

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2022
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
(State or other jurisdiction of
incorporation or organization)

1195 River Road, P.O. Box 302, Marietta, PA 17547
(Address of principal executive offices) (Zip code)

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

23-2424711
(I.R.S. Employer
Identification No.)

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether 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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Title of Each Class	Trading Symbols	Name of Each Exchange on Which Registered
Class A Common Stock, \$.01 par value	DGICA	The NASDAQ Global Select Market
Class B Common Stock, \$.01 par value	DGICB	The NASDAQ Global Select Market

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 25,842,665 shares of Class A Common Stock, par value \$0.01 per share, and 5,576,775 shares of Class B Common Stock, par value \$0.01 per share, outstanding on May 2, 2022.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Donegal Group Inc. and Subsidiaries
Consolidated Balance Sheets

	March 31, 2022	December 31, 2021
	(Unaudited)	
Assets		
Investments		
Fixed maturities		
Held to maturity, at amortized cost	\$ 690,691,302	\$ 668,104,568
Available for sale, at fair value	516,894,776	532,629,015
Equity securities, at fair value	54,046,368	63,419,973
Short-term investments, at cost, which approximates fair value	9,194,174	12,692,341
Total investments	1,270,826,620	1,276,845,897
Cash	56,074,886	57,709,375
Accrued investment income	9,448,842	8,214,971
Premiums receivable	182,475,495	168,862,580
Reinsurance receivable	448,295,785	455,411,009
Deferred policy acquisition costs	71,608,211	68,028,373
Deferred tax asset, net	12,493,161	6,685,619
Prepaid reinsurance premiums	174,523,309	176,935,842
Property and equipment, net	2,885,074	2,956,930
Accounts receivable - securities	1,936	2,252
Federal income taxes recoverable	1,863,053	5,290,938
Receivable from Michigan Catastrophic Claims Association	—	18,112,800
Due from affiliate	2,209,909	1,922,717
Goodwill	5,625,354	5,625,354
Other intangible assets	958,010	958,010
Other	1,472,250	1,612,732
Total assets	<u>\$ 2,240,761,895</u>	<u>\$ 2,255,175,399</u>
Liabilities and Stockholders' Equity		
Liabilities		
Losses and loss expenses	\$ 1,071,587,385	\$ 1,077,620,301
Unearned premiums	589,739,092	572,958,422
Accrued expenses	4,900,102	4,028,659
Reinsurance balances payable	4,069,560	3,946,105
Borrowings under lines of credit	35,000,000	35,000,000
Cash dividends declared to stockholders	—	4,915,268
Cash refunds due to Michigan policyholders	—	18,112,800
Accounts payable - securities	3,247,575	—
Other	7,952,320	7,557,757
Total liabilities	<u>1,716,496,034</u>	<u>1,724,139,312</u>
Stockholders' Equity		
Preferred stock, \$0.01 par value, authorized 2,000,000 shares; none issued	—	—
Class A common stock, \$0.01 par value, authorized 50,000,000 shares, issued 28,790,510 and 28,756,203 shares and outstanding 25,787,922 and 25,753,615 shares	287,906	287,562
Class B common stock, \$0.01 par value, authorized 10,000,000 shares, issued 5,649,240 shares and outstanding 5,576,775 shares	56,492	56,492
Additional paid-in capital	305,668,006	304,889,481
Accumulated other comprehensive (loss) income	(17,306,674)	3,283,551
Retained earnings	276,786,488	263,745,358
Treasury stock, at cost	(41,226,357)	(41,226,357)
Total stockholders' equity	<u>524,265,861</u>	<u>531,036,087</u>
Total liabilities and stockholders' equity	<u>\$ 2,240,761,895</u>	<u>\$ 2,255,175,399</u>

See accompanying notes to consolidated financial statements.

Donegal Group Inc. and Subsidiaries
Consolidated Statements of Income
(Unaudited)

	Three Months Ended March 31,	
	2022	2021
Revenues:		
Net premiums earned	\$ 199,248,624	\$ 187,251,600
Investment income, net of investment expenses	7,858,881	7,510,578
Net investment (losses) gains (includes \$ 165,354 and (\$29,186) accumulated other comprehensive income reclassifications)	(76,247)	2,469,054
Lease income	104,628	107,767
Installment payment fees	490,831	630,899
Total revenues	<u>207,626,717</u>	<u>197,969,898</u>
Expenses:		
Net losses and loss expenses	117,883,002	119,219,747
Amortization of deferred policy acquisition costs	34,182,000	30,179,000
Other underwriting expenses	37,106,304	33,782,050
Policyholder dividends	1,648,751	1,294,021
Interest	153,033	312,326
Other expenses, net	427,388	432,069
Total expenses	<u>191,400,478</u>	<u>185,219,213</u>
Income before income tax expense	16,226,239	12,750,685
Income tax expense (includes \$ 34,724 and (\$6,129) income tax expense (benefit) from reclassification items)	3,081,210	2,220,837
Net income	<u>\$ 13,145,029</u>	<u>\$ 10,529,848</u>
Earnings per common share:		
Class A common stock - basic and diluted	<u>\$ 0.43</u>	<u>\$ 0.35</u>
Class B common stock - basic and diluted	<u>\$ 0.39</u>	<u>\$ 0.32</u>

Donegal Group Inc. and Subsidiaries
Consolidated Statements of Comprehensive (Loss) Income
(Unaudited)

	Three Months Ended March 31,	
	2022	2021
Net income	\$ 13,145,029	\$ 10,529,848
Other comprehensive loss, net of tax		
Unrealized loss on securities:		
Unrealized holding loss during the period, net of income tax benefit of (\$5,438,628) and (\$1,125,625)	(20,459,595)	(4,230,172)
Reclassification adjustment for (gains) losses included in net income, net of income tax expense (benefit) of \$ 34,724 and (\$6,129)	(130,630)	23,057
Other comprehensive loss	<u>(20,590,225)</u>	<u>(4,207,115)</u>
Comprehensive (loss) income	<u>\$ (7,445,196)</u>	<u>\$ 6,322,733</u>

See accompanying notes to consolidated financial statements.

