)(4) and 410 of the Code.

(i) "Present Value of Accrued Benefit" means, in the case of a defined benefit plan, the present value of a Participant's accrued benefit as determined under the provisions of the applicable defined benefit plan.

(j) "Employer or any of its Affiliates" means the Employer maintaining the Plan, and all commonly controlled trades or businesses (as defined in Section 414(c) of the Code), and affiliated service groups (as defined in Section 414(m) of the Code) of which the Employer is a part.

9.2 Effective Date. In any Plan Year in which the Plan is a Top-Heavy Plan, the Plan shall meet the requirements set forth in Sections 9.3 and 9.7.

9.3 Minimum Contribution Requirements.

(a) Definition of Compensation. For purposes of this Section, Compensation for any Plan Year shall mean the amount of Compensation received from the Employer for that Plan Year.

(b) Allocation. The total allocable amount under Section 4.3 shall be allocated as follows:

(1) The total allocable amount shall first be allocated among the accounts of Participants who have completed a Year of Service as defined in Section 2.1 (except that such requirement that the Participant complete 1,000 Hours of Service in the Plan Year shall not apply to any Participant) in the same proportion that each such Participant's Compensation

bears to the aggregate Compensation of all such Participants for such Plan Year, provided that the amount so allocated to the account of any Participant who is not a Key Employee shall not be less than the lesser of 3% or the highest rate allocated to any Key Employee for the Plan Year (such rate determined by calculating the largest percentage of Compensation not in excess of \$200,000.00). If the highest rate allocated to a Key Employee for such Plan Year is less than 3%, amounts contributed attributable to a salary reduction arrangement shall be included in determining contributions made on behalf of Key Employees.

(2) The remainder of the total allocable amount, if any, shall be allocated as set forth in Section 4.3.

(c) Exceptions to the Minimum Contribution Requirement. The minimum contribution required under subsection (b) shall be reduced or eliminated, as the case may be, in the following circumstances:

(1) If the allocation in any Plan Year of the total allocable amount under Section 4.3 (determined without regard to this Section) results in an allocation to each Participant who is eligible to receive an allocation under Section 9.3(b)(1) of at least 3% of such Participant's Compensation for the Plan Year, then the provisions of Section 9.3(b) shall not apply for such Plan Year.

(2) No minimum contribution will be required (or the minimum contribution percentage will be reduced, as the case may be) for any Plan Year for a Participant who is eligible to receive an allocation under Section 9.3(b)(1) if the employer maintains another qualified plan under which a minimum benefit or contribution is being accrued or made for such Plan Year in whole or in part for the Participant in accordance with Section 416(c) of the Code.

(d) Effect of Defined Benefit Plan. The 3% minimum contribution requirement in subsections (b) and (c) shall be increased to 5% for any Plan Year in which the Employer also maintains a defined benefit pension plan to the extent necessary to avoid the application of Section 416(f) of the Code and regulations thereunder.

9.4 Maximum Compensation Limitation. The Compensation (as defined in both Section 9.3(a) and Section 1.3(d)) of each Participant in the Plan for any Plan Year shall not exceed the first \$200,000 of such Participant's Compensation; provided that such dollar limitation shall be adjusted to take into account any adjustments prescribed by the Secretary of the Treasury or his delegate under Section 416(d)(2) of the Code.

9.5 Adjustment to Section 415 Limits. If the Plan is a Super Top-Heavy Plan or if the Plan is a Top-Heavy Plan, and the minimum benefits required by Section 416(h) of the Code are not provided, then the 1.25 factor used in the denominators of the Defined Contribution Plan Fraction (under Section 4.4(c)(5)) and Defined Benefit Plan Fraction (under Section 4.4(c)(4)) shall be changed to 1.0.

9.6 Remedial Provisions. In addition to the other powers granted hereunder, the Plan Committee shall have the power to take such action as it deems necessary or appropriate to determine whether the Plan is a Top-Heavy Plan, and in such event, to apply the provisions of this

Article to the Plan, including, but not limited to the power to reallocate employer contributions, forfeitures and income, to reverse all or part of any forfeitures which may have been improperly recognized, and to direct the Trustee to make required distributions hereunder.

9.7 Top Heavy Vesting Schedule. For any Plan Year in which the Plan is determined to be "top heavy", as defined in Section 9.1 hereof, the vesting schedule applicable to Employer Matching Contributions as provided in Section 5.1(b) shall be superseded by the following schedule:

Years of Service -----	Vesting Percentage -----
Less than 2	0
2	20
3	40
4	60
5	80
6 or more	100

If the Plan ceases to be top heavy in a subsequent Plan Year, the vesting schedule provided in Section 5.1(b) will apply to a Participant's benefits accrued subsequent to the last year the Plan was top heavy, provided however that any Participant with 5 or more Years of Service must be given the opportunity to choose between the vesting schedule contained in this Section and that contained in Section 5.1(b).

ARTICLE X

MISCELLANEOUS

10.1 Non-Guarantee of Employment. Nothing contained herein shall be construed as a contract of employment between the Employer and any Employee, or as a right of any Employee to be continued in the employment of the Employer, or as a limitation of the right of the Employer to discharge any Employee, with or without cause.

10.2 Non-Alienation of Benefits. The benefits payable hereunder shall not be assigned or alienated by or on behalf of any Participant or Beneficiary except to the extent permitted under Sections 401(a)(13) and 414(p) of the Code.

10.3 Facility of Payment. If any Participant or Beneficiary shall be physically or mentally incapable of receiving or acknowledging receipt of any payment due under the terms of the Plan, and no legal representative shall have been appointed for him, the Plan Administrator may direct the Trustee to make such payment to the person or institution maintaining such Participant or Beneficiary, and the payment to such person or institution in good faith shall constitute a valid and complete discharge for such payment.

10.4 Exclusive Benefit. This Plan is established for the exclusive benefit of the Employees of the Employer.

10.5 No Reversion. Except as otherwise expressly permitted hereunder, no assets of the Plan or the Trust shall ever revert to or be used or enjoyed by the Employer, nor, prior to the satisfaction of all liabilities under this Plan to Participants and their Beneficiaries, shall any of the assets of the Plan or Trust ever be used other than for the benefit of the Employees of the Employer and their Beneficiaries and defraying reasonable expenses of administering the Plan.

10.6 Effect of Social Security Benefits. Benefits paid to or on behalf of a retired or terminated Participant hereunder shall not be reduced or otherwise affected by increases or other adjustments in Social Security benefits such Participants may receive.

10.7 Titles. Titles of Articles and Sections are inserted for convenience only and shall not affect the meaning or construction of the Plan.

10.8 Severability. If any provision of this Plan shall be held invalid or unenforceable, such invalidity or unenforceability shall not affect any other provisions hereof, and this Plan shall be construed and enforced as if such provision had not been included herein.

10.9 Applicable Law. This Plan shall be construed in accordance with Pennsylvania law.

10.10 Initial Qualification. This Plan has been adopted and is based upon the condition precedent that the Internal Revenue Service issue its determination that it meets the requirements of the Code and regulations issued hereunder with respect to qualified plans. Notwithstanding any other provision herein, if the Internal Revenue Service determines that the Plan does not initially qualify under the Code, any assets attributable to Employer contributions which have been made prior to notice of such adverse determination shall be returned to the Employer, and this Plan shall terminate.

10.11 Plan designation. For purposes of Codess.401(a)(27), this Plan is a profit sharing plan.

IN WITNESS WHEREOF, and as evidence of the adoption of the Plan, the Employer has caused its duly authorized president to execute this Plan as of this 28th day of October, 1999.

DONEGAL MUTUAL INSURANCE COMPANY

ATTEST:

/s/ Ralph G. Spontak

By: /s/ Donald H. Nikolaus

Secretary

President

[CORPORATE SEAL]

Amendment No. 1

Donegal Mutual Insurance Company
401(K) Plan ("Plan")

In accordance with Section 8.1 of the Plan, the Plan is hereby amended effective January 1, 2000 as follows:

1. Section 3.1 is deleted and the following substituted therefor:

"3.1 Employer's Matching Contribution. The Employer shall contribute annually on behalf of each Participant in the employ of the Employer on the Anniversary Date an amount equal to the sum of (a) 100% of each Participant's Elective deferrals for the Plan Year not in excess of 3% of the Participant's Compensation for the Plan year and (b) 50% of each Participant's Elective Deferrals in excess of 3% of the Participant's Compensation, but not in excess of 9% of the Participant's Compensation for the Plan year ("Matching Contribution"). The requirement that a Participant be employed by the Employer on the Anniversary Date shall be waived if the employment of the Participant terminated during the Plan Year because of retirement, disability or death."

2. Paragraph (a) of Section 3.4 is deleted and the following substituted therefor:

"(a) Each Participant may make an Elective Contribution to the Plan and to the extent he elects to reduce or forego an increase in his Compensation, the amount by which his compensation is reduced shall be treated as the Participant's Elective Contribution and be allocated to that Participant's elective account. The amount of the Elective Contribution may not be less than 1% nor more than 15% of the Participant's Compensation as elected by the Participant in units of one (1) percentage point on forms provided by the Plan Committee, which may limit the amount of the

Participant's Elective Contribution at any time if it determines that such limitation is necessary to satisfy the requirement with IRC Section 401(k)."

3. There is added to the Plan at the end of paragraph (b) of Section 4.5 the following:

"Effective January 1, 2000, each Participant shall have the opportunity to invest all or a portion of the Participant's Account in the common stock of the Employer. The duties of the Employer and Trustees concerning such investment and the rights of Participants concerning an investment in the stock of the Employer are detailed in Section 4.6 below."

4. There is added to the Plan new Section 4.6 reading as follows:

4.6 Investment in Employer Stock.

(a) Definitions.

i. Employer Stock means the common stock of Donegal Group, Inc., the parent company of the Employer as traded on the NASDAQ National Market Exchange.

ii. Custodian means Reliance Trust Company, a Georgia corporation. Custodian is an "investment manager" as defined in Section 3(38) of ERISA with respect to Employer Stock.

iii. Record Keeper means TransAmerica. The Record Keeper will maintain all record of the Participants' accounts with respect to investments in Employer Stock.

iv. Investment in Employer Stock. A Participant may elect to invest a portion of the Participant's Elective Contributions and Employer Matching Contributions made on his behalf in Employer Stock. Such election shall be made on forms supplied by the Trustees and

maintained by the Record Keeper.

(b) Purchase and Sale of Employer Stock.

i. Notwithstanding anything to the contrary contained in this Plan or the Trust Agreement, the Trustees may direct the Custodian to purchase shares of Employer Stock upon the receipt by the Custodian of contributions from the Employees pursuant to a nondiscretionary purchasing program developed by the Custodian to effect such purchases in an orderly manner without disruption of the market for such stock.

ii. If a Participant's vested interest in the Participant's Accounts or a portion thereof is to be distributed on account of the Participant's retirement, disability, death, termination of employment, pursuant to a hardship withdrawal, withdrawal of a rollover contribution or as a result of a qualified domestic relations order or because of the minimum distribution rules, the Trustees will direct the Custodian to sell the Participant's shares of Employer Stock or distribute such stock in kind, at the election of the Participant or the Participant's designated beneficiary. If the Participant elects to take a cash distribution, the amount of cash to be distributed to the Participant attributable to the Participant's shares of Employer Stock, will be determined on the basis of the price or the average of the prices realized on the disposition of such shares on the day or days during the calendar month as may be designated by the Trustees in a uniform and nondiscriminatory manner. Notwithstanding the foregoing, the Custodian may net out transactions internally (so as not to be both a buyer and a seller on the open market) at the then prevailing market prices as determined by the Custodian.

(c) Voting of Shares. Notwithstanding anything to the contrary contained in this Plan or the Trust Agreement, whenever any proxies or consents are solicited from shareholders, each

Participant (or designated beneficiary in the case of a deceased Participant) whose account contains Employer Stock will have the right to direct the Trustees, in writing, as to the voting of such shares. The Trustees or the Custodian will use their best efforts to distribute or cause to be distributed in a timely manner to each Participant or designated beneficiary a copy of the proxy solicitation material sent to shareholders, together with a form addressed to the Trustees or the Custodian containing confidential, written instructions as to the manner in which said shares will be voted. If the instructions are sent to the Custodian, the Custodian must communicate the instructions to the Trustees. Upon receipt of such instructions, the Trustees will vote said shares as instructed. Shares of Employer Stock as to which the Trustees do not receive instructions will be voted by the Trustees in the proportion as shares are to be voted pursuant to the written voting instructions received from all Participants by the Trustees. Each Participant (or designated beneficiary) will be entitled to one vote for each full share of Employer Stock allocated to the Participant's accounts. Fractional shares of Employer Stock will not be permitted to vote.

(d) Valuation. Employer Stock will be valued as of any business day of each Plan Year based on the published valuation for such stock on the NASDAQ National Market Exchange. Any dividends received on Employer Stock will be reinvested and become part of the Participant's Accounts. The Record Keeper will maintain adequate records of the cost basis of Employer Stock for each Participant's account. The Record Keeper may from time to time modify its accounting procedures to achieve equitable and nondiscriminatory allocations among Participants' Matching Contributions Account in accordance with the provisions of this Plan and requirements of law.

(e) Named Fiduciary Status\Confidentiality. Each Participant or designated beneficiary shall be deemed to be a named fiduciary within the meaning of Section 402(a) of ERISA

with respect to the voting of the shares of Employer Stock as to which such Participant or designated beneficiary has the right of direction. Directions received from Participants or designated beneficiaries by the Trustees or the Custodian shall be held in strict confidence and shall not be divulged or released to any person, including employees, officers or directors of the Employer, provided, however, that to the extent necessary for the operation of the Plan, such directions may be relayed by the Trustees to the Record Keeper or auditor for the Plan, which Record Keeper or Auditors is not the Employer and agrees not to divulge such directions to any other person including employees, officers or directors of the Employer."

5. There is added to the Plan new ARTICLE XI reading as follows:

"ARTICLE XI. Money Purchase Pension Plan Account.

Section 11.1. General. This Article applies only to those employees who were participants in DMIC Money Purchase Pension Plan and who had accounts in that Plan on December 31, 1999. This Articles does not apply to any other Employee or Participant.

Section 11.2. Money Purchase Pension Benefit. For purposes of this Plan, the term "Money Purchase Pension Benefit" means the account balance of the Participant in the Money Purchase Pension Plan as of December 31, 1999. As provided by amendment to that Plan, all such accounts are fully vested in the Participants and under no circumstances may any forfeitures arise with respect to those accounts.

Section 11.3. Participants' Accounts. Under all circumstances a Participant's Account shall be treated as a segregated investment individually directed by the Participant and shall be adjusted for only the income or loss realized with respect to each such Account.

Section 11.4. Determination and Distribution of Benefits. The provisions of ARTICLES VI

and VII of the Money Purchase Pension Plan as in effect on December 31, 1999 are hereby incorporated by reference and for convenience set forth in full in Appendix "A" to the Plan. The provisions of these Articles will apply to the determination and distribution of a Participant's Money Purchase Pension Benefit. Otherwise, the provisions of this Plan shall govern with respect to a Participant's Money Purchase Pension Benefit.

6. There is added to the Plan new ARTICLE XII reading as follows:

"ARTICLE XII. Profit Sharing Plan.

Section 12.1. General. This Article applies only to those employees who were participants in the DMIC Profit Sharing Plan and who had accounts in that Plan on December 31, 1999. This Article does not apply to any other Employee or Participant.

Section 12.2. Profit Sharing Plan. For purposes of this Plan, the term "Profit Sharing Benefit" means the account balance of the Participant in the Profit Sharing Pension Plan as of December 31, 1999. As provided by amendment to that Plan, all such accounts are fully vested in the Participants and under no circumstances may any forfeitures arise with respect to those accounts.

Section 12.3. Participants' Accounts. Under all circumstances a Participant's Account shall be treated as a segregated investment individually directed by the Participant and shall be adjusted for only the income or loss realized with respect to each such Account.

Section 12.4. Determination and Distribution of Benefits. The provisions of ARTICLES VI and VII of the Profit Sharing Plan as in effect on December 31, 1999 are hereby incorporated by reference and for convenience set forth in full in Appendix "B" to the Plan. The provisions of these Articles will apply to the determination and distribution of a Participant's Profit Sharing Benefit. Otherwise, the provisions of this Plan shall govern with respect to a Participant's Profit Sharing

Benefit.

IN WITNESS WHEREOF and as evidence of the adoption of this amendment, Donegal Mutual Insurance Company has caused its duly authorized officers to execute this document on its behalf and under its seal as of this 6th day January, 2000.