Donegal Group Inc. and Subsidiaries
Consolidated Statement of Stockholders' Equity
(Unaudited)
Three Months Ended March 31, 2022

	Class A Shares	Class B Shares	Class A Amount	Class B Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2021	28,756,203	5,649,240	\$ 287,562	\$ 56,492	\$ 304,889,481	\$ 3,283,551	\$ 263,745,358	\$ (41,226,357)	\$ 531,036,087
Issuance of common stock (stock compensation plans)	33,407	—	335	—	423,665	—	—	—	424,000
Share-based compensation	900	—	9	—	256,451	—	—	—	256,460
Net income	—	—	—	—	—	—	13,145,029	—	13,145,029
Cash dividends declared	—	—	—	—	—	—	(5,490)	—	(5,490)
Grant of stock options	—	—	—	—	98,409	—	(98,409)	—	—
Other comprehensive loss	—	—	—	—	—	(20,590,225)	—	—	(20,590,225)
Balance, March 31, 2022	<u>28,790,510</u>	<u>5,649,240</u>	<u>\$ 287,906</u>	<u>\$ 56,492</u>	<u>\$ 305,668,006</u>	<u>\$ (17,306,674)</u>	<u>\$ 276,786,488</u>	<u>\$ (41,226,357)</u>	<u>\$ 524,265,861</u>

Three Months Ended March 31, 2021

	Class A Shares	Class B Shares	Class A Amount	Class B Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2020	27,651,774	5,649,240	\$ 276,518	\$ 56,492	\$ 289,149,567	\$ 11,130,612	\$ 258,387,288	\$ (41,226,357)	\$ 517,774,120
Issuance of common stock (stock compensation plans)	33,336	—	334	—	419,454	—	—	—	419,788
Share-based compensation	346,124	—	3,461	—	4,719,388	—	—	—	4,722,849
Net income	—	—	—	—	—	—	10,529,848	—	10,529,848
Cash dividends declared	—	—	—	—	—	—	(5,000)	—	(5,000)
Grant of stock options	—	—	—	—	109,184	—	(109,184)	—	—
Other comprehensive loss	—	—	—	—	—	(4,207,115)	—	—	(4,207,115)
Balance, March 31, 2021	<u>28,031,234</u>	<u>5,649,240</u>	<u>\$ 280,313</u>	<u>\$ 56,492</u>	<u>\$ 294,397,593</u>	<u>\$ 6,923,497</u>	<u>\$ 268,802,952</u>	<u>\$ (41,226,357)</u>	<u>\$ 529,234,490</u>

See accompanying notes to consolidated financial statements.

Donegal Group Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2022	2021
Cash Flows from Operating Activities:		
Net income	\$ 13,145,029	\$ 10,529,848
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	1,343,128	1,654,449
Net investment losses (gains)	76,247	(2,469,054)
Changes in assets and liabilities:		
Losses and loss expenses	(6,032,916)	34,971,439
Unearned premiums	16,780,670	40,291,574
Premiums receivable	(13,612,915)	(12,012,018)
Deferred acquisition costs	(3,579,838)	(5,373,755)
Deferred income taxes	(334,190)	84,596
Reinsurance receivable	7,115,224	(17,430,975)
Prepaid reinsurance premiums	2,412,533	(11,681,526)
Accrued investment income	(1,233,871)	(1,009,425)
Due from affiliate	(287,192)	(6,372,406)
Reinsurance balances payable	123,455	581,043
Current income taxes	3,427,885	2,148,756
Accrued expenses	871,443	(5,552,527)
Other, net	535,049	1,516,906
Net adjustments	7,604,712	19,347,077
Net cash provided by operating activities	20,749,741	29,876,925
Cash Flows from Investing Activities:		
Purchases of fixed maturities, held to maturity	(28,656,113)	(33,904,795)
Purchases of fixed maturities, available for sale	(34,281,491)	(16,747,351)
Purchases of equity securities, available for sale	(5,276,815)	(13,885,992)
Maturity of fixed maturities:		
Held to maturity	9,203,976	7,317,449
Available for sale	23,296,757	69,586,285
Sales of equity securities, available for sale	14,408,819	6,300,459
Net sales of property and equipment	28,288	684,629
Net sales (purchases) of short-term investments	3,498,167	(198,239)
Net cash (used in) provided by investing activities	(17,778,412)	19,152,445
Cash Flows from Financing Activities:		
Cash dividends paid	(4,920,758)	(4,441,301)
Issuance of common stock	314,940	4,709,242
Payments on lines of credit	—	(50,000,000)
Net cash used in financing activities	(4,605,818)	(49,732,059)
Net decrease in cash	(1,634,489)	(702,689)
Cash at beginning of period	57,709,375	103,094,236
Cash at end of period	\$ 56,074,886	\$ 102,391,547
Cash paid during period - Interest	\$ 161,506	\$ 257,821
Net cash paid during period - Taxes	\$ —	\$ —

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC. AND SUBSIDIARIES
(Unaudited)
Notes to Consolidated Financial Statements

1 - Organization

Donegal Mutual Insurance Company (“Donegal Mutual”) organized us as an insurance holding company on August 26, 1986. Our insurance subsidiaries, Atlantic States Insurance Company (“Atlantic States”), Southern Insurance Company of Virginia (“Southern”), the Peninsula Insurance Group (“Peninsula”), which consists of Peninsula Indemnity Company and The Peninsula Insurance Company and Michigan Insurance Company (“MICO”), and our affiliates write personal and commercial lines of property and casualty coverages exclusively through a network of independent insurance agents in certain Mid-Atlantic, Midwestern, New England, Southern and Southwestern states.

At March 31, 2022, we had three segments: our investment function, our commercial lines of insurance and our personal lines of insurance. The commercial lines products of our insurance subsidiaries consist primarily of commercial automobile, commercial multi-peril and workers’ compensation policies. The personal lines products of our insurance subsidiaries consist primarily of homeowners and private passenger automobile policies.

At March 31, 2022, Donegal Mutual held approximately 41% of our outstanding Class A common stock and approximately 84% of our outstanding Class B common stock. This ownership provides Donegal Mutual with approximately 70% of the total voting power of our common stock. Our insurance subsidiaries and Donegal Mutual have interrelated operations due to a pooling agreement and other intercompany agreements and transactions. While each company maintains its separate corporate existence, our insurance subsidiaries and Donegal Mutual conduct business together as the Donegal Insurance Group. As such, Donegal Mutual and our insurance subsidiaries share the same business philosophy, the same management, the same employees and the same facilities and offer the same types of insurance products.

Atlantic States, our largest subsidiary, participates in a proportional reinsurance agreement, or pooling agreement, with Donegal Mutual. Under the pooling agreement, Donegal Mutual and Atlantic States contribute substantially all of their respective premiums, losses and loss expenses to the underwriting pool, and the underwriting pool, acting through Donegal Mutual, then allocates 80% of the pooled business to Atlantic States. Thus, Donegal Mutual and Atlantic States share the underwriting results of the pooled business in proportion to their respective participation in the underwriting pool.

In addition, Donegal Mutual has a 100% quota-share reinsurance agreement with Southern Mutual Insurance Company, or Southern Mutual. Donegal Mutual places its assumed business from Southern Mutual into the underwriting pool.

Donegal Mutual completed the merger of Mountain States Mutual Casualty Company, or Mountain States, with and into Donegal Mutual effective May 25, 2017. Donegal Mutual was the surviving company in the merger, and Mountain States’ insurance subsidiaries, Mountain States Indemnity Company and Mountain States Commercial Insurance Company (collectively, the “Mountain States insurance subsidiaries”), became insurance subsidiaries of Donegal Mutual upon completion of the merger. Upon completion of the merger, Donegal Mutual assumed all of the policy obligations of Mountain States and began to market its products together with the Mountain States insurance subsidiaries as the Mountain States Insurance Group in four Southwestern states. Donegal Mutual also entered into a 100% quota-share reinsurance agreement with the Mountain States insurance subsidiaries on the merger date. Beginning with policies effective in 2021, Donegal Mutual began to place the business of the Mountain States Insurance Group into the underwriting pool.

The same executive management and underwriting personnel administer products, classes of business underwritten, pricing practices and underwriting standards of Donegal Mutual and our insurance subsidiaries. In addition, as the Donegal Insurance Group, Donegal Mutual and our insurance subsidiaries share a combined business plan to achieve market penetration and underwriting profitability objectives. The products our insurance subsidiaries and Donegal Mutual market are generally complementary, thereby allowing the Donegal Insurance Group to offer a broader range of products to a given market and to expand the Donegal Insurance Group’s ability to service an entire personal lines or commercial lines account. Distinctions within the products of Donegal Mutual and our insurance subsidiaries generally relate to specific risk profiles targeted within similar classes of business, such as preferred tier versus standard tier products, but we do not allocate all of the standard risk gradients to one company. Therefore, the underwriting profitability of the business the individual companies write directly will vary. However, the underwriting pool homogenizes the risk characteristics of all business that Donegal Mutual and Atlantic States write directly. The business Atlantic States derives from the underwriting pool represents a significant percentage of our total consolidated revenues.

2 - Basis of Presentation

Our financial information for the interim periods included in this Form 10-Q Report is unaudited; however, our financial information we include in this Form 10-Q Report reflects all adjustments, consisting only of normal recurring adjustments that, in the opinion of our management, are necessary for a fair presentation of our financial position, results of operations and cash flows for those interim periods. Our results of operations for the three months ended March 31, 2022 are not necessarily indicative of the results of operations we expect for the year ending December 31, 2022.

We recommend you read the interim financial statements we include in this Form 10-Q Report in conjunction with the financial statements and the notes to our financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2021.

3 - Earnings Per Share

We have two classes of common stock, which we refer to as our Class A common stock and our Class B common stock. Our certificate of incorporation provides that whenever our board of directors declares a dividend on our Class B common stock, our board of directors shall simultaneously declare a dividend on our Class A common stock that is payable to the holders of our Class A common stock at the same time and as of the same record date at a rate that is at least 10% greater than the rate at which our board of directors declared a dividend on our Class B common stock. Accordingly, we use the two-class method to compute our earnings per common share. The two-class method is an earnings allocation formula that determines earnings per share separately for each class of common stock based on dividends we have declared and an allocation of our remaining undistributed earnings using a participation percentage that reflects the dividend rights of each class. The table below presents for the periods indicated a reconciliation of the numerators and denominators we used to compute basic and diluted net income per share for our Class A common stock and our Class B common stock:

	Three Months Ended March 31,			
	2022		2021	
	Class A	Class B	Class A	Class B
	(in thousands, except per share data)			
Basic earnings per share:				
Numerator:				
Allocation of net income	\$ 10,986	\$ 2,159	\$ 8,742	\$ 1,788
Denominator:				
Weighted-average shares outstanding	25,787	5,577	24,768	5,577
Basic earnings per share	\$ 0.43	\$ 0.39	\$ 0.35	\$ 0.32
Diluted earnings per share:				
Numerator:				
Allocation of net income	\$ 10,986	\$ 2,159	\$ 8,742	\$ 1,788
Denominator:				
Number of shares used in basic computation	25,787	5,577	24,768	5,577
Weighted-average shares effect of dilutive securities:				
Director and employee stock options	22	—	128	—
Number of shares used in diluted computation	25,809	5,577	24,896	5,577
Diluted earnings per share	\$ 0.43	\$ 0.39	\$ 0.35	\$ 0.32

We did not include outstanding options to purchase the following number of shares of Class A common stock in our computation of diluted earnings per share because the exercise price of the options exceeded the average market price of our Class A common stock during the applicable periods.

	Three Months Ended March 31,	
	2022	2021
Number of options to purchase Class A shares excluded	5,434,934	6,051,359

4 - Reinsurance

Atlantic States and Donegal Mutual have participated in a pooling agreement since 1986 under which they pool their direct premiums written, and Atlantic States and Donegal Mutual then share the underwriting results of the pool in accordance with the terms of the pooling agreement. Atlantic States has an 80% share of the results of the pool, and Donegal Mutual has a 20% share of the results of the pool. Donegal Mutual began placing the business of the Mountain States Insurance Group into the pool beginning with policies effective in 2021.