Donegal Mutual Insurance Company

ATTEST:

/s/ Ralph G. Spontak

Ralph G. Spontak, Secretary

(Corporate Seal)

By: /s/ Donald H. Nikolaus

Donald H. Nikolaus, President

INTEREST AND LIABILITIES CONTRACT

to

RETROCESSIONAL REINSURANCE CONTRACT

between

SOUTHERN HERITAGE INSURANCE COMPANY
DULUTH, GEORGIA

and

DONEGAL MUTUAL INSURANCE COMPANY

It is hereby agreed by and between Southern Heritage Insurance Company (Southern Heritage), Duluth, Georgia, and Donegal Mutual Insurance Company (Donegal) that Donegal will assume and retrocede a 100% share and Southern Heritage will assume a 100% share of the retrocession of the Interests and Liabilities as set forth in the attached Retrocessional Reinsurance Agreement effective January 1, 2000 until terminated.

This Contract made and executed in duplicate this 10th day of March, 2000

SOUTHERN HERITAGE INSURANCE COMPANY

/s/ Ralph G. Spontak

RALPH G. SPONTAK, SECRETARY

DONEGAL MUTUAL INSURANCE COMPANY

/s/ Donald H. Nikolaus

DONALD H. NIKOLAUS, PRESIDENT

REINSURANCE AND RETROCESSION AGREEMENT

between

SOUTHERN HERITAGE INSURANCE COMPANY
DULUTH, GEORGIA

and

DONEGAL MUTUAL INSURANCE COMPANY

Article 1 Business Covered

This Agreement, subject to the terms and conditions herein contained, is for Donegal Mutual Insurance Company (Donegal) to indemnify Southern Heritage Insurance Company (Southern Heritage), Duluth, Georgia, in respect of the net liability as herein provided and specified which may accrue to Southern Heritage as a result of any loss or losses which may occur during the term of this Agreement under any and all binders, policies, and contracts of insurance or reinsurance (hereinafter referred to as "policy" or "policies") heretofore or hereafter issued or entered into by or on behalf of Southern Heritage and for Donegal to retrocede the net liability back to Southern Heritage and Southern Heritage to assume the net liability back from Donegal as part of the retrocession.

Article 2 Territory

This Agreement shall cover wherever Southern Heritage's policies cover.

Article 3 Exclusions

This Agreement shall not cover:

A. Business classified by the Reinsured as:

- (1) Overhead transmission and distribution lines and their supporting structures other than those on or within 150 meters (or 500 feet) of the insured premises. It is understood and agreed that public utilities extension and/or suppliers extension and/or contingent business interruption coverage are not subject to this exclusion provided that these are not part of a transmitter's or distributor's policy.

- (2) Pools, Associations, or Syndicates, including State Insurance Guaranty Associations. However, such operations which Southern Heritage is obliged to cover by reason of membership or participation in any Automobile Assigned Risk Pool, Plan or Facility, any FAIR Plan, or any Coastal Pool are not to be excluded. Furthermore, this exclusion shall not apply to any Inter-Company Pooling.
- (3) Insurance on Growing and/or Standing Crops.
- (4) Reinsurance of any kind assumed by the Reinsured, except local agency reinsurance accepted in the normal course of business.
- (5) Bridges, tunnels and art collections valued at over \$150,000,000.
- (6) Aviation.
- (7) Insolvency Funds, as per clause attached.
- (8) Flood, when written as such.

B. Extra Contractual Obligations and Loss in Excess of Original Policy Limits - Extra Contractual Obligations" are defined as those liabilities not covered under any other provision of this Agreement and which arise from the handling of any claim on business covered hereunder, such liabilities arising because of, but not limited to, the following: failure by Southern Heritage to settle within the policy limit, or by reason of alleged or actual negligence, fraud or bad faith in rejecting an offer of settlement or in the preparation of the defense or in the trial of any action against its Insured or Reinsured or in the preparation or prosecution of an appeal consequent upon such action.

The term "Loss in Excess of Original Policy Limits" shall mean a net loss of Southern Heritage which is in excess of the limit of its original policy, such loss in excess of the limit having been incurred because of the following: failure by Southern Heritage to settle within the policy limit or by reason of alleged or actual negligence, fraud or bad faith in rejecting an offer or settlement or in the preparation of the defense or in the trial of any action against its Insured or Reinsured or in the preparation or prosecution of an appeal

consequent upon such action.

- C. Fidelity, Surety, Credit, Title, Insolvency and Financial Guaranty.
- D. Loss or Liability excluded by the provisions of the Nuclear Incident Exclusion Clause - Physical Damage Reinsurance, as per clause attached hereto.
- E. War, as defined in the original policy.
- F. Ocean Marine

Article 4 Term

This Agreement shall become effective on January 1, 2000 at 12:01 A. M. Standard Time. It is unlimited as to its duration and may be terminated by either party upon giving ninety (90) days notice of cancellation in writing. In the event either party terminates in accordance with the above, it is understood that all transactions coming within the terms of this Agreement will continue in effect within the said ninety (90) days and that losses will be included within the contract on a cut-off basis (losses with dates of loss within the contract period only will be included).

Article 5 Definition of Loss Occurrence

The term "Loss Occurrence" shall mean any one occurrence or series of occurrences arising out of one event.

Article 6 Net Retained Lines

This Agreement applies only to that portion of any insurance or reinsurance covered by this Agreement which Southern Heritage retains net for its own account, and in calculating the amount of any loss hereunder and also in computing the amount in excess of which this Agreement attaches, only loss or losses in respect of that portion of any insurance or reinsurance which Southern Heritage retains net for its own account shall be included. It being understood and agreed that the amount of Donegal's liability hereunder in respect of any loss or losses shall not be increased by reason of the inability of the Southern Heritage to collect from any other reinsurers whether specific or general any amounts which may have become due from them whether such inability arises from the insolvency of such other reinsurer or otherwise.

Article 7 Ultimate Net Loss Incurred

The term "Ultimate Net Loss Incurred" shall be understood to

mean the actual loss or losses incurred or to be incurred by Southern Heritage under its policies, such loss or losses to include expenses of litigation, if any, interest accrued where such interest is part of the judgement and all other loss expenses of Southern Heritage including legal expenses and costs incurred in connection with coverage and validity questions and legal actions connected thereto which are allocable only to a specific claim or action on policies covered hereunder less proper deductions for all recoveries (including amounts recoverable under other reinsurance) and salvages actually made by the Southern Heritage; provided always that nothing in this Article shall be construed to mean that losses under this Agreement are not recoverable until Southern Heritage's ultimate net loss has been ascertained.

All salvages, recoveries and payments recovered or received subsequent to a loss settlement under this Agreement shall be applied as if recovered or received prior to the said settlement and all necessary adjustments shall be made by the parties hereto.

Article 8 Ceding and Retroceding Net Loss

- A. As of the effective date and time of this agreement Southern Heritage will cede and Donegal will accept 100% of Southern Heritage's Net Liability for losses. Net Liability for losses includes case basis reserves and reserves for allocated loss adjusting retained for Southern Heritage's own account in accordance with Article 6. Thereafter Southern Heritage will cede and Donegal will accept 100% of Southern Heritage's Net Losses Incurred, Net losses incurred include losses and allocated loss adjusting expense incurred in accordance with Article 6.
- B. As of the effective date and time of this agreement Donegal will retrocede and Southern Heritage will accept 100% of the net liability for losses Donegal assumed from Southern Heritage and, thereafter, Donegal will retrocede 100% of the Net Incurred Losses it assumed from Southern Heritage including allocated loss adjusting expenses incurred.

Article 9 Rate and Premium

Southern Heritage shall pay to Donegal and Donegal will retrocede to Southern Heritage during the term of this Agreement Net Earned Premium Income of Southern Heritage during such term in respect of business the subject matter of this Agreement.

The term "Net Earned Premium Income" as used herein shall be understood to mean gross premiums earned by Southern Heritage less premiums for reinsurance which inure to the benefit of this Agreement.

All premiums and losses paid under this Agreement shall be made in United States currency.

Article 10 Access to Records

Southern Heritage and Donegal, by their duly appointed representatives, shall have the right at any reasonable time, to examine all papers in the possession of the other referring to business effected hereunder.

Article 11 Errors and Omissions

Any inadvertent delay, omission or error shall not be held to relieve either party hereto from any liability which would attach to it hereunder if such delay, omission or error had not been made. Such delay, omission or error shall be rectified immediately upon discovery.

Article 12 Rate and Premium

As a precedent to any right of action hereunder, if any dispute shall arise between Southern Heritage and Donegal with reference to the interpretation of this Agreement or their rights with respect to any transaction involved, whether such dispute arises before or after termination of this Agreement, such dispute upon the written request of either party, shall be submitted to three arbitrators, one to be chosen by each party, and the third by the two so chosen. If either party refuses or neglects to appoint an arbitrator within thirty days after the receipt of written notice from the other party requesting it to do so, the requesting party may appoint two arbitrators. If the two arbitrators fail to agree in the selection of a third arbitrator within thirty days of their appointment, each of them shall name two, of whom the other shall decline one and the decision shall be made by drawing lots. All arbitrators shall be disinterested active or retired executive officers of insurance or reinsurance companies or Underwriters at Lloyd's, London not under the control of either party to this Agreement.

The Arbitrators shall interpret the Agreement and make their decision with regard to the custom and usage of the insurance and reinsurance business. They shall issue their decision in writing based upon a hearing in which evidence may be introduced without following strict rules of evidence, but in

which cross examination and rebuttal shall be allowed. They shall make their award with a view to effecting the general purpose of this Agreement in a reasonable manner rather than in accordance with a literal interpretation of the language.

The decision in writing of any two arbitrators, when filed with the parties hereto, shall be final and binding on both parties. Judgment may be entered upon the final decision of the arbitrators in any court having jurisdiction. Each party shall bear the expense of its own arbitrator and shall jointly and equally bear with the other party the expense of the third arbitrator and of the arbitration. Said arbitration shall take place in the state of Georgia.

Article 13 Insolvency Funds Exclusion Clause

This Agreement excludes all liability of Southern Heritage arising, by contract, operation of law, or otherwise, from its participation or membership, whether voluntary or involuntary, in any insolvency fund. "Insolvency fund" includes any guaranty fund, insolvency fund, plan, pool, association, fund or other arrangement, howsoever denominated, established or governed; which provides for any assessment of or payment or assumption by the Company of part or all of any claim, debt, charge, fee, or other obligation of an insurer, or its successors or assigns, which has been declared by any competent authority to be insolvent, or which is otherwise deemed unable to meet any claim, debt, charge, fee or other obligation in whole or in part.

The term of this exclusion shall not operate so as to result in a diminution of the subscribing Reinsurer's obligation to the Company under policy obligations subject to cessions under this Agreement.

Article 14 Reporting and Settlement

Southern Heritage shall provide to the reinsurer, no less frequently than at the end of each quarter, the necessary reports needed to document the calculation of premiums and losses ceded under this agreement. Net amounts due under this contract must be remitted within 15 days from the issuance of said reports.

Article 15 Insolvency

In the event of the insolvency of the Reinsured, this reinsurance shall be payable directly to the reinsured, or to its liquidator, receiver, conservator or statutory successor on the basis of the liability of the Reinsured without diminution because of the insolvency of the Reinsured or because the liquidator, receiver, conservator or statutory successor of the Reinsured has failed to pay all or a portion of any claim. It is agreed, however that the liquidator,

receiver, conservator or statutory successor of the Reinsured shall give written notice to the Reinsurer of the pendency of a claim against the Reinsured indicating the policy or bond reinsured which claim would involve a possible liability on the part of the Reinsurer within a reasonable time after such claim is filed in the conservation or liquidation proceeding or in the receivership, and that during the pendency of such claim, the Reinsurer may investigate such claim and interpose, at their own expense, in the proceeding where such claim is to be adjudicated any defense or defenses that they may deem available to the Reinsured or its liquidator, receiver, conservator or statutory successor. The expense thus incurred by the Reinsurer shall be chargeable subject to the approval of the court, against the Reinsured as part of the expense of conservation or liquidation to the extent of a pro rata share of the benefit which may accrue to the Reinsured solely as a result of the defense undertaken by the Reinsurer.

PROPERTY CATASTROPHE EXCESS OF LOSS
REINSURANCE AGREEMENT

between

SOUTHERN HERITAGE INSURANCE COMPANY
Duluth, Georgia

(hereinafter collectively called the "Reinsured")

and

The Reinsurers subscribing to the respective
Interests and Liabilities Contract to which
this Agreement is attached (hereinafter called
the "Reinsurer")

ARTICLE 1 BUSINESS COVERED

This Agreement, subject to the terms and conditions herein contained, is to indemnify the Reinsured in respect of the net excess liability as herein provided and specified which may accrue to the Reinsured as a result of any loss or losses which may occur during the term of this Agreement under any and all binders, policies, and contracts of insurance or reinsurance (hereinafter referred to as "policy" or "policies") heretofore or hereafter issued or entered into by or on behalf of the Reinsured and classified by the Reinsured as Property, including the property portion of Multi-Peril and Automobile policies.

ARTICLE 2 TERRITORY

This Agreement shall cover wherever the Reinsured's policies cover.

ARTICLE 3 EXCLUSIONS

This Agreement shall not cover:

A. Business classified by the Reinsured as:

(1) Overhead transmission and distribution lines and their supporting structures other than those on or within 150 meters (or 500 feet) of the insured premises. It is understood and agreed that public utilities extension and/or suppliers extension and/or contingent business interruption coverages are not

subject to this exclusion provided that these are not part of a transmitter's or distributor's policy.

(2) Pools, Associations, or Syndicates, including State Insurance Guaranty Associations. However, such operations which the Reinsured is obliged to cover by reason of membership or participation in any Automobile Assigned Risk Pool, Plan or Facility, any FAIR Plan, or any Coastal Pool are not to be excluded. Furthermore, this exclusion shall not apply to any Inter-Company Pooling.

(3) Insurance on Growing and/or Standing Crops.

(4) Reinsurance of any kind assumed by the Reinsured, except local agency reinsurance accepted in the normal course of business.

(5) Bridges, tunnels and art collections valued at over \$150,000,000.

(6) Aviation.

(7) Insolvency Funds, as per clause attached.

(8) Flood, when written as such.

B. Extra Contractual Obligations and Loss in Excess of Original Policy Limits - "Extra Contractual Obligations" are defined as those liabilities not covered under any other provision of this Agreement and which arise from the handling of any claim on business covered hereunder, such liabilities arising because of, but not limited to, the following: failure by the Reinsured to settle within the policy limit, or by reason of alleged or actual negligence, fraud or bad faith in rejecting an offer of settlement or in the preparation of the defense or in the trial of any action against its Insured or Reinsured or in the preparation or prosecution of an appeal consequent upon such action.

The term "Loss in Excess of Original Policy Limits" shall mean a net loss of the Reinsured which is in excess of the limit of its original policy, such loss in excess of the limit having been incurred because of the following: failure by the Reinsured to settle within the policy limit or by reason of alleged or actual negligence, fraud or bad faith in rejecting an offer or settlement or in the preparation of the defense or in the trial of any action against its Insured or Reinsured or in the preparation or prosecution of an appeal consequent upon such action.

C. Fidelity, Surety, Credit, Title, Insolvency and Financial Guaranty.

D. Loss or Liability excluded by the provisions of the Nuclear Incident Exclusion Clause - Physical Damage - Reinsurance, as per clause attached hereto.

E. War, as defined in the original policy.

F. Ocean Marine

G. Loss/or Damage/or Costs/or Expenses arising from Seepage and/or Pollution and/or Contamination, other than Contamination from Smoke Damage. Nevertheless, this exclusion does not preclude any payment of the cost of the removal of debris of property damaged by a loss otherwise covered hereunder, but subject always to a limit of 25% of the Reinsured's Property loss under the original policy.

ARTICLE 4 TERM

This Agreement shall become effective January 1, 2000 and the Reinsurer shall be liable for all losses occurring during the term of this Agreement.

If this Agreement shall terminate while a loss covered hereunder is in progress, subject to the other conditions of this Agreement, the Reinsurer shall indemnify the Reinsured as if the entire loss had occurred during the time this Agreement is in force, provided the loss covered hereunder started before the time of termination.