Our insurance subsidiaries and Donegal Mutual participate in a consolidated third-party reinsurance program. The coverage and parameters of the program are common to all of our insurance subsidiaries and Donegal Mutual. The program utilizes several different reinsurers. They require their reinsurers to maintain an A.M. Best rating of A- (Excellent) or better or, with respect to foreign reinsurers, have a financial condition that, in the opinion of our management, is equivalent to a company with at least an A- rating from A.M. Best. The following information describes the external reinsurance Donegal Mutual and our insurance subsidiaries have in place for 2022:

- excess of loss reinsurance, under which Donegal Mutual and our insurance subsidiaries recover losses over a set retention of \$2.0 million; and
- catastrophe reinsurance, under which Donegal Mutual and our insurance subsidiaries recover 100% of an accumulation of many losses resulting from a single event, including natural disasters, over a set retention of \$15.0 million up to aggregate losses of \$185.0 million per occurrence.

For property insurance, our insurance subsidiaries have excess of loss reinsurance that provide for coverage of \$38.0 million per loss over a set retention of \$2.0 million. For liability insurance, our insurance subsidiaries have excess of loss reinsurance that provide for coverage of \$73.0 million per occurrence over a set retention of \$2.0 million. For workers' compensation insurance, our insurance subsidiaries have excess of loss reinsurance that provide for coverage of \$18.0 million on any one life over a set retention of \$2.0 million.

In addition to the pooling agreement and third-party reinsurance, our insurance subsidiaries have a catastrophe reinsurance agreement with Donegal Mutual, under which each of our insurance subsidiaries recovers 100% of an accumulation of multiple losses resulting from a single event, including natural disasters, over a set retention of \$2.0 million up to aggregate losses of \$13.0 million per occurrence. The agreement also provides additional coverage for an accumulation of losses from a single event including a combination of our insurance subsidiaries over a combined retention of \$5.0 million.

Our insurance subsidiaries and Donegal Mutual also purchase facultative reinsurance to cover certain exposures, including property exposures that exceeded the limits provided by their respective treaty reinsurance.

In order to write automobile insurance in the state of Michigan, MICO is required to be a member of the Michigan Catastrophic Claims Association ("MCCA"). The MCCA provides reinsurance to MICO for personal automobile and commercial automobile personal injury claims in the state of Michigan over a set retention. In November 2021, the MCCA approved the return of approximately \$3.0 billion of its estimated surplus to its member insurance companies and provided guidance to those companies with respect to the payment of refunds to Michigan policyholders in the first half of 2022. We recorded a receivable from the MCCA and a corresponding payable for cash refunds due to Michigan policyholders in the amount of \$18.1 million on our balance sheet as of December 31, 2021. In March 2022, we received such payment from the MCCA and subsequently paid the refunds due to our Michigan policyholders.

5 - Investments

The amortized cost and estimated fair values of our fixed maturities at March 31, 2022 were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
	(in thousands)			
Held to Maturity				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 89,848	\$ 310	\$ 4,139	\$ 86,019
Obligations of states and political subdivisions	395,793	5,884	21,439	380,238
Corporate securities	190,105	2,594	5,844	186,855
Mortgage-backed securities	14,945	6	156	14,795
Totals	<u>\$ 690,691</u>	<u>\$ 8,794</u>	<u>\$ 31,578</u>	<u>\$ 667,907</u>

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
	(in thousands)			
Available for Sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 37,003	\$ —	\$ 2,258	\$ 34,745
Obligations of states and political subdivisions	57,822	456	1,973	56,305
Corporate securities	219,350	1,307	5,484	215,173
Mortgage-backed securities	219,597	134	9,059	210,672
Totals	<u>\$ 533,772</u>	<u>\$ 1,897</u>	<u>\$ 18,774</u>	<u>\$ 516,895</u>

At March 31, 2022, our holdings of obligations of states and political subdivisions included general obligation bonds with an aggregate fair value of \$283.6 million and an amortized cost of \$296.1 million. Our holdings at March 31, 2022 also included special revenue bonds with an aggregate fair value of \$152.9 million and an amortized cost of \$157.5 million. With respect to both categories of those bonds at March 31, 2022, we held no securities of any issuer that comprised more than 10% of our holdings of either bond category. Education bonds and water and sewer utility bonds represented 48% and 35%, respectively, of our total investments in special revenue bonds based on the carrying values of these investments at March 31, 2022. Many of the issuers of the special revenue bonds we held at March 31, 2022 have the authority to impose ad valorem taxes. In that respect, many of the special revenue bonds we held at March 31, 2022 are similar to general obligation bonds.

The amortized cost and estimated fair values of our fixed maturities at December 31, 2021 were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
	(in thousands)			
Held to Maturity				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 89,268	\$ 1,923	\$ 1,015	\$ 90,176
Obligations of states and political subdivisions	371,436	17,857	948	388,345
Corporate securities	191,147	11,576	773	201,950
Mortgage-backed securities	16,254	676	—	16,930
Totals	<u>\$ 668,105</u>	<u>\$ 32,032</u>	<u>\$ 2,736</u>	<u>\$ 697,401</u>

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
	(in thousands)			
Available for Sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 32,501	\$ 144	\$ 461	\$ 32,184
Obligations of states and political subdivisions	55,459	2,002	83	57,378
Corporate securities	215,669	6,817	874	221,612
Mortgage-backed securities	219,664	3,001	1,210	221,455
Totals	<u>\$ 523,293</u>	<u>\$ 11,964</u>	<u>\$ 2,628</u>	<u>\$ 532,629</u>

At December 31, 2021, our holdings of obligations of states and political subdivisions included general obligation bonds with an aggregate fair value of \$284.9 million and an amortized cost of \$272.7 million. Our holdings also included special revenue bonds with an aggregate fair value of \$160.8 million and an amortized cost of \$154.2 million. With respect to both categories of bonds, we held no securities of any issuer that comprised more than 10% of that category at December 31, 2021. Education bonds and water and sewer utility bonds represented 48% and 35%, respectively, of our total investments in special revenue bonds based on their carrying values at December 31, 2021. Many of the issuers of the special revenue bonds we held at December 31, 2021 have the authority to impose ad valorem taxes. In that respect, many of the special revenue bonds we held are similar to general obligation bonds.

We have segregated within accumulated other comprehensive (loss) income the net unrealized losses of \$15.1 million arising prior to the November 30, 2013 reclassification date for fixed maturities reclassified from available for sale to held to maturity. We are amortizing this balance over the remaining life of the related securities as an adjustment of yield in a manner consistent with the accretion of discount on the same fixed maturities. We recorded amortization of \$149,475 and \$371,265 in other comprehensive loss during the three months ended March 31, 2022 and 2021, respectively. At March 31, 2022 and December 31, 2021, net unrealized losses of \$5.0 million and \$5.2 million, respectively, remained within accumulated other comprehensive (loss) income.

We show below the amortized cost and estimated fair value of our fixed maturities at March 31, 2022 by contractual maturity. Expected maturities may differ from contractual maturities because issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties

	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
	(in thousands)	
Held to maturity		
Due in one year or less	\$ 60,854	\$ 62,484
Due after one year through five years	84,257	85,415
Due after five years through ten years	223,309	216,052
Due after ten years	307,326	289,161
Mortgage-backed securities	14,945	14,795
Total held to maturity	<u>\$ 690,691</u>	<u>\$ 667,907</u>
Available for sale		
Due in one year or less	\$ 29,090	\$ 29,320
Due after one year through five years	148,499	145,592
Due after five years through ten years	105,650	101,917
Due after ten years	30,936	29,394
Mortgage-backed securities	219,597	210,672
Total available for sale	<u>\$ 533,772</u>	<u>\$ 516,895</u>

The cost and estimated fair values of our equity securities at March 31, 2022 were as follows:

	<u>Cost</u>	<u>Gross Gains</u>	<u>Gross Losses</u>	<u>Estimated Fair Value</u>
		(in thousands)		
Equity securities	\$ 35,307	\$ 18,795	\$ 56	\$ 54,046

The cost and estimated fair values of our equity securities at December 31, 2021 were as follows:

	<u>Cost</u>	<u>Gross Gains</u>	<u>Gross Losses</u>	<u>Estimated Fair Value</u>
		(in thousands)		
Equity securities	\$ 43,263	\$ 20,413	\$ 256	\$ 63,420

We present below gross gains and losses from investments and the change in the difference between fair value and cost of investments:

	<u>Three Months Ended March 31,</u>	
	<u>2022</u>	<u>2021</u>
	(in thousands)	
Gross realized gains:		
Fixed maturities	\$ 234	\$ 193
Equity securities	843	73
Real estate	477	—
	<u>1,554</u>	<u>266</u>
Gross realized losses:		
Fixed maturities	69	222
Equity securities	824	—
	<u>893</u>	<u>222</u>
Net realized gains	<u>661</u>	<u>44</u>
Gross unrealized gains on equity securities	<u>716</u>	<u>3,204</u>
Gross unrealized losses on equity securities	<u>(1,453)</u>	<u>(779)</u>
Net investment (losses) gains	<u>\$ (76)</u>	<u>\$ 2,469</u>

We held fixed maturities with unrealized losses representing declines that we considered temporary at March 31, 2022 as follows:

	<u>Less Than 12 Months</u>		<u>More Than 12 Months</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
	(in thousands)			
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 52,488	\$ 2,816	\$ 31,710	\$ 3,581
Obligations of states and political subdivisions	231,429	19,976	28,289	3,436
Corporate securities	188,463	8,531	25,649	2,797
Mortgage-backed securities	192,115	7,590	14,313	1,625
Totals	<u>\$ 664,495</u>	<u>\$ 38,913</u>	<u>\$ 99,961</u>	<u>\$ 11,439</u>

We held fixed maturities with unrealized losses representing declines that we considered temporary at December 31, 2021 as follows:

	Less Than 12 Months		More Than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)			
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 27,691	\$ 412	\$ 28,426	\$ 1,064
Obligations of states and political subdivisions	56,655	899	7,091	132
Corporate securities	92,737	1,610	1,463	37
Mortgage-backed securities	90,006	1,128	2,361	82
Totals	<u>\$ 267,089</u>	<u>\$ 4,049</u>	<u>\$ 39,341</u>	<u>\$ 1,315</u>

We make estimates concerning the valuation of our investments and the recognition of other-than-temporary declines in the value of our investments. For equity securities, we measure investments at fair value, and we recognize changes in fair value in our results of operations. With respect to a debt security that is in an unrealized loss position, we first assess if we intend to sell the debt security. If we determine we intend to sell the debt security, we recognize the impairment loss in our results of operations. If we do not intend to sell the debt security, we determine whether it is more likely than not that we will be required to sell the debt security prior to recovery. If we determine it is more likely than not that we will be required to sell the debt security prior to recovery, we recognize the impairment loss in our results of operations. If we determine it is more likely than not that we will not be required to sell the debt security prior to recovery, we then evaluate whether a credit loss has occurred with respect to that security. We determine whether a credit loss has occurred by comparing the amortized cost of the debt security to the present value of the cash flows we expect to collect. If we expect a cash flow shortfall, we consider that a credit loss has occurred. If we determine that a credit loss has occurred, we consider the impairment to be other than temporary. We then recognize the amount of the impairment loss related to the credit loss in our results of operations, and we recognize the remaining portion of the impairment loss in our other comprehensive income, net of applicable taxes. In addition, we may write down securities in an unrealized loss position based on a number of other factors, including when the fair value of an investment is significantly below its cost, when the financial condition of the issuer of a security has deteriorated, the occurrence of industry, issuer or geographic events that have negatively impacted the value of a security and rating agency downgrades. We held 593 debt securities that were in an unrealized loss position at March 31, 2022. Based upon our analysis of general market conditions and underlying factors impacting these debt securities, we considered these declines in value to be temporary.

We amortize premiums and discounts on debt securities over the life of the security as an adjustment to yield using the effective interest method. We compute realized investment gains and losses using the specific identification method.

We amortize premiums and discounts on mortgage-backed debt securities using anticipated prepayments.

6 - Segment Information

We evaluate the performance of our personal lines and commercial lines segments based upon the underwriting results of our insurance subsidiaries using statutory accounting principles (“SAP”) that various state insurance departments prescribe or permit. Our management uses SAP to measure the performance of our insurance subsidiaries instead of United States generally accepted accounting principles (“GAAP”). SAP financial measures are considered non-GAAP financial measures under applicable SEC rules because they include or exclude certain items that the most comparable GAAP financial measures do not ordinarily include or exclude.