ARTICLE 5 DEFINITION OF LOSS OCCURRENCE

The term "Loss Occurrence" shall mean the sum of all individual losses occasioned by any one disaster, accident or loss or series of disasters, accidents or losses arising out of one event which occurs within the area of one state of the United States or province of Canada and states or provinces contiguous thereto and to one another. However, the duration and extent of any one "Loss Occurrence" shall be limited to all individual losses sustained by the Reinsured occurring during any period of 168 consecutive hours arising out of and directly occasioned by the same event except that the term "Loss Occurrence" shall be further defined as follows:

i) As regards windstorm, hail, tornado, hurricane, cyclone, including ensuing collapse and water damage, all individual losses sustained by the Reinsured occurring during any period of 72 consecutive hours and arising out of and directly occasioned by the same event. However, the event need not be limited to one state or province or states or provinces contiguous thereto.

ii) As regards riot, riot attending a strike, civil commotion, vandalism and malicious mischief, all individual losses sustained by the Reinsured occurring

during any period of 72 consecutive hours within the area of one municipality or county and the municipalities or counties contiguous thereto arising out of and directly occasioned by the same event. The maximum duration of 72 consecutive hours may be extended in respect of individual losses which occur beyond such 72 consecutive hours during the continued occupation of an assured's premises by strikers, provided such occupation commenced during the aforesaid period.

iii) As regards earthquake (the epicenter of which need not necessarily be within the territorial confines referred to in the opening paragraph of this article) and fire following directly occasioned by the earthquake, only those individual fire losses which commence during the period of 168 consecutive hours may be included in the Reinsured's "Loss Occurrence".

iv) As regards "Freeze", only individual losses directly occasioned by collapse, breakage of glass and water damage (caused by bursting of frozen pipes and tanks) may be included in the Reinsured's "Loss Occurrence".

Except for those "Loss Occurrences" referred to in (i) and (ii) the Reinsured may choose the date and time when any such period of consecutive hours commences provided that it is not earlier than the date and time of the occurrence of the first recorded individual loss sustained by the Reinsured arising out of that disaster, accident or loss and provided that only one such period of 168 consecutive hours shall apply with respect to one event.

However, as respects those "Loss Occurrences" referred to in (i) and (ii), if the disaster, accident or loss occasioned by the event is of greater duration than 72 consecutive hours, then the Reinsured may divide that disaster, accident or loss into two or more "Loss Occurrences" provided no two periods overlap and no individual loss is included in more than one such period and provided that no period commences earlier than the date and time of the occurrence of the first recorded individual loss sustained by the Reinsured arising out of that disaster, accident or loss.

No individual losses occasioned by an event that would be covered by 72 hours clauses may be included in any "Loss Occurrence" claimed under the 168 hours provision.

ARTICLE 6 NET RETAINED LINES

This Agreement applies only to that portion of any insurance or reinsurance covered by this Agreement which the Reinsured retains net for its own account, and in calculating the amount of any loss hereunder and also in computing the amount in excess of which this Agreement attaches, only loss or losses in

respect of that portion of any insurance or reinsurance which the Reinsured retains net for its own account shall be included, it being understood and agreed that the amount of the Reinsurer's liability hereunder in respect of any loss or losses shall not be increased by reason of the inability of the Reinsured to collect from any other reinsurers, whether specific or general any amounts which may have become due from them whether such inability arises from the insolvency of such other reinsurers or otherwise.

It is understood that any Inter-Company Pooling shall be disregarded hereunder when determining the net retained lines.

ARTICLE 7 ULTIMATE NET LOSS

The term "Ultimate Net Loss" shall be understood to mean the actual loss or losses paid or to be paid by the Reinsured under its policies, such loss or losses to include expenses of litigation, if any, interest accrued where such interest is part of the judgement and all other loss expenses of the Reinsured including legal expenses and costs incurred in connection with coverage and validity questions and legal actions connected thereto which are allocable only to a specific claim or action on policies covered hereunder (including a pro rata share of salaries and expenses of the Reinsured's field employees while adjusting such claims or losses and expenses of the Reinsured's officials incurred in connection with claims or losses, but no salaries of the Reinsured's officials or any normal overhead charges such as rent, postal, lighting, cleaning, heating, etc., shall be included) less proper deductions for all recoveries (including amounts recoverable under other reinsurance except reinsurance, if any, inuring to the benefit of the Reinsured) and salvages actually made by the Reinsured; provided always that nothing in this Article shall be construed to mean that losses under this Agreement are not recoverable until the Reinsured's ultimate net loss has been ascertained.

All salvages, recoveries and payments recovered or received subsequent to a loss settlement under this Agreement shall be applied as if recovered or received prior to the said settlement and all necessary adjustments shall be made by the parties hereto.

ARTICLE 8 LIMIT AND RETENTION

No claim shall be made upon the Reinsurer unless and until the Reinsured shall have first sustained an ultimate net loss in excess of \$400,000 each and every loss occurrence and then the Reinsurer shall be liable for the ultimate net loss sustained by the Reinsured in excess of \$400,000 in respect of each such loss occurrence. The limit of liability of the Reinsurer in respect of any one such loss

occurrence shall be \$2,600,000.

It is further warranted that the Reinsurer shall not be liable hereunder until two or more risks are involved in any one loss occurrence. The Reinsured shall be the sole judge of what constitutes one risk.

ARTICLE 9 RATE AND PREMIUM

The Reinsured shall pay to the Reinsurer during the term of this Agreement premium calculated by applying a rate of 3.00% to the Gross Net Earned Premium Income of the Reinsured during such term in respect of business the subject matter of this Agreement.

The term "Gross Net Earned Premium Income" as used herein shall be understood to mean gross premiums earned by the Reinsured less premiums paid for reinsurances which inure to the benefit of this Agreement. For purposes hereof, 90% of the Reinsured's original premium in respect of Homeowners and Farmowners and 80% in respect of Commercial Multiple Peril Policies, where the premium is indivisible, shall be considered subject matter premium.

As soon as practicable after each year, the Reinsured shall submit a statement showing the actual premium due for the term calculated in accordance with the first paragraph of this Article, and the debtor party shall remit to the other.

ARTICLE 10 CURRENCY

All premiums and losses paid under this Agreement shall be made in United States currency.

ARTICLE 11 NOTICE OF LOSS AND LOSS SETTLEMENTS

In the event of a loss occurrence which either results in or appears to be of serious enough nature as probably to result in a loss involving this Agreement, the Reinsured shall give notice as soon as reasonably practicable to the Reinsurer and the Reinsured shall keep the Reinsurer advised of all subsequent developments in connection therewith.

The Reinsurer agrees to abide by the loss settlements of the Reinsured, such settlements to be considered as satisfactory proof of loss, and amounts falling to the share of the Reinsurer shall be immediately payable to the Reinsured by them upon reasonable evidence of the amount paid or to be paid by the Reinsured.

ARTICLE 12 ACCESS TO RECORDS

The Reinsurer, by its duly appointed representatives, shall have the right at any reasonable time, to examine all papers in the possession of the Reinsured referring to business effected hereunder.

ARTICLE 13 STATISTICS

The Reinsured shall furnish the Reinsurer such quarterly and annual statistics as may be necessary to comply with statutory requirements and in such form as may be mutually agreed upon.

ARTICLE 14 ERRORS AND OMISSIONS

Any inadvertent delay, omission or error shall not be held to relieve either party hereto from any liability which would attach to it hereunder if such delay, omission or error had not been made. Such delay, omission or error shall be rectified immediately upon discovery.

ARTICLE 15 TAXES

In consideration of the terms under which this Agreement is issued, the Reinsured undertakes not to claim any deduction in respect of the premium hereon when making tax returns other than Income or Profits Tax returns to any State or Territory or the District of Columbia.

ARTICLE 16 FEDERAL EXCISE TAX

(Applies only to those Reinsurers, excepting Underwriters at Lloyd's, London and other Reinsurers exempt from the Federal Excise Tax, who are domiciled outside the United States of America.)

The Reinsurer has agreed to allow for the purpose of paying the Federal Excise Tax the percentage specified by United States law of the premium payable hereon to the extent such premium is subject to Federal Excise Tax.

In the event of any return of premium becoming due hereunder the Reinsurer will deduct the percentage specified by United States law from the amount of the return and the Reinsured or its agent should take steps to recover the Tax from the U.S. Government.

ARTICLE 17 LOSS RESERVES

(This Clause is applicable to any Reinsurer who does not qualify for credit by states having jurisdiction over the Reinsured.)

At annual intervals (or more frequently as determined by the Reinsured, but not more frequently than quarterly) the Reinsured will submit to the Reinsurer a statement showing the proportion of losses, as defined below, applicable to the Reinsurer.

The Reinsurer will apply for, and secure delivery thereof to the Reinsured, a clean, irrevocable and unconditional Letter of Credit in an amount equal to the Reinsurer's share of said losses. The Letter of Credit shall be issued by a United States bank which is a member of the Federal Reserve System and which is acceptable to the Insurance Departments of such states.

If, as of a statement date, the Reinsurer's share of losses under this Agreement shall exceed the then available balance of the Letter of Credit, the Reinsurer shall, within thirty (30) days after receiving such statement, secure delivery to the Reinsured of an amendment to the clean, irrevocable and unconditional Letter of Credit increasing the balance of the Letter of Credit available by the amount of such difference.

If the Reinsurer's share of losses under this Agreement shall be less than the then available balance of the Letter of Credit, the Reinsured shall, within thirty (30) days after receipt of written request of Reinsurer, release such excess amount by agreeing to consent to an amendment to the Letter of Credit reducing the balance of the Letter of Credit available by the amount of such excess. The Reinsured undertakes to use and apply any amounts which it may draw upon the Letter of Credit, without diminution because of the insolvency of the Reinsured or Reinsurer, notwithstanding any other provision in this contract, only for one or more of the following purposes:

(1) To pay or reimburse itself for the Reinsurer's share of losses paid by the Reinsured for which the Reinsurer is obligated to reimburse the Reinsured, if not otherwise paid by the Reinsurer.

(2) To obtain a cash deposit of the Reinsurer's share under this contract of losses, if the clean, irrevocable and unconditional Letter of Credit is not renewed at least thirty (30) days before the expiration thereof, and the Reinsurer shall continue thereafter to have a share in such losses.

(3) To pay any other amounts the Reinsured claims are due under this reinsurance contract.

The Reinsured will immediately return to the Reinsurer any amounts drawn down

on the Letter of Credit that are subsequently determined not to be due.

The term "losses" as used in this Article shall include:

losses and allocated loss adjustment expenses paid by the Reinsured but not recovered (in proportion) from the Reinsurer,

reserves for losses reported and outstanding, and allocated loss adjustment expenses.

ARTICLE 18 ARBITRATION

As a precedent to any right of action hereunder, if any dispute shall arise between the Reinsured and the Reinsurer with reference to the interpretation of this Agreement or their rights with respect to any transaction involved, whether such dispute arises before or after termination of this Agreement, such dispute upon the written request of either party, shall be submitted to three arbitrators, one to be chosen by each party, and the third by the two so chosen. If either party refuses or neglects to appoint an arbitrator within thirty days after the receipt of written notice from the other party requesting it to do so, the requesting party may appoint two arbitrators. If the two arbitrators fail to agree in the selection of a third arbitrator within thirty days of their appointment, each of them shall name two, of whom the other shall decline one and the decision shall be made by drawing lots. All arbitrators shall be disinterested active or retired executive officers of insurance or reinsurance companies or Underwriters at Lloyd's, London not under the control of either party to this Agreement.

The Arbitrators shall interpret the Agreement and make their decision with regard to the custom and usage of the insurance and reinsurance business. They shall issue their decision in writing based upon a hearing in which evidence may be introduced without following strict rules of evidence, but in which cross examination and rebuttal shall be allowed. They shall make their award with a view to effecting the general purpose of this Agreement in a reasonable manner rather than in accordance with a literal interpretation of the language.

The decision in writing of any two arbitrators, when filed with the parties hereto, shall be final and binding on both parties. Judgment may be entered upon the final decision of the arbitrators in any court having jurisdiction. Each party shall bear the expense of its own arbitrator and shall jointly and equally bear with the other party the expense of the third arbitrator and of the arbitration. Said arbitration shall take place in Marietta, Pennsylvania unless some other place is mutually agreed upon by the Reinsured and the Reinsurer.

ARTICLE 19 WRITTEN AGREEMENT

There are no other agreements between the Reinsurer and the Reinsured regarding the reinsurance provided by this Agreement, including but not limited to agreements which directly or indirectly guarantee a profit under this Agreement for either party.

INSOLVENCY FUNDS EXCLUSION CLAUSE

This Agreement excludes all liability of the Company arising, by contract, operation of law, or otherwise, from its participation or membership, whether voluntary or involuntary, in any insolvency fund. "Insolvency fund" includes any guaranty fund, insolvency fund, plan, pool, association, fund or other arrangement, howsoever denominated, established or governed; which provides for any assessment of or payment or assumption by the Company of part or all of any claim, debt, charge, fee, or other obligation of an insurer, or its successors or assigns, which has been declared by any competent authority to be insolvent, or which is otherwise deemed unable to meet any claim, debt, charge, fee or other obligation in whole or in part.

NOTES: Wherever used herein the terms:

"Company" shall be understood to mean "Company", "Reinsured", "Reassured" or whatever other term is used in the attached reinsurance contract to designate the reinsured company or companies.

"Agreement" shall be understood to mean "Agreement", "Contract", "Policy" or whatever other term is used to designate the attached reinsurance document.

"Reinsurers" shall be understood to mean "Reinsurers", "Underwriters" or whatever other term is used in the attached reinsurance contract to designate the reinsurer or reinsurers.

NUCLEAR INCIDENT EXCLUSION CLAUSE -
PHYSICAL DAMAGE - REINSURANCE

1. This Reinsurance does not cover any loss or liability accruing to the Reinsured, directly or indirectly, and whether as Insurer or Reinsurer, from any Pool of Insurers or Reinsurers formed for the purpose of covering Atomic or Nuclear Energy risks.

2. Without in any way restricting the operation of paragraph (1) of this Clause, this Reinsurance does not cover any loss or liability accruing to the Reinsured, directly or indirectly and whether as Insurer or Reinsurer, from any insurance against Physical Damage (including business interruption or consequential loss arising out of such Physical Damage) to:

I. Nuclear reactor power plants including all auxiliary property on the site, or

II. Any other nuclear reactor installation, including laboratories handling radioactive materials in connection with reactor installations, and "critical facilities" as such, or

III. Installations for fabricating complete fuel elements or for processing substantial quantities of "special nuclear material", and for reprocessing, salvaging, chemically separating, storing or disposing of "spent" nuclear fuel or waste materials, or

IV. Installations other than those listed in paragraph (2) III above using substantial quantities of radioactive isotopes or other products of nuclear fission.

3. Without in any way restricting the operations of paragraphs (1) and (2) hereof, this Reinsurance does not cover any loss or liability by radioactive contamination accruing to the Reinsured, directly or indirectly, and whether as Insurer or Reinsurer, from any insurance on property which is on the same site as a nuclear reactor power plant or other nuclear installation and which normally would be insured therewith except that this paragraph (3) shall not operate

(a) where Reinsured does not have knowledge of such nuclear reactor power plant or nuclear installation, or

(b) where said insurance contains a provision excluding coverage for damage to property caused by or resulting from radioactive contamination, however caused. However on and after 1st January 1960 this sub-paragraph (b) shall only apply provided the said radioactive contamination exclusion provision has been approved by the Governmental Authority having jurisdiction thereof.

4. Without in any way restricting the operations of paragraphs (1), (2) and (3) hereof, this Reinsurance does not cover any loss or liability by radioactive

contamination accruing to the Reinsured, directly or indirectly, and whether as Insurer or Reinsurer, when such radioactive contamination is a named hazard specifically insured against.

5. It is understood and agreed that this Clause shall not extend to risks using radioactive isotopes in any form where the nuclear exposure is not considered by the Reinsured to be the primary hazard.

6. The term "special nuclear material" shall have the meaning given it in the Atomic Energy Act of 1954, or by any law amendatory thereof.

7. Reinsured to be sole judge of what constitutes:
(a) substantial quantities, and
(b) the extent of installation, plant or site.

NOTE: Without in any way restricting the operation of paragraph (1) hereof, it is understood and agreed that

(a) all policies issued by the Reinsured on or before 31st December 1957 shall be free from the application of the other provisions of this Clause until expiry date or 31st December 1960 whichever first occurs whereupon all the provisions of this Clause shall apply.

(b) with respect to any risk located in Canada policies issued by the Reinsured on or before 31st December 1958 shall be free from the application of the other provisions of this Clause until expiry date or 31st December 1960 whichever first occurs whereupon all the provisions of this Clause shall apply.

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FIRST AMENDMENT AND WAIVER
TO THE
AMENDED AND RESTATED CREDIT AGREEMENT

DONEGAL GROUP INC.

Dated as of December 31, 1999

This FIRST AMENDMENT AND WAIVER TO THE AMENDED AND RESTATED CREDIT AGREEMENT dated as of December 31, 1999 (the "First Amendment") is between DONEGAL GROUP INC., (the "Borrower"); the Banks and other financial institutions that have executed the signature pages hereto (together with their successors and assigns, individually, a "Bank" and collectively, the "Banks"); and FLEET NATIONAL BANK, as Agent for the Banks (in such capacity, together with its successors in such capacity, the "Agent").

The Borrower and the Banks entered into an Amended and Restated Credit Agreement dated as of July 27, 1998 (the "Credit Agreement"). The Borrower and the Banks wish to amend the Credit Agreement, to amend, among other things, certain financial covenants and to waive a default with respect to Borrower's failure to comply with Section 6.11 of the Credit Agreement. Capitalized terms used herein but not defined shall have the meanings assigned to them in the Credit Agreement. Accordingly, the Borrower and the Banks agree as follows:

Section 1. Amendments to the Credit Agreement. Effective as of the effective date hereof and subject to the satisfaction of the conditions precedent set forth in Section 3 hereof, the Credit Agreement is hereby amended as follows:

(a) Section 6.10 (Minimum Statutory Surplus of Insurance Subsidiaries) of the Credit Agreement is deleted in its entirety and replaced with the following:

"Section 6.10. Minimum Statutory Surplus of Insurance Subsidiaries. As of the end of any fiscal quarter, permit the Combined Statutory Surplus to be less than an amount equal to the sum of (a) \$85,000,000 plus (b) 50% of any cumulative positive Combined Statutory Net Income, after dividends to the Borrower, for each fiscal quarter, commencing with the quarter ended December 31, 1999, plus (c) any contributions to surplus made by the Borrower to any Insurance Subsidiary, from Revolving Loans, during each fiscal quarter, commencing with the quarter ended December 31, 1999, plus (d) 50% of any contributions to surplus made by the Borrower to any Insurance Subsidiary, other than from Revolving Loans, during each fiscal quarter, commencing with the quarter ended December 31, 1999."

(b) Section 6.11 (Minimum Statutory Surplus of Donegal Mutual) of the Credit Agreement is deleted in its entirety and replaced with the following:

"Section 6.11. Minimum Statutory Surplus of Donegal Mutual. As of the end of any fiscal quarter, permit the Statutory Surplus of Donegal Mutual to be less than an amount equal to the sum of (a) \$50,000,000 plus (b) 50% of any cumulative positive Statutory Net Income of Donegal Mutual for each fiscal quarter, commencing with the fiscal quarter ended December 31, 1999."

Section 2. Waivers. The Banks waive any Event of Default which would result from the Borrower's failure to comply with that certain financial covenant under Section 6.11 of the Credit Agreement as of the fiscal quarter ended September 30, 1999. The foregoing waiver is effective only for said Event of Default and shall not entitle Borrower to any future waiver in similar or other circumstances.

Section 3. Conditions of Effectiveness. This First Amendment shall become effective as of December 31, 1999 when, and only when, the Banks shall have received a counterpart of this First Amendment duly executed by the Borrower and the payment of an amendment fee (in immediately available funds) as follows: (a) Fleet National Bank, \$25,000; and (b) Credit Lyonnais New York Branch, \$15,000.

Section 4. Representations and Warranties of the Borrower. Borrower represents as follows:

(a) The execution, delivery and performance by the Borrower of this First Amendment is within Borrower's corporate powers, have been duly authorized by all necessary corporate action and does not and will not (a) require any consent or approval of the shareholders of Borrower; (b) contravene Borrower's charter or by-laws; (c) violate any provision of, or require any filing, registration, consent or approval under, any law, rule, regulation (including without limitation, Regulations U and X), order, writ, judgment, injunction, decree, determination or award presently in effect having applicability to and binding upon Borrower; (d) result in a breach of or constitute a default or require any consent under any indenture or loan or credit agreement or any other material agreement, lease or instrument to which Borrower is a party or by which it or its properties may be bound or affected; or (e) result in, or require, the creation or imposition of any mortgage, deed of trust, pledge, lien, security interest or other charge or encumbrance of any nature upon or with respect to any of the properties now owned or hereafter acquired by Borrower; and (f) Borrower is not in default under any such law, rule, regulation, order, writ, judgment, injunction, decree, determination or award or any such indenture, agreement, lease or instrument.

(b) No authorization or approval or other action by a governmental authority or regulatory body or other Person, and no notice to or filing with such authority or body or Person by any Person is required for the due execution, delivery and performance by Borrower of this First Amendment.

(c) This First Amendment has been duly executed and when delivered by the Borrower will constitute the legal, valid and binding obligations of the Borrower enforceable against Borrower in accordance with its terms, except to the extent that such enforcement may be limited by applicable bankruptcy, insolvency and other similar laws affecting creditors' rights generally and by general principles of equity.

(d) The representations and warranties contained in Article 4 of the Credit Agreement are correct on and as of the date hereof as though made on and as of the date hereof.

(e) No Event of Default has occurred and is continuing (except those that have been waived pursuant to Section 2 of this First Amendment) or would result from the signing of this First Amendment or the transactions contemplated hereby.

(f) Since the date of the last financial statements furnished to the Banks, there has occurred no event which would have a Materially Adverse Effect.

(g) There are no actions, suits or proceedings or investigations (other than routine examinations performed by insurance regulatory authorities) pending or, as far as the Borrower can reasonably foresee, threatened against or affecting the Borrower or any of its Subsidiaries, or any property of any of them before any court, governmental agency or arbitrator, which if determined adversely to the Borrower or any Subsidiary would in any one case or in the aggregate, have a Materially Adversely Effect, or affect Borrower's ability to perform its obligations under this First Amendment.

(h) No information, exhibit or report furnished in writing by or on behalf of the Borrower or any officer or director of Borrower to the Banks in connection with the negotiation of, or pursuant to the terms of, this First Amendment contained when made any material misstatement of fact or omitted to state a materially fact necessary to make the statements contained therein not misleading.

Section 4. Reference to and Effect on the Credit Agreement and Revolving Notes.

(a) Upon the effectiveness of this First Amendment, on and after the date hereof, each reference in the Credit Agreement to this "Agreement", "hereunder", "hereof", "herein" or words of like import and each reference in the Revolving Notes shall mean and be a reference to the Credit Agreement as amended hereby.

(b) Except as specifically amended above, the Credit Agreement shall remain in full force and effect and is hereby ratified and confirmed.

(c) The execution, delivery and effectiveness of this First Amendment shall not, except as expressly provided herein, operate as a waiver of any right, power or remedy of any Bank under the Credit Agreement, nor constitute a waiver of any provision of the Credit Agreement.

Section 5. Costs, Expenses and Taxes. The Borrower agrees to pay on demand all costs and expenses of the Banks in connection with the preparation, execution and delivery of this First Amendment and the other instruments and documents to be delivered hereunder, including, without limitation, the reasonable fees and out-of-pocket expenses of counsel for the Agent with respect thereto and with respect to advising the Banks as to its rights and responsibilities hereunder and thereunder. In addition, the Borrower shall pay any and all stamp and other taxes payable or determined to be payable in connection with the execution and delivery of this First Amendment and the other instruments and documents to be delivered hereunder, and agrees to

save the Banks harmless from and against any and all liabilities with respect to or resulting from any delay in paying or omission to pay such taxes.

Section 6. Execution in Counterparts. This First Amendment may be executed in any number of counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same instrument.

Section 7. Governing Law. This First Amendment shall be governed by, and construed in accordance with, the laws of the State of Connecticut.

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IN WITNESS WHEREOF, the parties hereto have caused this First Amendment to be executed by their respective officers thereunto duly authorized, as of the date first above written.

BORROWER:

DONEGAL GROUP, INC.

By: /s/ Ralph G. Spontak

Name: Ralph G. Spontak
Title: Sr. V.P. / Secretary

AGENT:

FLEET NATIONAL BANK, as Agent

By:

Name:
Title:

BANKS:

FLEET NATIONAL BANK

By:

Name:
Title:

CREDIT LYONNAIS NEW YORK
BRANCH

By:

Name:
Title:

IN WITNESS WHEREOF, the parties hereto have caused this First Amendment to be executed by their respective officers thereunto duly authorized, as of the date first above written.

BORROWER:

DONEGAL GROUP, INC.

By:

Name:
Title:

AGENT:

FLEET NATIONAL BANK, as Agent

By: /s/ Holly A. O'Neill

Name: Holly A. O'Neill
Title: Loan Officer

BANKS:

FLEET NATIONAL BANK

By: /s/ Holly A. O'Neill

Name: Holly A. O'Neill
Title: Loan Officer

CREDIT LYONNAIS NEW YORK
BRANCH

By:

Name:
Title:

IN WITNESS WHEREOF, the parties hereto have caused this First Amendment to be executed by their respective officers thereunto duly authorized, as of the date first above written.

BORROWER:

DONEGAL GROUP, INC.

By: _____

Name:
Title:

AGENT:

FLEET NATIONAL BANK, as Agent

By: _____

Name:
Title:

BANKS:

FLEET NATIONAL BANK

By: _____

Name:
Title:

CREDIT LYONNAIS NEW YORK
BRANCH

By: /s/ Sebastian Rocco

Name: Sebastian Rocco
Title: Senior Vice President

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Donegal Group Inc. ("DGI" or the "Company") is a regional insurance holding company doing business in the Mid-Atlantic and Southern states through its five wholly-owned property-casualty insurance subsidiaries, Atlantic States Insurance Company ("Atlantic States"), Southern Insurance Company of Virginia ("Southern"), Southern Heritage Insurance Company ("Southern Heritage"), Delaware Atlantic Insurance Company ("Delaware") and Pioneer Insurance Company ("Pioneer") (collectively "Insurance Subsidiaries"). The Company has three operating segments: the investment function, the personal lines of insurance and the commercial lines of insurance. Products offered in the personal lines of insurance consist primarily of homeowners and private passenger automobile policies. Products offered in the commercial lines of insurance consist primarily of commercial automobile, commercial multiple peril and workers' compensation policies. The Insurance Subsidiaries are subject to regulation by Insurance Departments in those states in which they operate and undergo periodic examination by those departments. The Insurance Subsidiaries are also subject to competition from other insurance carriers in their operating areas. DGI was formed in September 1986 by Donegal Mutual Insurance Company (the "Mutual Company"), which owns 62% of the outstanding common shares of the Company as of December 31, 1999.

Atlantic States participates in an intercompany pooling arrangement with the Mutual Company and assumes 65% of the pooled business. Southern cedes 50% of its business to the Mutual Company and Delaware cedes 70% of its workers' compensation business to the Mutual Company. Because the Mutual Company places substantially all of the business assumed from Southern and Delaware into the pool, from which the Company has a 65% allocation, the Company's results of operations include approximately 83% of the business written by Southern and approximately 76% of the workers' compensation business written by Delaware.

In November 1998, the Company acquired all of the outstanding stock of Southern Heritage. This transaction was accounted for as a "purchase." The Company's financial statements include Southern Heritage as a consolidated subsidiary from November 1, 1998.

In addition to the Company's Insurance Subsidiaries, it also owned all of the outstanding stock of Atlantic Insurance Services, Inc. ("AIS"), an insurance services organization which provided inspection and policy auditing information on a fee-for-service basis to its affiliates and the insurance industry. The Company sold all of the outstanding shares of AIS on October 1, 1999.

RESULTS OF OPERATIONS 1999 COMPARED TO 1998

Total revenues for 1999 were \$159,711,107, which were \$29,124,742, or 22.3%, greater than 1998. Net premiums earned increased to \$143,873,970, an increase of \$27,704,978, or 23.9%, over 1998. The acquisition of Southern Heritage accounted for \$19,674,071, or 71% of the increase in earned premiums in 1999. Direct premiums written of the combined pool of Atlantic States and the Mutual Company increased \$9,516,654 or 6.6%. A 9.4% increase in the direct premiums written of Southern, a 4.9% increase in the direct premiums written of Delaware and a 13.9% increase in the direct premiums written of Pioneer accounted for the majority of the remaining change. The Company reported net realized investment losses of \$38,702, compared to net realized investment losses of \$13,562 in 1998. Net realized losses in both years resulted from normal turnover of the Company's investment portfolio. As of December 31, 1999, 99.9% of the Company's bond portfolio was classified as Class 1 (highest quality) by the National Association of Insurance Commissioners' Securities Valuation Office. Investment income increased \$1,225,876. An increase in the average invested assets from \$208,303,664 to \$258,218,661, offset by a decrease in the average yield to 5.1% from 5.6% in 1998, accounted for the change.

The GAAP combined ratio of insurance operations was 106.5% in 1999, compared to 99.8% in 1998. The GAAP combined ratio is the sum of the ratios of incurred losses and loss expenses to premiums earned (loss ratio), underwriting expenses to premiums earned (expense ratio) and policyholder dividends to premiums earned (dividend ratio). The loss ratio in 1999 was 69.0%, compared to 63.0% in 1998. The increase in the loss ratio in 1999 resulted from a deterioration in operating results in both the commercial and personal lines segments of the Company. The commercial lines loss ratio increased from 54.9% in 1998 to 68.8% in 1999, with results in workers' compensation suffering the largest increase from 46.9% in 1998 to 68.8% in 1999. Homeowners results suffered the largest increase in personal lines as the loss ratio increased from 72.3% in 1998 to 77.1% in 1999. This increase was somewhat offset by a decrease in the private passenger automobile loss ratio from 71.0% in 1998 to 69.4% in 1999. The expense ratio for 1999 was 36.6%, compared to 35.4% in 1998, with the dividend ratio decreasing from 1.4% in 1998 to 0.9% in 1999. The expense ratio was adversely affected by a charge to earnings resulting from a restructuring charge of \$2 million which increased the expense ratio by 1.4%. The dividend ratio decreased due to a higher loss ratio in workers' compensation in 1999 compared to 1998.

The Company benefited from a federal income tax law change that was enacted during 1999 which allows net operating loss carryforwards of an acquired company to be used to offset future taxable income of other affiliated companies filing as part of a consolidated tax return.

operating loss carryforward, obtained as part of the acquisition of Southern Heritage, can now be used to offset taxable income generated by the other consolidated affiliates. Because of this change, management determined that a valuation allowance for Southern Heritage's net operating loss carryforward is no longer needed, and the Company recognized a tax benefit of \$3,004,524 in 1999.

RESULTS OF OPERATIONS 1998 COMPARED TO 1997

Total revenues for 1998 were \$130,586,365, which were \$9,258,759, or 7.6%, greater than 1997. Net premiums earned increased to \$116,168,992, an increase of \$8,866,824, or 8.3%, over 1997. The acquisition of Southern Heritage contributed \$4,835,036, or 4.5%, to the earned premiums in 1998. Direct premiums written by the combined pool of Atlantic States and the Mutual Company increased \$6,426,444 or 4.7%. A 17.5% increase in the direct premiums written of Southern, a 6.5% decrease in the direct premiums written of Delaware and an 11.7% decrease in the direct premiums written of Pioneer accounted for the majority of the remaining change. The Company reported net realized investment losses of \$13,562, compared to net realized investment gains of \$314,136 in 1997. Net realized gains and losses in both years resulted from normal turnover of the Company's investment portfolio. As of December 31, 1998, 99.9% of the Company's bond portfolio was classified as Class 1 (highest quality) by the National Association of Insurance Commissioners' Securities Valuation Office. Investment income increased \$490,384. An increase in the average invested assets from \$198,727,027 to \$208,303,664, offset by a decrease in the average yield to 5.6% from 5.8% in 1997, accounted for the change.

The GAAP combined ratio of insurance operations was 99.8% in 1998, compared to 97.6% in 1997. The GAAP combined ratio is the sum of the ratios of incurred losses and loss expenses to premiums earned (loss ratio), underwriting expenses to premiums earned (expense ratio) and policyholder dividends to premiums earned (dividend ratio). The loss ratio in 1998 was 63.0%, compared to 63.1% in 1997. The expense ratio for 1998 was 35.4%, compared to 33.3% in 1997, with the dividend ratio increasing from 1.2% in 1997 to 1.4% in 1998. The increase in the Company's expense ratio accounted for the change in its combined ratio. The expense ratio was adversely affected by a charge to earnings in the third quarter resulting from an unprecedented large mandatory Pennsylvania Insurance Guaranty Association assessment arising from the insolvency of two medical malpractice companies. The Company's share of the Guaranty Association liability arising from these two companies was \$1.3 million. Guaranty Association assessments represent mandatory regulatory charges that must be absorbed by substantially all property and casualty insurance companies doing business in a state where an insolvent company had been writing business, including companies, like Donegal, who do not write lines of business that the insolvent companies were writing.