Financial data by segment for the three months ended March 31, 2022 and 2021 is as follows:

	Three Months Ended March 31,	
	2022	2021
	(in thousands)	
Revenues:		
Premiums earned:		
Commercial lines	\$ 124,329	\$ 109,226
Personal lines	74,920	78,026
GAAP premiums earned	199,249	187,252
Net investment income	7,859	7,511
Investment (losses) gains	(76)	2,469
Other	595	738
Total revenues	<u>\$ 207,627</u>	<u>\$ 197,970</u>
Income before income tax expense:		
Underwriting income (loss):		
Commercial lines	\$ 62	\$ (8,242)
Personal lines	4,642	5,037
SAP underwriting income (loss)	4,704	(3,205)
GAAP adjustments	3,725	5,982
GAAP underwriting income	8,429	2,777
Net investment income	7,859	7,511
Investment (losses) gains	(76)	2,469
Other	14	(6)
Income before income tax expense	<u>\$ 16,226</u>	<u>\$ 12,751</u>

7 - Borrowings

Lines of Credit

In August 2020, we entered into a credit agreement with Manufacturers and Traders Trust Company (“M&T”) that related to a \$20.0 million unsecured demand line of credit. The line of credit has no expiration date, no annual fees and no covenants. At March 31, 2022, we had no outstanding borrowings from M&T and had the ability to borrow up to \$20.0 million at interest rates equal to the then-current LIBOR rate plus 2.00%.

Atlantic States is a member of the FHLB of Pittsburgh. Through its membership, Atlantic States has the ability to issue debt to the FHLB of Pittsburgh in exchange for cash advances. Atlantic States has a fixed-rate cash advance of \$35.0 million that was outstanding at March 31, 2022. The cash advance carries a fixed interest rate of 1.74% and is due in August 2024. In March 2020, Atlantic States issued \$50.0 million of debt to the FHLB of Pittsburgh in exchange for a cash advance in the same amount that carried a fixed interest rate of 0.83%. Atlantic States obtained this contingent liquidity funding in light of uncertainty surrounding the economic impact of the COVID-19 pandemic. Atlantic States repaid this advance when it became due in March 2021. The table below presents the amount of FHLB of Pittsburgh stock Atlantic States purchased, collateral pledged and assets related to Atlantic States' membership in the FHLB of Pittsburgh at March 31, 2022.

FHLB of Pittsburgh stock purchased and owned	\$	1,575,600
Collateral pledged, at par (carrying value \$39,728,104)		40,871,156
Borrowing capacity currently available		2,703,399

8 - Share-Based Compensation

We measure all share-based payments to employees, including grants of stock options, and use a fair-value-based method for the recording of related compensation expense in our results of operations. In determining the expense we record for stock options granted to directors and employees of our subsidiaries and affiliates, we estimate the fair value of each option award on the date of grant using the Black-Scholes option pricing model. The significant assumptions we utilize in applying the Black-Scholes option pricing model are the risk-free interest rate, the expected term, the dividend yield and the expected volatility.

We recorded compensation expense related to our stock compensation plans of \$244,140 and \$292,795 for the three months ended March 31, 2022 and 2021, respectively, with a corresponding income tax benefit of \$51,269 and \$61,487, respectively. At March 31, 2022, we had \$1.2 million of unrecognized compensation expense related to nonvested share-based compensation granted under our stock compensation plans that we expect to recognize over a weighted average period of approximately 1.8 years.

We received cash from option exercises under all stock compensation plans during the three months ended March 31, 2022 and 2021 of \$ 12,321 and \$4.4 million, respectively. We realized actual tax benefits for the tax deductions related to those option exercises of \$ 153 and \$149,156 for the three months ended March 31, 2022 and 2021, respectively.

9 - Fair Value Measurements

We account for financial assets using a framework that establishes a hierarchy that ranks the quality and reliability of the inputs, or assumptions, we use in the determination of fair value, and we classify financial assets and liabilities carried at fair value in one of the following three categories:

Level 1 – quoted prices in active markets for identical assets and liabilities;

Level 2 – directly or indirectly observable inputs other than Level 1 quoted prices; and

Level 3 – unobservable inputs not corroborated by market data.

For investments that have quoted market prices in active markets, we use the quoted market price as fair value and include these investments in Level 1 of the fair value hierarchy. We classify publicly-traded equity securities as Level 1. When quoted market prices in active markets are not available, we base fair values on quoted market prices of comparable instruments or price estimates we obtain from independent pricing services and include these investments in Level 2 of the fair value hierarchy. We classify our fixed maturity investments and non-publicly traded equity securities as Level 2. Our fixed maturity investments consist of U.S. Treasury securities and obligations of U.S. government corporations and agencies, obligations of states and political subdivisions, corporate securities and mortgage-backed securities.

We present our investments in available-for-sale fixed maturity and equity securities at estimated fair value. The estimated fair value of a security may differ from the amount that could be realized if we sold the security in a forced transaction. In addition, the valuation of fixed maturity investments is more subjective when markets are less liquid, increasing the potential that the estimated fair value does not reflect the price at which an actual transaction would occur. We utilize nationally recognized independent pricing services to estimate fair values or obtain market quotations for substantially all of our fixed maturity and equity investments. We generally obtain two prices per security. These pricing services utilize market quotations for fixed maturity and equity securities that have quoted prices in active markets. For fixed maturity securities that generally do not trade on a daily basis, the pricing services prepare estimates of fair value measurements based predominantly on observable market inputs. The pricing services do not use broker quotes in determining the fair values of our investments. Our investment personnel review the estimates of fair value the pricing services provide to verify that the estimates we obtain from the pricing services are representative of fair values based upon our investment personnel’s general knowledge of the market, their research findings related to unusual fluctuations in value and their comparison of such values to execution prices for similar securities. Our investment personnel monitor the market and are familiar with current trading ranges for similar securities and the pricing of specific investments. Our investment personnel review all pricing estimates that we receive from the pricing services against their expectations with respect to pricing based on fair market curves, security ratings, coupon rates, security types and recent trading activity. Our investment personnel periodically review documentation with respect to the pricing services’ pricing methodology that they obtain to determine if the primary pricing sources, market inputs and pricing frequency for various security types are reasonable. At March 31, 2022, we received two estimates per security from the pricing services, and we priced substantially all of our Level 1 and Level 2 investments using those prices. In our review of the estimates the pricing services provided at March 31, 2022, we did not identify any material discrepancies, and we did not make any adjustments to the estimates the pricing services provided.