LIQUIDITY AND CAPITAL RESOURCES

The Company generates sufficient funds from its operations and maintains a high degree of liquidity in its investment portfolio. The primary source of funds to meet the demands of claim settlements and operating expenses are premium collections, investment earnings and maturing investments. As of December 31, 1999, the Company had no material commitment for capital expenditures.

In investing funds made available from operations, the Company maintains securities' maturities consistent with its projected cash needs for the payment of claims and expenses. The Company maintains a portion of its investment portfolio in relatively short-term and highly liquid assets to ensure the availability of funds.

As of December 31, 1999, pursuant to a credit agreement dated December 29, 1995, with Fleet National Bank of Connecticut, the Company had unsecured borrowings of \$37 million. Such borrowings were made in connection with the acquisitions of Delaware, Pioneer and Southern Heritage and various capital contributions to the subsidiaries. Per the terms of the credit agreement, the Company may borrow up to \$40 million at interest rates equal to the bank's then current prime rate or the then current London interbank Eurodollar bank rate plus 1.70%. At December 31, 1999, the interest rates on the outstanding balances were 8.5% on an outstanding prime rate balance of \$22 million and 7.84% on an outstanding Eurodollar rate balance of \$15 million. In addition, the Company pays a rate of 3/10 of 1% per annum on the average daily unused portion of the bank's commitment. On each July 27, commencing July 27, 2001, the credit line will be reduced by \$8 million. Any outstanding loan in excess of the remaining credit line after such reduction will then be payable.

The Company's principal sources of cash with which to meet obligations and pay stockholder dividends are dividends from the Insurance Subsidiaries which are required by law to maintain certain minimum surplus on a statutory basis and are subject to regulations under which payment of dividends from statutory surplus is restricted and may require prior approval of their domiciliary insurance regulatory authorities. The Insurance Subsidiaries are also subject to Risk Based Capital (RBC) requirements which may further impact their ability to pay dividends. At December 31, 1999, all five companies' statutory capital and surplus were substantially above the RBC requirements. At December 31, 1999, amounts available for distribution as dividends to DGI without prior approval of the insurance regulatory authorities were \$6,851,802 from Atlantic States, \$184,285 from Southern, \$956,381 from Delaware, \$567,793 from Pioneer and \$1,650,842 from Southern Heritage.

Net unrealized gains (losses) resulting from fluctuations in the fair value of investments reported in the balance sheet at fair value were \$(2,073,989) (net of applicable federal income tax benefit) at December 31, 1999, and \$1,315,425 (net of applicable federal income tax) at December 31, 1998.

CREDIT RISK

The Company provides property and liability coverages through its subsidiaries' independent agency systems located throughout its operating area. The majority of this business is billed directly to the insured, although a portion of the Company's commercial business is billed through its agents, who are extended credit in the normal course of business.

The Company's Insurance Subsidiaries have reinsurance agreements in place with the Mutual Company, as described in Note 3 of the financial statements, and with a number of other major authorized reinsurers, as described in Note 9 of the financial statements.

IMPACT OF INFLATION

Property and casualty insurance premiums are established before the amount of losses and loss expenses, or the extent to which inflation may impact such expenses, are known. Consequently, the Company attempts, in establishing rates, to anticipate the potential impact of inflation.

YEAR 2000 ISSUES

The Company has not encountered difficulties to date with respect to the Year 2000 millennium change, either internally or with third parties. The Company will continue to monitor exposure to any Year 2000 related problems.

The Company's expenses to address Year 2000 issues were not material.

The Company has risk that claims related to Year 2000 issues will be made under insurance policies that it underwrites. The Company has concluded that its policies do not generally provide coverage for losses relating to Year 2000 issues and has issued endorsements further clarifying this exclusion. However, due in part to the potential for judicial decisions which expand policies to cover risks that were not contemplated by the policy, which in turn may produce unanticipated claims, and because there is no prior history of such claims at this point in time, the amount of any potential Year 2000 coverage liabilities is not determinable. However, the Company has not had any claims reported to date.

IMPACT OF NEW ACCOUNTING STANDARDS ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES - DEFERRAL OF THE EFFECTIVE DATE

In June 1999, Statement of Financial Accounting Standards (SFAS) No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133," was issued deferring the effective date of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," from all fiscal quarters of fiscal years beginning after June 15, 1999 to all fiscal quarters of fiscal years beginning after June 15, 2000. The Company is in the process of determining the effect, if any, of SFAS No. 133 on its financial statements. The Company has not held or issued derivative financial instruments.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK INTEREST RATE RISK

The Company's exposure to market risk for changes in interest rates is concentrated in its investment portfolio and, to a lesser extent, its debt obligations. The Company monitors this exposure through periodic reviews of asset and liability positions. Estimates of cash flows and the impact of interest rate fluctuations relating to the investment portfolio are modeled regularly.

Principal cash flows and related weighted-average interest rates by expected maturity dates for financial instruments sensitive to interest rates at December 31, 1999 are as follows:

	Principal Cash Flows	Weighted-Average Interest Rate

Fixed maturities and short-term investments:		
2000	\$ 34,005,257	5.96%
2001	17,174,618	6.58%
2002	10,435,292	5.98%
2003	17,600,000	5.79%
2004	13,500,000	5.73%
Thereafter	161,493,548	6.03%

Total	\$254,208,715	
=====		
Market value	\$250,034,799	
=====		
Debt		
2000	\$ 0	8.23%
2001	5,000,000	8.23%
2002	8,000,000	8.23%
2003	8,000,000	8.23%
2004	8,000,000	8.23%
Thereafter	8,000,000	8.23%

Total	\$ 37,000,000	
=====		
Fair value	\$ 37,000,000	
=====		

Actual cash flows may differ from those stated as a result of calls and prepayments.

EQUITY PRICE RISK

The Company's portfolio of equity securities, which is carried on the balance sheet at market value, has exposure to price risk. Price risk is defined as the potential loss in market value resulting from an adverse change in prices. Portfolio characteristics are analyzed regularly and market risk is actively managed through a variety of techniques. The portfolio is diversified across industries, and concentrations in any one company or industry are limited by parameters established by management.

The combined total of realized and unrealized equity investment gains and (losses) were \$(404,147), \$(307,147), and \$586,178 in 1999, 1998 and 1997, respectively. During these three years the largest total equity investment gain and (loss) in a quarter was \$897,971 and \$(1,435,101), respectively.

DONEGAL GROUP INC.
CONSOLIDATED BALANCE SHEETS

Year Ended December 31,	1999	1998
Assets		
Investments		
Fixed maturities		
Held to maturity, at amortized cost (fair value \$133,995,994 and \$131,633,299)	\$136,173,547	\$127,183,788
Available for sale, at fair value (amortized cost \$103,419,994 and \$89,089,995)	100,043,548	90,525,855
Equity securities, available for sale, at fair value (cost \$9,043,818 and \$6,206,735)	9,229,498	6,763,943
Short-term investments, at cost, which approximates fair value	15,995,257	30,521,887
Total investments	261,441,850	254,995,473
Cash	3,922,403	8,227,042
Accrued investment income	3,474,430	3,164,599
Premiums receivable	18,218,525	19,824,894
Reinsurance receivable	53,070,283	48,339,223
Deferred policy acquisition costs	11,203,302	11,334,301
Federal income taxes receivable	698,969	227,841
Deferred tax asset, net	9,121,232	3,536,692
Prepaid reinsurance premiums	32,154,837	27,203,111
Property and equipment, net	5,516,688	5,920,420
Accounts receivable--securities	--	329,299
Due from affiliate	262,954	--
Other	647,184	2,128,611
Total assets	\$399,732,657	\$385,231,506
Liabilities and Stockholders' Equity		
Liabilities		
Losses and loss expenses	\$149,979,141	\$141,409,008
Unearned premiums	97,657,020	94,722,785
Accrued expenses	5,888,392	4,821,594
Drafts payable	597,775	1,394,373
Reinsurance balances payable	1,216,034	1,785,914
Cash dividend declared to stockholders	760,673	708,513
Borrowings under line of credit	37,000,000	37,500,000
Accounts payable--securities	2,500,000	503,840
Due to affiliate	--	870,083
Other	719,010	884,392
Total liabilities	296,318,045	284,600,502
Stockholders' Equity		
Preferred stock, \$1.00 par value, authorized 2,000,000 shares; none issued		
Common stock, Class A, authorized 15,000,000 shares; none issued		
Common stock, \$1.00 par value, authorized 20,000,000 shares, issued 8,574,210 and 8,325,221 shares and outstanding 8,451,922 and 8,202,933 shares	8,574,210	8,325,221
Additional paid-in capital	43,536,748	41,271,322
Accumulated other comprehensive income (loss)	(2,073,989)	1,315,425
Retained earnings	54,269,399	50,610,792
Treasury stock, at cost	(891,756)	(891,756)
Total stockholders' equity	103,414,612	100,631,004
Total liabilities and stockholders' equity	\$399,732,657	\$385,231,506

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

Year Ended December 31,	1999	1998	1997
STATEMENTS OF INCOME			
Revenues			
Premiums earned	\$211,361,789	\$172,507,090	\$159,055,645
Premiums ceded	67,487,819	56,338,098	51,753,477
Net premiums earned	143,873,970	116,168,992	107,302,168
Investment income, net of investment expenses	13,223,537	11,997,661	11,507,277
Installment payment fees	1,439,334	895,283	818,981
Lease income	819,474	753,408	643,183
Service fees	393,494	784,583	741,861
Net realized investment gains (losses)	(38,702)	(13,562)	314,136
Total revenues	159,711,107	130,586,365	121,327,606
Expenses			
Losses and loss expenses	145,493,825	110,448,552	99,408,492
Reinsurance recoveries	46,288,823	37,281,467	31,751,974
Net losses and loss expenses	99,205,002	73,167,085	67,656,518
Amortization of deferred policy acquisition costs	24,608,000	19,490,000	18,696,000
Other underwriting expenses	28,034,876	21,712,346	17,058,668
Policy dividends	1,341,294	1,635,300	1,319,384
Interest	1,535,249	1,292,992	910,237
Other	1,357,585	1,611,627	1,513,256
Total expenses	156,082,006	118,909,350	107,154,063
Income before income tax expense (benefit)	3,629,101	11,677,015	14,173,543
Income tax expense (benefit)	(3,027,836)	2,659,175	3,532,357
Net income	\$ 6,656,937	\$ 9,017,840	\$ 10,641,186
Net income per common share			
Basic	\$.80	\$ 1.11	\$ 1.33
Diluted	\$.80	\$ 1.09	\$ 1.32
STATEMENTS OF COMPREHENSIVE INCOME			
Net income	\$ 6,656,937	\$ 9,017,840	\$ 10,641,186
Other comprehensive income (loss), net of tax			
Unrealized gains (losses) on securities:			
Unrealized holding gain (loss) arising during the period, net of income tax expense (benefit) of \$(1,781,261), \$151,999 and \$409,974	(3,414,957)	295,057	795,831
Reclassification adjustment for (gains) losses included in net income, net of income tax expense (benefit) of \$(13,159), \$(4,611) and \$106,806	25,543	8,951	(207,330)
Other comprehensive income (loss)	(3,389,414)	304,008	588,501
Comprehensive income	\$ 3,267,523	\$ 9,321,848	\$ 11,229,687

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total Stockholders' Equity
	Shares	Amount					
Balance, January 1, 1997	4,540,569	\$4,540,569	\$37,862,715	\$ 422,916	\$39,664,830	\$(891,756)	\$ 81,599,274
Issuance of common stock	61,523	61,523	1,069,402				1,130,925
Net income					10,641,186		10,641,186
Other comprehensive income				588,501			588,501
Cash dividends \$.2925 per share					(2,363,223)		(2,363,223)
Stock dividend	1,520,339	1,520,329			(1,520,329)		
Balance, December 31, 1997	6,122,431	\$6,122,431	\$38,932,117	\$ 1,011,417	\$46,422,454	\$(891,756)	\$ 91,596,663
Issuance of common stock	141,542	141,542	2,339,205				2,480,747
Net income					9,017,840		9,017,840
Other comprehensive income				304,008			304,008
Cash dividends \$.3375 per share					(2,768,254)		(2,768,254)
Stock dividend	2,061,248	2,061,248			(2,061,248)		
Balance, December 31, 1998	8,325,221	\$8,325,221	\$41,271,322	\$ 1,315,425	\$50,610,792	\$(891,756)	\$100,631,004
Issuance of common stock	248,989	248,989	2,265,426				2,514,415
Net income					6,656,937		6,656,937
Other comprehensive loss				(3,389,414)			(3,389,414)
Cash dividends \$.36 per share					(2,998,330)		(2,998,330)
Balance, December 31, 1999	8,574,210	\$8,574,210	\$43,536,748	\$(2,073,989)	\$54,269,399	\$(891,756)	\$103,414,612

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31,	1999	1998	1997
Cash Flows from Operating Activities:			
Net income	\$ 6,656,937	\$ 9,017,840	\$10,641,186
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	936,373	520,675	390,857
Realized investment (gains) losses	38,702	13,562	(314,136)
Changes in Assets and Liabilities, net of acquisition:			
Losses and loss expenses	8,570,133	7,125,806	3,490,429
Unearned premiums	2,934,235	6,478,435	811,785
Accrued expenses	1,066,798	(542,693)	827,727
Premiums receivable	1,606,369	(1,253,529)	(169,213)
Deferred policy acquisition costs	130,999	(399,428)	(610,161)
Deferred income taxes	(3,790,122)	158,593	7,108
Reinsurance receivable	(4,731,060)	(6,182,621)	(78,023)
Accrued investment income	(309,831)	(186,170)	(112,644)
Amounts due to/from affiliate	(1,133,037)	(4,180,378)	(438,442)
Reinsurance balances payable	(569,880)	(127,931)	(11,926)
Prepaid reinsurance premiums	(4,951,726)	(3,819,226)	(508,964)
Current income taxes	(471,128)	(171,387)	(700,983)
Other, net	519,441	100,292	192,808
Net adjustments	(153,734)	(2,466,000)	2,776,222
Net cash provided by operating activities	6,503,203	6,551,840	13,417,408
Cash Flows from Investing Activities:			
Purchase of fixed maturities			
Held to maturity	(23,132,805)	(24,774,417)	(15,834,418)
Available for sale	(32,233,424)	(43,662,157)	(21,614,427)
Purchase of equity securities	(14,258,861)	(15,824,465)	(10,598,546)
Sale of fixed maturities			
Available for sale	503,895	2,207,500	--
Maturity of fixed maturities			
Held to maturity	14,393,638	24,815,155	11,909,421
Available for sale	19,049,880	16,106,644	18,860,222
Sale of equity securities	11,767,268	16,155,130	6,695,236
Sale of Atlantic Insurance Services, net	(48,810)	--	--
Acquisition of Southern Heritage	--	(18,028,072)	--
Purchase of property and equipment	(443,498)	(650,014)	(2,758,851)
Net sales (purchases) of short-term investments	14,526,630	15,099,631	(1,242,030)
Net cash used in investing activities	(9,876,087)	(28,555,065)	(14,583,393)
Cash Flows from Financing Activities:			
Issuance of common stock	2,514,415	2,480,747	1,130,925
Borrowings (payments) under line of credit, net	(500,000)	27,000,000	2,000,000
Cash dividends paid	(2,946,170)	(2,663,795)	(2,251,788)
Net cash provided by (used in) financing activities	(931,755)	26,816,952	879,137
Net increase (decrease) in cash	(4,304,639)	4,813,727	(286,848)
Cash at beginning of year	8,227,042	3,413,315	3,700,163
Cash at end of year	\$ 3,922,403	\$ 8,227,042	\$ 3,413,315

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND BUSINESS

Donegal Group Inc. (the "Company") was organized as a regional insurance holding company by Donegal Mutual Insurance Company (the "Mutual Company") and operates in the Mid-Atlantic and Southern states through its wholly-owned stock insurance companies, Atlantic States Insurance Company ("Atlantic States"), Southern Insurance Company of Virginia ("Southern"), Southern Heritage Insurance Company ("Southern Heritage"), Delaware Atlantic Insurance Company ("Delaware"), and Pioneer Insurance Company ("Pioneer") (collectively "Insurance Subsidiaries"). The Company has three operating segments: the investment function, the personal lines of insurance and the commercial lines of insurance. Products offered in the personal lines of insurance consist primarily of homeowners and private passenger automobile policies. Products offered in the commercial lines of insurance consist primarily of commercial automobile, commercial multiple peril and workers' compensation policies. The Insurance Subsidiaries are subject to regulation by Insurance Departments in those states in which they operate and undergo periodic examination by those departments. The Insurance Subsidiaries are also subject to competition from other insurance carriers in their operating areas. Atlantic States participates in an intercompany pooling arrangement with the Mutual Company and assumes 65% of the pooled business. Southern cedes 50% of its business to the Mutual Company and Delaware cedes 70% of its Workers' Compensation business to the Mutual Company. At December 31, 1999, the Mutual Company held 62% of the outstanding common stock of the Company.

In addition to the Company's Insurance Subsidiaries, it also owned all of the outstanding stock of Atlantic Insurance Services, Inc. ("AIS"), an insurance services organization. The Company sold all of the stock of AIS on October 1, 1999.

BASIS OF CONSOLIDATION

The consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles, include the accounts of Donegal Group Inc. and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. The term "Company" as used herein refers to the consolidated entity.

USE OF ESTIMATES

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the liabilities for losses and loss expenses. While management uses available information to provide for such liabilities, future changes to these liabilities may be necessary based on changes in trends in claim frequency and severity.

INVESTMENTS

The Company classifies its debt and equity securities into the following categories:

Held to Maturity--Debt securities that the Company has the positive intent and ability to hold to maturity; reported at amortized cost.

Available for Sale--Debt and equity securities not classified as held to maturity; reported at fair value, with unrealized gains and losses excluded from income and reported as a separate component of stockholders' equity (net of tax effects).

Short-term investments are carried at amortized cost, which approximates fair value.

If there is a decline in fair value below amortized cost which is other than temporary, the cost basis for such investments in the held to maturity and available for sale categories is reduced to fair value. Such decline in cost basis is recognized as a realized loss and charged to income.

Premiums and discounts on debt securities are amortized over the life of the security as an adjustment to yield using the effective interest method. Realized investment gains and losses are computed using the specific identification method.

Premiums and discounts for mortgage-backed debt securities are amortized using anticipated prepayments with significant changes in estimated prepayments accounted for under the prospective method.

FAIR VALUES OF FINANCIAL INSTRUMENTS

The Company has used the following methods and assumptions in estimating its fair value disclosures:

Investments--Fair values for fixed maturity securities are based on quoted market prices, when available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or values obtained from independent pricing services through a bank trustee. The fair values for equity securities are based on quoted market prices.

Cash and Short-Term Investments--The carrying amounts reported in the balance sheet for these instruments approximate their fair values.

Premium and Reinsurance Receivables and Payables--The carrying amounts reported in the balance sheet for these instruments approximate their fair values.

Borrowings Under Line of Credit--The carrying amounts reported in the balance sheet for the line of credit approximate fair value due to the variable rate nature of the line of credit.

REVENUE RECOGNITION

Insurance premiums are recognized as income over the terms of the policies. Unearned premiums are calculated on a daily pro-rata basis.

POLICY ACQUISITION COSTS

Policy acquisition costs, consisting primarily of commissions, premium taxes and certain other variable underwriting costs, are deferred and amortized over the period in which the premiums are earned. Anticipated losses and loss expenses, expenses for maintenance of policies in force and anticipated investment income are considered in the determination of the recoverability of deferred acquisition costs.

PROPERTY AND EQUIPMENT

Property and equipment are reported at depreciated cost that is computed using the straight-line method based upon estimated useful lives of the assets.

LOSSES AND LOSS EXPENSES

The liability for losses and loss expenses includes amounts determined on the basis of estimates for losses reported prior to the close of the accounting period and other estimates, including those for incurred but not reported losses and salvage and subrogation recoveries.

These liabilities are continuously reviewed and updated by management, and management believes that such liabilities are adequate to cover the ultimate net cost of claims and expenses. When management determines that changes in estimates are required, such changes are included in current earnings.

The Company has no material exposures to environmental liabilities.

INCOME TAXES

The Company and its subsidiaries currently file a consolidated federal income tax return.

The Company accounts for income taxes using the asset and liability method. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled.

CREDIT RISK

The Company provides property and liability coverages through its Insurance Subsidiaries' independent agency systems located throughout its operating area. The majority of this business is billed directly to the insured, although a portion of the Company's commercial business is billed through its agents, who are extended credit in the normal course of business.

The Company's Insurance Subsidiaries have reinsurance agreements in place with the Mutual Company and with a number of other authorized reinsurers with at least an A.M. Best rating of A- or an equivalent financial condition.

REINSURANCE ACCOUNTING AND REPORTING

The Company relies upon reinsurance agreements to limit its maximum net loss from large single risks or risks in concentrated areas, and to increase its capacity to write insurance. Reinsurance does not relieve the primary insurer from liability to its policyholders. To the extent that a reinsurer may be unable to pay losses for which it is liable under the terms of a reinsurance agreement, the Company is exposed to the risk of continued liability for such losses. However, in an effort to reduce the risk of non-payment, the Company requires all of its reinsurers to have an A.M. Best rating of A- or better or, with respect to foreign reinsurers, to have a financial condition which, in the opinion of management, is equivalent to a company with at least an A- rating.

STOCK-BASED COMPENSATION

Stock-based compensation plans are accounted for under the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation expense would be recorded on the date of a stock option grant only if the current market price of the underlying stock exceeded the exercise price. Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," permits entities to recognize as expense, over the vesting period, the fair value of all stock-based awards on the date of the grant. Alternatively, SFAS No. 123 allows entities to continue to apply the provisions of APB Opinion No. 25 and provide pro-forma net income and earnings per share disclosures for employee stock option grants made as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro-forma disclosures under SFAS No. 123.

EARNINGS PER SHARE

Basic earnings per share are calculated by dividing net income by the weighted-average number of common shares outstanding for the period, while diluted earnings per share reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

2--ACQUISITIONS OF BUSINESSES

In November 1998, the Company acquired all of the outstanding stock of Southern Heritage for a cash price of \$18,824,950. Southern Heritage primarily writes personal automobile and homeowners policies in the Southeastern region of the country. This transaction was accounted for as a "purchase." The Company's financial statements include Southern Heritage as a consolidated subsidiary from November 1, 1998.

Assets in the amount of \$56,568,710 were acquired, and liabilities in the amount of \$38,330,912 were assumed in the purchase transaction. The purchase price exceeded the fair value of net assets acquired by \$587,152, which is recognized as goodwill and is being amortized over five years.

The following table reflects unaudited pro-forma combined results of operations of the Company and Southern Heritage on the basis that the acquisition had taken place at the beginning of each year. The pro-forma information is presented for information purposes only and is not indicative of the actual results that would have resulted if the acquisition had been made as of those dates. The pro-forma is not intended to be a projection of future results.

	1998	1997
Revenues	\$161,307,562	\$157,037,483
Net income	2,978,411	9,558,889
Earnings per common share		
Basic	.37	1.20
Diluted	.36	1.19

The above table includes interest expense and amortization of goodwill as if the acquisition occurred January 1, 1997.

In March 1997, the Company acquired all of the outstanding stock of Pioneer. This transaction was accounted for as if it were a "pooling of interest," and as such the Company's financial statements have been restated to include Pioneer as a consolidated subsidiary from January 1, 1993 to the present.

3--TRANSACTIONS WITH AFFILIATES

The Company conducts business and has various agreements with the Mutual Company which are described below:

A. REINSURANCE POOLING AND OTHER REINSURANCE ARRANGEMENTS

Atlantic States cedes to the Mutual Company all of its insurance business and assumes from the Mutual Company 65% of the Mutual Company's total pooled insurance business, including that assumed from Atlantic States and substantially all of the business assumed and retained by the Mutual Company from Southern and Delaware. Atlantic States, Southern, Delaware and Pioneer each have a catastrophe reinsurance agreement with the Mutual Company which limits the maximum liability under any one catastrophic occurrence to \$400,000, \$300,000, \$300,000 and \$200,000, respectively, and \$700,000 for a catastrophe involving more than one of the companies. The Mutual Company and Delaware have an excess of loss reinsurance agreement in which the Mutual Company assumes up to \$200,000 of losses in excess of \$50,000 and a workers' compensation quota share agreement whereby Delaware cedes 70% of that business. The Mutual Company and Pioneer have an excess of loss reinsurance agreement in which the Mutual Company assumes up to \$200,000 of losses in excess of \$50,000. The Mutual Company and Pioneer also have an aggregate excess of loss reinsurance agreement, entered into as part of the sale of Pioneer from the Mutual Company to Donegal Group Inc., in which the Mutual Company agreed to assume the adverse loss development of claims with dates of loss prior to December 31, 1996, as developed through December 31, 1998, and to assume losses in excess of a 60% loss ratio through December 31, 1998. The Mutual Company and Southern have an excess of loss reinsurance agreement in which the Mutual Company assumes up to \$25,000 of losses in excess of \$100,000 and a quota share agreement whereby Southern cedes 50% of its direct business less certain reinsurance to the Mutual Company. Southern, Delaware and Pioneer each have retrocessional reinsurance agreements with the Mutual Company under which they cede, and then assume back, 100% of their business net of other reinsurance.

The following amounts represent reinsurance transactions with the Mutual Company during 1999, 1998 and 1997:

CEDED REINSURANCE:	1999	1998	1997
Premiums written	\$ 66,090,699	\$ 55,372,556	\$ 47,946,847
Premiums earned	\$ 60,977,975	\$ 51,617,429	\$ 47,488,716
Losses and loss expenses	\$ 41,775,579	\$ 32,791,739	\$ 28,582,315
Unearned premiums	\$ 30,999,377	\$ 25,886,653	\$ 22,131,526
Liability for losses and loss expenses	\$ 43,907,885	\$ 39,039,648	\$ 35,295,994

ASSUMED REINSURANCE:

Premiums written	\$124,433,678	\$114,667,549	\$107,604,989
Premiums earned	\$119,364,863	\$111,333,956	\$107,302,168
Losses and loss expenses	\$ 80,325,374	\$ 69,869,999	\$ 68,104,859
Unearned premiums	\$ 56,887,815	\$ 51,819,000	\$ 48,485,408
Liability for losses and loss expenses	\$ 90,397,135	\$ 85,766,514	\$ 83,271,292

Losses and loss expenses assumed from the Mutual Company for 1999, 1998 and 1997 are reported net of inter-company catastrophe recoveries which amounted to approximately \$2.0 million, \$2.3 million, and \$0 million, respectively.

B. EXPENSE SHARING

The Mutual Company provides facilities, management and other services to the Company, and the Company reimburses the Mutual Company for such services on a periodic basis under usage agreements and pooling arrangements. The charges are based upon the relative participation of the Company and the Mutual Company in the pooling arrangement, and management of both the Company and the Mutual Company consider this allocation to be reasonable. Charges for these services totalled \$27,466,898, \$25,250,873 and \$22,115,329 for 1999, 1998 and 1997, respectively.

C. LEASE AGREEMENT

The Company leases office equipment and automobiles to the Mutual Company under a 10-year lease dated January 1, 1990.

D. WORKERS' COMPENSATION AGREEMENTS

The Mutual Company has agreements in place with Delaware, Southern and Pioneer to reallocate the loss results of workers' compensation business written by those companies as part of commercial accounts primarily written by the Mutual Company or Atlantic States. These agreements provide for the workers' compensation loss ratios of each company to be no worse than the average workers' compensation loss ratio for all of the companies combined.

E. LEGAL SERVICES

Donald H. Nikolaus, President and a director of the Company, is also a partner in the law firm of Nikolaus & Hohenadel. Such firm has served as general counsel to the Company since 1986, principally in connection with the defense of claims litigation arising in Lancaster, Dauphin and York counties. Such firm is paid its customary fees for such services.

4--INVESTMENTS

The amortized cost and estimated fair values of fixed maturities and equity securities at December 31, 1999 and 1998, are as follows:

	1999			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
HELD TO MATURITY				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 36,860,655	\$ 34,292	\$1,219,840	\$35,675,107
Canadian government obligation	498,245	--	8,245	490,000
Obligations of states and political subdivisions	67,823,291	819,155	1,005,936	67,636,510
Corporate securities	15,819,143	73,228	639,010	15,253,361
Mortgage-backed securities	15,172,213	30,077	261,274	14,941,016
Totals	\$136,173,547	\$956,752	\$3,134,305	\$133,995,994

1999

AVAILABLE FOR SALE	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$63,645,993	\$ 1,982	\$2,443,578	\$ 61,204,397
Obligations of states and political subdivisions	20,524,977	204,284	506,415	20,222,846
Corporate securities	15,472,456	578	419,871	15,053,163
Mortgage-backed securities	3,776,568	321	213,747	3,563,142
Equity securities	9,043,818	1,384,882	1,199,202	9,229,498
Totals	\$112,463,812	\$1,592,047	\$4,782,813	\$109,273,046

1998

HELD TO MATURITY	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 32,890,694	\$ 484,622	\$ 29,816	\$ 33,345,500
Obligations of states and political subdivisions	66,941,133	3,489,849	10,044	70,420,938
Corporate securities	9,131,114	422,916	4,030	9,550,000
Mortgage-backed securities	18,220,847	96,014	--	18,316,861
Totals	\$127,183,788	\$ 4,493,401	\$ 43,890	\$131,633,299

1998

AVAILABLE FOR SALE	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 54,975,813	\$ 570,376	\$106,689	\$ 55,439,500
Obligations of states and political subdivisions	19,140,686	822,884	6,497	19,957,073
Corporate securities	10,642,598	150,045	5,324	10,787,319
Mortgage-backed securities	4,330,898	11,065	--	4,341,963
Equity securities	6,206,735	743,210	186,002	6,763,943
Totals	\$ 95,296,730	\$2,297,580	\$304,512	\$ 97,289,798

The amortized cost and estimated fair value of fixed maturities at December 31, 1999, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
HELD TO MATURITY		
Due in one year or less	\$ 6,063,143	\$ 6,064,900
Due after one year through five years	27,717,192	27,557,500
Due after five years through ten years	65,406,112	64,593,457
Due after ten years	21,814,887	20,839,121
Mortgage-backed securities	15,172,213	14,941,016
Total held to maturity	\$136,173,547	\$133,995,994

AVAILABLE FOR SALE		
Due in one year or less	\$ 11,952,924	11,948,304
Due after one year through five years	30,723,822	30,267,827
Due after five years through ten years	40,342,032	39,476,379
Due after ten years	16,624,648	14,787,896
Mortgage-backed securities	3,776,568	3,563,142
Total available for sale	\$103,419,994	\$100,043,548

The amortized cost of fixed maturities on deposit with various regulatory authorities at December 31, 1999 and 1998, amounted to \$5,655,877 and \$5,285,367, respectively.

Net investment income of the Company, consisting primarily of interest and dividends, is attributable to the following sources:

	1999	1998	1997
Fixed maturities	\$12,738,765	\$10,981,353	\$10,703,397
Equity securities	439,660	294,646	238,777
Short-term investments	770,562	1,385,500	1,141,834
Real estate	236,139	175,250	127,250
Investment income	14,185,126	12,836,749	12,211,258
Investment expenses	961,589	839,088	703,981
Net investment income	\$13,223,537	\$11,997,661	\$11,507,277

Gross realized gains and losses from sales of investments and the change in the difference between fair value and cost of investments, before applicable income taxes, are as follows:

	1999	1998	1997
Gross realized gains:			
Fixed maturities	\$ --	\$ 132,431	\$ 84,196
Equity securities	586,745	1,119,679	408,429
	586,745	1,252,110	492,625
Gross realized losses:			
Fixed maturities	6,083	5,180	694
Equity securities	619,364	1,260,492	177,795
	625,447	1,265,672	178,489
Net realized gains (losses)	\$ (38,702)	\$ (13,562)	\$ 314,136

Change in difference between fair value and cost of investments:

Fixed maturities	\$ (11,439,370)	\$ 1,439,782	\$ 2,248,484
Equity securities	(371,528)	(166,335)	355,544

	\$ (11,810,898)	\$ 1,273,447	\$ 2,604,028
=====			

Income taxes (benefit) on realized investment gains were (\$13,159), (\$4,611) and \$106,806 for 1999, 1998 and 1997, respectively. Deferred income taxes applicable to net unrealized investment gains and losses included in shareholders' equity were \$(1,116,777) and \$677,643 at December 31, 1999 and 1998, respectively.

Donegal Group has not held or issued derivative financial instruments.