We present our cash and short-term investments at estimated fair value. We classify these items as Level 1.

The carrying values we report in our balance sheet for premium receivables, reinsurance receivables related to paid losses and loss expenses and reinsurance balances payable approximate their fair values. The carrying amounts we report in our balance sheets for our subordinated debentures and borrowings under lines of credit approximate their fair values. We classify these items as Level 3.

We evaluate our assets and liabilities to determine the appropriate level at which to classify them for each reporting period.

The following table presents our fair value measurements for our investments in available-for-sale fixed maturity and equity securities at March 31, 2022:

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 34,745	\$ —	\$ 34,745	\$ —
Obligations of states and political subdivisions	56,305	—	56,305	—
Corporate securities	215,173	—	215,173	—
Mortgage-backed securities	210,672	—	210,672	—
Equity securities	54,046	51,759	2,287	—
Total investments in the fair value hierarchy	<u>\$ 570,941</u>	<u>\$ 51,759</u>	<u>\$ 519,182</u>	<u>\$ —</u>

The following table presents our fair value measurements for our investments in available-for-sale fixed maturity and equity securities at December 31, 2021:

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1) (in thousands)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 32,185	\$ —	\$ 32,185	\$ —
Obligations of states and political subdivisions	57,378	—	57,378	—
Corporate securities	221,611	—	221,611	—
Mortgage-backed securities	221,455	—	221,455	—
Equity securities	63,420	61,130	2,290	—
Totals	<u>\$ 596,049</u>	<u>\$ 61,130</u>	<u>\$ 534,919</u>	<u>\$ —</u>

10 - Income Taxes

At March 31, 2022 and December 31, 2021, respectively, we had no material unrecognized tax benefits or accrued interest and penalties. Tax years 2016 through 2021 remained open for examination at March 31, 2022. We provide a valuation allowance when we believe it is more likely than not that we will not realize some portion of our tax assets. We established a valuation allowance of \$7.9 million for our net state operating loss carryforward. We have determined that we are not required to establish a valuation allowance for our other deferred tax assets of \$32.5 million and \$28.1 million at March 31, 2022 and December 31, 2021, respectively, because it is more likely than not that we will realize these deferred tax assets through reversals of existing temporary differences, future taxable income and the implementation of tax planning strategies.

11 - Liabilities for Losses and Loss Expenses

The establishment of appropriate liabilities for losses and loss expenses is an inherently uncertain process, and we can provide no assurance that our insurance subsidiaries' ultimate liabilities for losses and loss expenses will not exceed their loss and loss expense reserves and have an adverse effect on our results of operations and financial condition. Furthermore, we cannot predict the timing, frequency and extent of adjustments to our insurance subsidiaries' estimated future liabilities, because the historical conditions and events that serve as a basis for our insurance subsidiaries' estimates of ultimate claim costs may change. As is the case for substantially all property and casualty insurance companies, our insurance subsidiaries have found it necessary in the past to increase their estimated future liabilities for losses and loss expenses in certain periods, and, in other periods, their estimated future liabilities for losses and loss expenses have exceeded their actual liabilities for losses and loss expenses. Changes in our insurance subsidiaries' estimate of their liabilities for losses and loss expenses generally reflect actual payments and their evaluation of information received subsequent to the prior reporting period.

We summarize activity in our insurance subsidiaries' liabilities for losses and loss expenses as follows:

	Three Months Ended March 31,	
	2022	2021
	(in thousands)	
Balance at January 1	\$ 1,077,620	\$ 962,007
Less reinsurance recoverable	(451,261)	(404,818)
Net balance at January 1	<u>626,359</u>	<u>557,189</u>
Incurred related to:		
Current year	134,432	127,433
Prior years	(16,549)	(8,213)
Total incurred	<u>117,883</u>	<u>119,220</u>
Paid related to:		
Current year	40,293	35,584
Prior years	76,088	65,192
Total paid	<u>116,381</u>	<u>100,776</u>
Net balance at end of period	627,861	575,633
Plus reinsurance recoverable	443,726	421,346
Balance at end of period	<u>\$ 1,071,587</u>	<u>\$ 996,979</u>

Our insurance subsidiaries recognized a decrease in their liabilities for losses and loss expenses of prior years of \$16.5 million and \$8.2 million for the three months ended March 31, 2022 and 2021, respectively. Our insurance subsidiaries made no significant changes in their reserving philosophy or claims management personnel, and they have made no significant offsetting changes in estimates that increased or decreased their loss and loss expense reserves in those years. The 2022 development represented 2.6% of the December 31, 2021 net carried reserves and resulted primarily from lower-than-expected loss emergence or severity in nearly all lines of business. The majority of the 2022 development related to decreases in the liabilities for losses and loss expenses of prior years for Atlantic States and MICO. The 2021 development represented 1.5% of the December 31, 2020 net carried reserves and resulted primarily from lower-than-expected loss emergence or severity in nearly all lines of business. The majority of the 2021 development related to decreases in the liabilities for losses and loss expenses of prior years for Atlantic States and MICO.

Short-duration contracts are contracts for which our insurance subsidiaries receive premiums that they recognize as revenue over the period of the contract in proportion to the amount of insurance protection our insurance subsidiaries provide. Our insurance subsidiaries consider the policies they issue to be short-duration contracts. We consider the material lines of business of our insurance subsidiaries to be personal automobile, homeowners, commercial automobile, commercial multi-peril and workers' compensation.

Our insurance subsidiaries determine incurred but not reported ("IBNR") reserves by subtracting the cumulative loss and loss expense amounts our insurance subsidiaries have paid and the case reserves our insurance subsidiaries have established at the balance sheet date from their actuaries' estimate of the ultimate cost of losses and loss expenses. Accordingly, the IBNR reserves of our insurance subsidiaries include their actuaries' projections of the cost of unreported claims as well as their actuaries' projected development of case reserves on known claims and reopened claims. Our insurance subsidiaries' methodology for estimating IBNR reserves has been in place for many years, and their actuaries made no significant changes to that methodology during the three months ended March 31, 2022.