5--DEFERRED POLICY ACQUISITION COSTS

Changes in deferred policy acquisition costs are as follows:

	1999	1998	1997

Balance, January 1	\$ 11,334,301	\$ 8,448,060	\$ 7,837,899
Acquisition of Southern Heritage	--	2,486,813	--
Acquisition costs deferred	24,477,001	19,889,428	19,306,161
Amortization charged to earnings	24,608,000	19,490,000	18,696,000

Balance, December 31	\$ 11,203,302	\$ 11,334,301	\$ 8,448,060
=====			

6--PROPERTY AND EQUIPMENT

Property and equipment at December 31, 1999 and 1998, consisted of the following:

	1999	1998	Estimated Useful Life

Cost--office equipment	\$ 4,615,884	\$ 5,648,108	5-15 years
automobiles	958,313	890,264	3 years
leasehold improvements	--	59,233	15-40 years
real estate	2,627,599	2,627,597	15-50 years
software	315,973	434,344	5 years

Accumulated depreciation	8,517,769 (3,001,081)	9,659,546 (3,739,126)	

	\$ 5,516,688	\$ 5,920,420	
=====			

Depreciation expense for 1999, 1998, and 1997 amounted to \$847,228, \$559,710 and \$442,726, respectively.

7--LIABILITY FOR LOSSES AND LOSS EXPENSES

Activity in the liability for losses and loss expenses is summarized as follows:

	1999	1998	1997
Balance at January 1	\$141,409,008	\$118,112,390	\$114,621,961
Less reinsurance recoverable	47,545,592	40,638,565	39,194,405
Net balance at January 1	93,863,416	77,473,825	75,427,556
Acquisition of Southern Heritage	--	14,967,242	--
New balance at beginning as adjusted	93,863,416	92,441,067	75,427,556
Incurred related to:			
Current year	99,659,002	75,463,085	69,040,518
Prior years	(454,000)	(2,296,000)	(1,384,000)
Total incurred	99,205,002	73,167,085	67,656,518
Paid related to:			
Current year	58,906,426	44,388,736	39,133,249
Prior years	36,668,000	27,356,000	26,477,000
Total paid	95,574,426	71,744,736	65,610,249
Net balance at December 31	97,493,992	93,863,416	77,473,825
Plus reinsurance recoverable	52,485,149	47,545,592	40,638,565
Balance at December 31	\$149,979,141	\$141,409,008	\$118,112,390

The Company recognized a decrease in the liability for losses and loss expenses of prior years (favorable development) of \$0.5 million, \$2.3 million and \$1.4 million in 1999, 1998 and 1997, respectively. These favorable developments are primarily attributable to lower-than-expected claim severity in the private passenger automobile liability, workers' compensation and commercial multiple peril lines of business.

8--LINE OF CREDIT

At December 31, 1999 and 1998, pursuant to a credit agreement dated December 29, 1995, and amended as of July 27, 1998, with Fleet National Bank of Connecticut, the Company had unsecured borrowings of \$37 million and \$37.5 million, respectively. Such borrowings were made in connection with the acquisitions of Delaware, Pioneer, and Southern Heritage and various capital contributions to the subsidiaries. Per the terms of the credit agreement, the Company may borrow up to \$40 million at interest rates equal to the bank's then current prime rate or the then current London interbank Eurodollar bank rate plus 1.70%. At December 31, 1999, the interest rates were 8.5% on an outstanding prime rate balance of \$22 million and 7.84% on an outstanding Eurodollar rate balance of \$15 million. In addition, the Company pays a rate of 3/10 of 1% per annum on the average daily unused portion of the bank's commitment. On each July 27, commencing July 27, 2001, the credit line will be reduced by \$8 million. Any outstanding loan in excess of the remaining credit line, after such reduction, will then be payable. The Company violated one of the covenants in the loan agreement that required Donegal Mutual's surplus to be maintained at a certain level. This violation was waived by the bank and the agreement was amended to lower this requirement.

9--UNAFFILIATED REINSURERS

In addition to the primary reinsurance in place with the Mutual Company, the Insurance Subsidiaries have other reinsurance in place, principally with four unaffiliated reinsurers. The following amounts represent reinsurance transactions with unaffiliated reinsurers during 1999, 1998 and 1997:

Ceded reinsurance:	1999	1998	1997
Premiums written	\$ 6,348,846	\$4,784,768	\$4,315,594
Premiums earned	\$ 6,509,844	\$4,720,669	\$4,264,761
Losses and loss expenses	\$ 4,513,244	\$4,489,728	\$3,169,659
Unearned premiums	\$ 1,155,460	\$1,316,458	\$ 750,757
Liability for losses and loss expenses	\$ 8,577,264	\$8,505,944	\$5,342,571

10--INCOME TAXES

The provision for income tax consists of the following:

	1999	1998	1997
Current	\$ 762,286	\$2,500,582	\$3,525,249
Deferred	(3,790,122)	158,593	7,108

Federal tax provision	\$ (3,027,836)	\$ 2,659,175	\$ 3,532,357
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The effective tax rate is different than the amount computed at the statutory federal rate of 34% for 1999, 1998 and 1997. The reason for such difference and the related tax effect are as follows:

	1999	1998	1997
Income before income taxes	\$ 3,629,101	\$ 11,677,015	\$ 14,173,543
Computed "expected" taxes at 34%	\$ 1,233,894	\$ 3,970,185	\$ 4,819,005
Recognition of net operating loss carryover of Southern Heritage	(3,004,524)	--	--
Tax-exempt interest	(1,352,657)	(1,180,773)	(1,130,311)
Dividends received deduction	(83,948)	(177,374)	(48,477)
Other, net	179,399	47,137	(107,860)
Federal income tax provision	\$ (3,027,836)	\$ 2,659,175	\$ 3,532,357

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1999 and 1998, are as follows:

	1999	1998

Deferred tax assets:		
Unearned premium	\$ 4,454,147	\$ 4,593,745
Loss reserves	4,666,536	4,581,026
AMT credit carryforward	577,611	--
Net operating loss carryforward -		
Southern Heritage	2,646,172	3,429,107
Valuation allowance	--	(3,429,107)
Unrealized loss	1,116,777	--
Other	306,412	--

Total	\$13,767,655	\$ 9,174,771
=====		
Deferred tax liabilities:		
Depreciation expense	\$ 469,426	\$ 425,292
Deferred policy acquisition costs	3,809,123	3,853,662
Salvage recoverable	367,874	483,960
Unrealized gain	--	677,643
Other	--	197,522

Total	\$ 4,646,423	\$ 5,638,079
=====		
Net deferred tax assets	\$ 9,121,232	\$ 3,536,692
=====		

A valuation allowance is provided when it is more likely than not that some portion of the tax asset will not be realized. At December 31, 1998, management determined that a valuation allowance related to the net operating loss carryforward of Southern Heritage should be established. Management has determined that it is not required to establish a valuation allowance for any deferred tax asset at December 31, 1999, since it is more likely than not that the deferred tax assets will be realized through reversals of existing temporary differences, future taxable income, carryback to taxable income in prior years and the implementation of tax planning strategies.

A change in the federal income laws was enacted during 1999 which now allows net operating loss carryforwards of an acquired company to be used to offset future taxable income of other affiliated companies filing as part of a consolidated tax return. Prior law allowed such net operating loss carryforward to be used to offset taxable income of the acquired company only. Due to this law change, the net operating loss carryforward, obtained as part of the acquisition of Southern Heritage, can now be used to offset taxable income generated by the other consolidated affiliates. This is the primary factor in management's determination that no valuation allowance is required at the end of 1999. Accordingly, the tax benefit of this carryforward, as adjusted for the 1998 tax return as filed, of \$3,004,524 was recognized in 1999.

At December 31, 1999 the Company has a net operating loss carryforward of \$7,782,859 which is available to offset taxable income of the Company. Such net operating loss carryforward will expire beginning in 2009. Federal income tax laws limit the amount of net operating loss carryforward that the Company can use in any one year to approximately \$1 million.

11--STOCK COMPENSATION PLANS

EQUITY INCENTIVE PLANS

The Company has had an Equity Incentive Plan for key employees since 1986 and adopted a nearly identical new plan in 1996. Both plans provide for the granting of awards by the Board of Directors in the form of stock options, stock appreciation rights, restricted stock or any combination of the above. The new plan was adopted in 1996 and amended in 1997 and 1999 making a total of 1,800,000 shares available. The plans provide that stock options may become exercisable up to 10 years from date of grant, with an option price not less than fair market value on date of grant. The stock appreciation rights permit surrender of the option and receipt of the excess of current market price over option price in cash.

Information regarding activity in the Company's stock option plans is presented below:

	Number of Shares	Weighted-Average Exercise Price Per Share

Outstanding at December 31, 1996	--	\$ --
Granted - 1997	532,451	13.50
Exercised - 1997	2,963	13.50
Forfeited - 1997	13,632	13.50

Outstanding at December 31, 1997	515,856	13.50
Granted - 1998	505,333	18.00
Exercised - 1998	10,073	13.50
Forfeited - 1998	--	--

Outstanding at December 31, 1998	1,011,116	15.73
Granted - 1999	433,500	8.00
Exercised - 1999	--	--
Forfeited - 1999	19,335	15.52

Outstanding at December 31, 1999	1,425,281	\$13.50
=====		

Exercisable at:		
December 31, 1997	173,333	\$13.50
December 31, 1998	502,965	\$15.00
December 31, 1999	826,226	\$16.20

Shares available for future grants at December 31, 1999 are 374,719.

The following table summarizes information about fixed stock options at December 31, 1999:

	Exercise Prices		
	\$8.00	\$13.50	\$18.00
Options outstanding at December 31, 1999: Number of options	418,500	495,115	511,666
Weighted-average remaining contractual life	5.0 years	2.0 years	.25 years
Options exercisable at December 31, 1999: Number of options	--	495,115	331,111

1996 EQUITY INCENTIVE PLAN FOR DIRECTORS

During 1996 the Company adopted an Equity Incentive Plan For Directors. The plan was amended in 1998, making 265,735 shares available for award. Awards may be made in the form of stock options, and the plan additionally provides for the issuance of 177 shares of restricted stock to each director on the first business day of January in each year, commencing January 2, 1997. As of December 31, 1999, the Company has 71,112 unexercised options under this plan. Additionally 2,124, 2,124 and 2,124 shares of restricted stock were issued on January 2, 1999, 1998 and 1997, respectively.

EMPLOYEE STOCK PURCHASE PLANS

During 1996 the Company adopted the 1996 Employee Stock Purchase Plan which replaced a similar plan that had been adopted effective January 1, 1988. The 1996 plan made 162,873 shares available for issuance.

The 1996 Plan extends over a 10-year period and provides for shares to be offered to all eligible employees at a purchase price equal to the lesser of 85% of the fair market value of the Company's common stock on the last day before the first day of the enrollment period (June 30 and December 31). A summary of plan activity follows:

	Shares Issued	
	Price	Shares
January 1, 1997	\$ 8.24766	11,689
July 1, 1997	\$ 9.26367	11,357
January 1, 1998	\$11.65430	8,901
July 1, 1998	\$13.06875	9,179
January 1, 1999	\$13.28125	10,227
July 1, 1999	\$ 9.66875	11,876

On January 1, 2000, the Company issued an additional 23,906 shares at a price of \$5.41875 per share under this plan.

AGENCY STOCK PURCHASE PLAN

On December 31, 1996, the Company adopted the Agency Stock Purchase Plan which made 514,102 shares available for issuance. The plan provides for agents of affiliated companies of Donegal Group Inc. to invest up to \$12,000 per subscription period (April 1 to September 30 and October 1 to March 31) under various methods. Stock is issued at the end of the subscription period at a price equal to 90% of the average market price during the last ten trading days of the subscription period. During 1999, 1998 and 1997, 47,841, 35,003 and 40,200 shares, respectively, were issued under this plan.

PRO-FORMA DISCLOSURES

The weighted-average grant date fair value of options granted for the various plans during 1999, 1998 and 1997 was \$1.98, \$4.48 and \$4.74, respectively.

The fair values above were calculated based upon risk-free interest rates of 6.3% for the Stock Purchase Plans and the Equity Incentive Plans, expected lives of 6 months for the Stock Purchase Plans and 5 years for the Equity Incentive Plans, expected volatility of 47% for 1999 and 34% for 1998 and 1997 and an expected dividend yield of 5.0% for 1999 and 2.4% for 1998 and 1997.

The Company applies APB Opinion No. 25 in accounting for its stock-based compensation plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans and certain of its stock purchase plans. Had the Company recognized stock compensation expense in accordance with SFAS No. 123, net income and earnings per share would have been reduced to the pro-forma amounts shown below:

	1999	1998	1997
Net income:			
As reported	\$6,656,937	\$9,017,840	\$10,641,186
Pro-forma	5,457,591	8,362,764	10,263,965
Basic earnings per share:			
As reported	.80	1.11	1.33
Pro-forma	.66	1.03	1.28
Diluted earnings per share:			
As reported	.80	1.09	1.32
Pro-forma	.66	1.01	1.28

12--STATUTORY NET INCOME, CAPITAL AND SURPLUS AND DIVIDEND RESTRICTIONS

The following is selected information for the Insurance Subsidiaries as determined in accordance with accounting practices prescribed or permitted by insurance regulatory authorities:

	1999	1998	1997
ATLANTIC STATES			
Statutory capital and surplus	\$ 68,518,020	\$ 62,672,151	\$ 56,606,354
Statutory unassigned surplus	\$ 37,557,156	\$ 31,711,287	\$ 25,645,490
Statutory net income	\$ 3,855,803	\$ 6,480,524	\$ 7,349,284
SOUTHERN			
Statutory capital			

and surplus	\$ 7,293,856	\$ 6,388,316	\$ 7,069,112
Statutory unassigned surplus	\$ 2,191,586	\$ 1,636,046	\$ 2,316,842
Statutory net income	\$ 184,285	\$ 66,297	\$ 703,727
=====			
DELAWARE			
Statutory capital and surplus	\$ 9,563,808	\$ 8,548,354	\$ 7,657,691
Statutory unassigned surplus	\$ 4,363,808	\$ 3,348,354	\$ 2,457,691
Statutory net income	\$ 898,360	\$ 1,085,807	\$ 1,070,463
=====			
PIONEER			
Statutory capital and surplus	\$ 5,677,926	\$ 5,300,349	\$ 5,377,492
Statutory unassigned deficit	\$ (1,322,074)	\$ (1,699,651)	\$ (1,622,508)
Statutory net income	\$ 108,322	\$ 188,579	\$ 542,799
=====			
SOUTHERN HERITAGE			
Statutory capital and surplus	\$ 16,508,422	\$ 15,805,641	\$ 16,532,876
Statutory unassigned deficit	\$(16,006,893)	\$(16,709,674)	\$(12,482,439)
Statutory net income (loss)	\$ 487,098	\$ (3,937,548)	\$ 151,135
=====			

The Company's principal source of cash for payment of dividends are dividends from its Insurance Subsidiaries which are required by law to maintain certain minimum capital and surplus on a statutory basis and are subject to regulations under which payment of dividends from statutory surplus is restricted and may require prior approval of their domiciliary insurance regulatory authorities. Atlantic States, Southern, Delaware, Pioneer and Southern Heritage are also subject to Risk Based Capital (RBC) requirements which may further impact their ability to pay dividends. At December 31, 1999, all five companies' statutory capital and surplus were substantially above the RBC requirements. At December 31, 1999, amounts available for distribution as dividends to Donegal Group Inc. without prior approval of insurance regulatory authorities are \$6,851,802 from Atlantic States, \$184,285 from Southern, \$956,381 from Delaware, \$567,793 from Pioneer and \$1,650,842 from Southern Heritage.

13--RECONCILIATION OF STATUTORY FILINGS TO AMOUNTS REPORTED HEREIN

The Company's Insurance Subsidiaries are required to file statutory financial statements with state insurance regulatory authorities. Accounting principles used to prepare these statutory financial statements differ from financial statements prepared on the basis of generally accepted accounting principles.

Reconciliations of statutory net income and capital and surplus, as determined using statutory accounting principles, to the amounts included in the accompanying financial statements are as follows:

	Year Ended December 31,		
	1999	1998	1997
Statutory net income of Insurance Subsidiaries	\$5,533,868	\$ 8,301,081	\$ 9,666,273
Increases (decreases):			
Deferred policy acquisition costs	(130,999)	399,428	610,161
Deferred federal income taxes	3,790,122	(158,593)	(7,108)
Salvage and subrogation recoverable	(226,617)	1,217,092	984,981
Consolidating eliminations and adjustments	(1,387,864)	(967,940)	(950,000)
Parent-only net income (loss)	(908,987)	178,249	291,831
Non-insurance subsidiary net income (loss)	(12,586)	48,523	45,048
Net income as reported herein	\$6,656,937	\$ 9,017,840	\$ 10,641,186

	December 31,		
	1999	1998	1997
Statutory capital and surplus of Insurance Subsidiaries	\$107,562,032	\$ 98,714,811	\$76,710,649
Increases (decreases):			
Deferred policy acquisition costs	11,203,302	11,334,301	8,448,060
Deferred federal income taxes	9,121,232	3,592,605	3,302,043
Salvage and subrogation recoverable	7,736,942	7,963,559	6,155,467
Statutory reserves	5,066,505	9,066,998	8,712,694
Non-admitted assets and other adjustments, net	793,715	1,178,102	394,432
Fixed maturities available for sale	(2,889,365)	2,038,604	808,908
Consolidating eliminations and adjustments	(36,630,839)	(36,383,362)	(16,121,711)
Parent-only equity	1,451,088	2,843,990	2,953,248
Non-insurance subsidiary equity	--	281,396	232,873
Stockholders' equity as reported herein	\$103,414,612	\$100,631,004	\$91,596,663

14--SUPPLEMENTARY INFORMATION ON STATEMENT OF CASH FLOWS

The following reflects income taxes and interest paid during 1999, 1998 and 1997:

	1999	1998	1997
Income taxes	\$1,233,414	\$ 2,671,969	\$ 4,094,338
Interest	\$1,370,155	\$ 1,270,646	\$ 904,385

During 1999, the Company wrote off fixed assets with a net carrying value of \$407,000 which was a non-cash charge to earnings.

15--EARNINGS PER SHARE

The following information illustrates the computation of net income, outstanding shares and earnings per share on both a basic and diluted

basis for the years ending December 31, 1999, 1998 and 1997:

	Net Income	Weighted- Average Shares Outstanding	Earnings Per Share

1999:			
Basic	\$ 6,656,937	8,327,356	\$.80
Effect of stock options	--	--	--

Diluted	\$ 6,656,937	8,327,356	\$.80
=====			
1998:			
Basic	\$ 9,017,840	8,126,286	\$1.11
Effect of stock options	--	123,404	(0.02)

Diluted	\$ 9,017,840	8,249,690	\$1.09
=====			
1997:			
Basic	\$10,641,186	7,994,937	\$1.33
Effect of stock options	--	41,274	(0.01)

Diluted	\$10,641,186	8,036,211	\$1.32
=====			

The following options to purchase shares of common stock were not included in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price:

	1999	1998	1997
Options excluded from diluted earnings per share	1,425,281	887,712	474,582

16--CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY

CONDENSED BALANCE SHEETS
(\$ in thousands)

December 31,	1999	1998
ASSETS		
Investment in subsidiaries (equity method)	\$138,702	\$134,441
Cash	371	599
Property and equipment	2,232	2,276
Other	750	2,124
Total assets	\$142,055	\$139,440
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Cash dividends declared to stockholders	\$ 761	\$ 708
Line of credit	37,000	37,500
Other	879	601
Total liabilities	38,640	38,809
Stockholders' equity		
Preferred stock, \$1.00 par value, authorized 2,000,000 shares, none issued		
Common stock, Class A, authorized 15,000,000 shares, none issued		
Commonstock, \$1.00 par value, authorized 20,000,000 shares, issued 8,574,210 and 8,325,221 shares and outstanding 8,451,922 and 8,202,933 shares	8,574	8,325
Additional paid-in capital	43,537	41,271
Accumulated other comprehensive income (loss)	(2,074)	1,316
Retained earnings, including equity in undistributed net income of subsidiaries(\$72,539 and \$64,922)	54,270	50,611
Treasury stock, at cost	(892)	(892)
Total stockholders' equity	103,415	100,631
Total liabilities and stockholders' equity	\$142,055	\$139,440

CONDENSED STATEMENTS OF INCOME
(\$ in thousands)

Years Ended December 31,	1999	1998	1997
Revenues			
Dividends-subsidiaries	\$ 820	\$ 1,000	\$ 950
Other	865	776	658
Total revenues	1,685	1,776	1,608
Expenses			
Operating expenses	938	718	643
Interest	2,463	1,293	1,022
Total expenses	3,401	2,011	1,665
Loss before income tax benefit and equity in undistributed net income of subsidiaries	(1,716)	(235)	(57)
Income tax benefit	(807)	(413)	(346)
Income (loss) before equity in undistributed net income of subsidiaries	(909)	178	289
Equity in undistributed net income of subsidiaries	7,566	8,840	10,352
Net income	\$ 6,657	\$ 9,018	\$10,641

CONDENSED STATEMENTS OF CASH FLOWS
(\$ in thousands)

Years Ended December 31,	1999	1998	1997

Cash flows from operating activities:			
Net income	\$ 6,657	\$ 9,018	\$10,641

Adjustments:			
Equity in undistributed net income of subsidiaries	(7,566)	(8,840)	(10,352)
Other	2,365	(921)	382

Net adjustments	(5,201)	(9,761)	(9,970)

Net cash provided (used)	1,456	(743)	671

Cash flows from investing activities:			
Net purchase of property and equipment	(426)	(564)	(1,251)
Capital contribution to subsidiaries	--	(2,000)	--
Sale of AIS	100	--	--
Acquisition of Southern Heritage	--	(18,028)	--
Other	(426)	(5,613)	4

Net cash used	(752)	(26,205)	(1,247)

Cash flows from financing activities:			
Cash dividends paid	(2,946)	(2,664)	(2,252)
Issuance of common stock	2,514	2,481	1,131
Line of credit, net	(500)	27,000	2,000

Net cash provided (used)	(932)	26,817	879

Net change in cash	(228)	(131)	303
Cash at beginning of year	599	730	427

Cash at ending of year	\$ 371	\$ 599	\$ 730
=====			

17--SEGMENT INFORMATION

As an underwriter of property and casualty insurance, the Company has three reportable segments which consist of the investment function, the personal lines of insurance and the commercial lines of insurance. Using independent agents, the Company markets personal lines of insurance to individuals and commercial lines of insurance to small and medium-sized businesses.

The Company evaluates the performance of the personal lines and commercial lines primarily based upon underwriting results as determined under statutory accounting practices (SAP) for the total business of the Company.

Assets are not allocated to the personal and commercial lines and are reviewed in total by management for purposes of decision making. Donegal Group Inc. operates only in the United States and no single customer or agent provides 10 percent or more of revenues.

Financial data by segment is as follows:

	1999	1998	1997
----- (\$ in thousands) -----			
Revenues:			
Premiums earned:			
Commercial lines	\$ 47,707	\$ 44,493	\$ 45,702
Personal lines	96,167	71,676	61,600

Total premiums earned	143,874	116,169	107,302

Net investment income	13,224	11,998	11,507
Realized investment			
gains (losses)	(39)	(14)	314
Other	2,652	2,433	2,205

Total revenues	\$159,711	\$130,586	\$121,328
=====			

Income before income taxes:
Underwriting income (loss):

Commercial lines	\$ (826)	\$ 3,688	\$ 3,497
Personal lines	(8,238)	(5,327)	(2,734)

SAP underwriting gain			
(loss)	(9,064)	(1,639)	763
GAAP adjustments	(251)	1,803	1,809

GAAP underwriting gain			
(loss)	(9,315)	164	2,572
Net investment income	13,224	11,998	11,507
Realized investment gains (losses)	(39)	(14)	314
Other	(241)	(471)	(219)

Income before income taxes	\$ 3,629	\$ 11,677	\$ 14,174
=====			

18--RESTRUCTURING CHARGE

On September 29, 1999, the Company announced a plan to consolidate certain subsidiary support functions into its Marietta, Pennsylvania office. As a result of this consolidation, the Company recorded a restructuring charge of \$2,206,000 for employee termination benefits, occupancy charges, lease cancellation costs, and asset impairments. The charge is included in other underwriting expenses. The consolidation is expected to be complete by the end of the first quarter of 2000.

Employee termination benefits of \$782,000 include severance payments, which may be paid in a lump sum or over a defined period, and related benefits for approximately 60 employees. Of the terminated employees, approximately 50% were from subsidiary support functions and approximately 50% were from the Marietta, Pennsylvania office. By December 31, 1999, all of the terminated employees had left the employment of the Company.

Included in occupancy charges of \$488,000 are future lease obligations, less anticipated sublease benefits, for leased space which will no longer be used by the Delaware and Southern Heritage subsidiary support functions.

Also included in the restructuring charge was \$529,000 related to contract cancellation costs that represented the estimated cost to buy out of the remaining term on printer, copier, and computer processing contracts that provided no future benefit to the Company as a result of the restructuring. All such assets have been taken out of service.

Asset impairments, which were a direct result of the consolidation of subsidiary functions, amounted to \$407,000. They consisted of capitalized programming and data center costs, voice systems, and leasehold and office improvements. These assets were written-down to zero. All such assets have been taken out of service.

Activity in the restructuring accrual is as follows:

Employee Termination Benefits	Occupancy	Contract Cancellations	Total
-------------------------------------	-----------	---------------------------	-------

Restructuring charge	\$782,000	\$488,000	\$529,000	\$1,799,000
Cash payments	(343,000)	(47,000)	(365,000)	(755,000)
Reversal of prior accrual	(71,000)	--	(91,000)	(162,000)
Balance at December 31, 1999	\$368,000	\$441,000	\$ 73,000	\$ 882,000

Based on revised estimates, \$162,000 of the restructuring accrual was reversed by a reduction to the restructuring charge in other underwriting expenses in the fourth quarter of 1999. Employee termination benefits and contract cancellation costs were lower than original estimates.

19--GUARANTY FUND AND OTHER INSURANCE-RELATED ASSESSMENTS

The Company accrues for guaranty-fund and other insurance-related assessments in accordance with Statement of Position (SOP) 97-3, "Accounting by Insurance and Other Enterprises for Insurance-Related Assessments." SOP 97-3 provides guidance for determining when an entity should recognize a liability for guaranty-fund and other insurance-related assessments, how to measure that liability, and when an asset may be recognized for the recovery of such assessments through premium tax offsets or policy surcharges. The Company's liability for guaranty-fund and other insurance-related assessments was \$534,518 at December 31, 1999, most of which the Company expects to pay in 2000.

20--INTERIM FINANCIAL DATA (UNAUDITED)

	1999			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net premiums earned	\$36,093,971	\$35,829,815	\$35,955,556	\$35,994,628
Total revenues	40,109,990	39,787,987	39,802,234	40,010,896
Net losses and loss expenses	24,451,651	24,162,300	26,449,962	24,141,089
Net income (loss)	2,151,367	1,300,736	(2,442,880)	5,647,714
Net income (loss) per common share				
Basic	\$.26	\$.16	\$ (.29)	\$.67
Diluted	.26	.16	(.29)	.67

	1998			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net premiums earned	\$27,204,544	\$27,578,257	\$28,064,764	\$33,321,427
Total revenues	30,896,144	31,023,026	31,654,736	37,012,459
Net losses and loss expenses	15,801,905	19,225,138	20,434,534	17,705,508
Net income	3,316,653	1,892,892	44,414	3,763,881
Net income per common share				
Basic	\$.41	\$.22	\$.01	\$.46
Diluted	.40	.22	.01	.46

INDEPENDENT AUDITORS' REPORT

The Stockholders and Board of Directors
Donegal Group Inc.

We have audited the accompanying consolidated balance sheets of Donegal Group Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Donegal Group Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999 in conformity with generally accepted accounting principles.

KPMG LLP

Philadelphia, Pennsylvania
February 18, 2000

SELECTED CONSOLIDATED FINANCIAL DATA

Year Ended December 31,	1999	1998	1997	1996	1995
INCOME STATEMENT DATA:					
Premiums earned	\$143,873,970	\$116,168,992	\$107,302,168	\$104,527,038	\$ 89,522,203
Investment income, net	13,223,537	11,997,661	11,507,277	10,799,369	9,713,744
Realized investment gains (losses)	(38,702)	(13,562)	314,136	172,734	399,706
Total revenues	159,711,107	130,586,365	121,327,606	117,581,664	101,615,698
Income before income taxes	3,629,101	11,677,015	14,173,543	10,736,628	12,060,351
Income taxes	(3,027,836)	2,659,175	3,532,357	2,178,854	2,500,741
Net income	6,656,937	9,017,840	10,641,186	8,557,774	9,559,610
Basic earnings per share	0.80	1.11	1.33	1.10	1.29
Diluted earnings per share	0.80	1.09	1.32	1.09	1.26
Cash dividends per share	0.36	0.34	0.29	0.25	0.23
BALANCE SHEET DATA AT YEAR END:					
Total investments	\$261,441,850	\$254,995,473	\$204,964,805	\$192,489,250	\$168,215,538
Total assets	399,732,657	385,231,506	304,104,505	287,990,994	244,943,598
Debt obligations	37,000,000	37,500,000	10,500,000	8,500,000	5,000,000
Stockholders' equity	103,414,612	100,631,004	91,596,663	81,599,274	73,020,689
Stockholders' equity per share	12.24	12.27	11.39	10.26	9.64

In November 1998, the Company acquired all of the outstanding stock of Southern Heritage. This transaction was accounted for as a "purchase." The Company's financial statements include Southern Heritage as a consolidated subsidiary from November 1, 1998.

CORPORATE INFORMATION

ANNUAL MEETING

April 20, 2000 at the Company's headquarters at 10:00 a.m.

FORM 10-K

A copy of Donegal Group's Annual Report on Form 10-K will be furnished free upon written request to Ralph G. Spontak, Senior Vice President and Chief Financial Officer, at the corporate address.

MARKET INFORMATION

Donegal Group's common stock is traded on NASDAQ under the symbol "DGIC." During 1998 and 1999, the stock price ranged as follows:

QUARTER	HIGH	LOW	CASH DIVIDEND DECLARED PER SHARE
1998			
1st	17.625	15.188	--
2nd	22.781	16.875	.0825
3rd	19.875	14.250	.085
4th	15.750	12.625	.17
1999			
1st	16.250	10.500	--
2nd	13.000	10.063	.09
3rd	11.625	6.125	.09
4th	10.625	5.750	.18

CORPORATE OFFICES

1195 River Road
P.O. Box 302
Marietta, Pennsylvania 17547-0302
(717) 426-1931
E-mail Address: fctc@em.fcxbd.com
Donegal Website: <http://www.donegalgroup.com>

TRANSFER AGENT

First Chicago Trust Co., a Division of EquiServe
P.O. Box 2500
Jersey City, NJ 07303-2500
(800) 317-4445
E-mail Address: fctc@em.fcxbd.com
FCTC Website: <http://www.fctc.com>
Hearing Impaired: TDD: 201-222-4955

DIVIDEND REINVESTMENT PLAN

The Company offers a dividend reinvestment plan through its transfer agent. For information contact:
Donegal Group Inc. Dividend Reinvestment Plan
c/o First Chicago Trust Co., a Division of EquiServe
P.O. Box 2598
Jersey City, NJ 07303-2598
(800) 317-4445

STOCKHOLDERS

The number of common stockholders of record as of December 31, 1999 was 622.

SUBSIDIARIES OF REGISTRANT

Registrant owns 100% of the outstanding stock of the following insurance companies:

Name -----	State of Formation -----
Atlantic States Insurance Company	Pennsylvania
Southern Insurance Company of Virginia	Virginia
Pioneer Insurance Company	Ohio
Delaware Atlantic Insurance Company	Delaware
Southern Heritage Insurance Company	Georgia

Independent Auditors' Consent and Report on Schedules

The Board of Directors
Donegal Group Inc.:

The audits referred to in our report dated February 18, 2000 include the related financial statement schedules as of December 31, 1999, and for each of the years in the three-year period ended December 31, 1999, included in the annual report on Form 10-K. These financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statement schedules based on our audits. In our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We consent to incorporation by reference in the registration statements (Nos. 333-1287, 333-06681, 33-26693, 33-61095, 333-93785 and 333-94301) on Form S-8 and registration statement (No. 333-36585) on Form S-3 of Donegal Group Inc. of our reports dated February 18, 2000, relating to the consolidated balance sheets of Donegal Group Inc. as of December 31, 1999 and 1998, and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows and related financial statement schedules for each of the years in the three-year period ended December 31, 1999, which reports appear in the December 31, 1999 annual report on Form 10-K of Donegal Group Inc.

KPMG LLP

Philadelphia, Pennsylvania
March 28, 2000

YEAR	DEC-31-1999	DEC-31-1999
	100,043,548	
	136,173,547	
	133,995,994	
		9,229,498
		0
		0
	261,441,850	
		3,922,403
		0
11,203,302		
	399,732,657	
	149,979,141	
	97,657,020	
		0
		0
	37,000,000	
		0
		0
		8,547,210
		94,867,402
399,732,657		
		143,873,970
	13,223,537	
	(38,702)	
	2,652,302	
		99,205,002
24,608,000		
	28,034,876	
	3,629,101	
	(3,027,836)	
	6,656,937	
		0
		0
		0
		6,656,937
		.80
		.80
		93,863,416
	99,659,002	
	(454,000)	
	58,906,426	
	36,668,000	
	97,493,992	
(454,000)		