The actuaries for our insurance subsidiaries generally prepare an initial estimate for ultimate losses and loss expenses for the current accident year by multiplying earned premium by an "a priori," or expected, loss ratio for each line of business our insurance subsidiaries write. Expected loss ratios represent the actuaries' expectation of losses at the time our insurance subsidiaries price and write their policies and before the emergence of any actual claims experience. The actuaries determine an expected loss ratio by analyzing historical experience and adjusting for loss cost trends, loss frequency and severity trends, premium rate level changes, reported and paid loss emergence patterns and other known or observed factors.

The actuaries use a variety of actuarial methods to estimate the ultimate cost of losses and loss expenses. These methods include paid loss development, incurred loss development and the Bornhuetter-Ferguson method from which the actuaries select loss development factor assumptions. The actuaries base their selection of a point estimate on a judgmental weighting of the estimates each of these methods produce.

The actuaries consider loss frequency and severity trends when they develop expected loss ratios and point estimates. Loss frequency is a measure of the number of claims per unit of insured exposure, and loss severity is a measure of the average size of claims. Factors that affect loss frequency include changes in weather patterns and economic activity. Factors that affect loss severity include changes in policy limits, reinsurance retentions, inflation rates and judicial interpretations.

Our insurance subsidiaries create a claim file when they receive notice of an actual demand for payment, an event that may lead to a demand for payment or when they otherwise determine that a demand for payment could potentially lead to a future demand for payment on another coverage under the same policy or another policy they have issued. In recent years, our insurance subsidiaries have noted an increase in the period of time between the occurrence of a casualty loss event and the date at which they receive notice of a liability claim. Changes in the length of time between the loss occurrence date and the claim reporting date affect the actuaries' ability to predict loss frequency accurately and the amount of IBNR reserves our insurance subsidiaries require.

Our insurance subsidiaries generally create a claim file for a policy at the claimant level by type of coverage and generally recognize one count for each claim event. In certain lines of business where it is common for multiple parties to claim damages arising from a single claim event, our insurance subsidiaries recognize one count for each claimant involved in the event. Atlantic States recognizes one count for each claim event, or claimant involved in a multiple-party claim event, related to losses Atlantic States assumes through its participation in its pooling agreement with Donegal Mutual. Our insurance subsidiaries accumulate the claim counts and report them by line of business.

12 - Impact of New Accounting Standards

In September 2016, the FASB issued guidance that amends previous guidance on the impairment of financial instruments by adding an impairment model that requires an entity to recognize expected credit losses as an allowance rather than impairments as credit losses are incurred. The intent of this guidance is to reduce complexity and result in a more timely recognition of expected credit losses. In November 2019, the FASB issued guidance that delays the effective date for "smaller reporting companies," as defined in Item 10(f)(1) of Regulation S-K, to annual and interim reporting periods beginning after December 15, 2022 from December 15, 2019. We are a smaller reporting company and are in the process of evaluating the impact of the adoption of this guidance on our financial position, results of operations and cash flows.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

We recommend that you read the following information in conjunction with the historical financial information and the footnotes to that financial information we include in this Quarterly Report on Form 10-Q. We also recommend you read Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2021.

Critical Accounting Policies and Estimates

We combine our financial statements with those of our insurance subsidiaries and present our financial statements on a consolidated basis in accordance with GAAP.

Our insurance subsidiaries make estimates and assumptions that can have a significant effect on amounts and disclosures we report in our financial statements. The most significant estimates relate to the liabilities of our insurance subsidiaries for property and casualty insurance losses and loss expenses. While we believe our estimates and the estimates of our insurance subsidiaries are appropriate, the ultimate amounts of these liabilities may differ from the estimates we provided. We regularly review our methods for making these estimates and we reflect any adjustment we consider necessary in our current consolidated results of operations.

Liabilities for Losses and Loss Expenses

Liabilities for losses and loss expenses are estimates at a given point in time of the amounts an insurer expects to pay with respect to incurred policyholder claims based on facts and circumstances the insurer knows at that point in time. For example, legislative, judicial and regulatory actions may expand coverage definitions, retroactively mandate coverage or otherwise require our insurance subsidiaries to pay losses for damages that their policies explicitly excluded or did not intend to cover. At the time of establishing its estimates, an insurer recognizes that its ultimate liability for losses and loss expenses will exceed or be less than such estimates. Our insurance subsidiaries base their estimates of liabilities for losses and loss expenses on assumptions as to future loss trends, expected claims severity, judicial theories of liability and other factors. However, during the loss adjustment period, our insurance subsidiaries may learn additional facts regarding individual claims, and, consequently, it often becomes necessary for our insurance subsidiaries to refine and adjust their estimates for these liabilities. We reflect any adjustments to the liabilities for losses and loss expenses of our insurance subsidiaries in our consolidated results of operations in the period in which our insurance subsidiaries make adjustments to their estimates.

Our insurance subsidiaries maintain liabilities for the payment of losses and loss expenses with respect to both reported and unreported claims. Our insurance subsidiaries establish these liabilities for the purpose of covering the ultimate costs of settling all losses, including investigation and litigation costs. Our insurance subsidiaries base the amount of their liability for reported losses primarily upon a case-by-case evaluation of the type of risk involved, knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss the policyholder incurred. Our insurance subsidiaries determine the amount of their liability for unreported claims and loss expenses on the basis of historical information by line of insurance. Our insurance subsidiaries account for inflation in the reserving function through analysis of costs and trends and reviews of historical reserving results. Our insurance subsidiaries monitor their liabilities closely and recompute them periodically using new information on reported claims and a variety of statistical techniques. Our insurance subsidiaries do not discount their liabilities for losses and loss expenses.

Reserve estimates can change over time because of unexpected changes in assumptions related to our insurance subsidiaries' external environment and, to a lesser extent, assumptions related to our insurance subsidiaries' internal operations. For example, our insurance subsidiaries have experienced an increase in claims severity and a lengthening of the claim settlement periods on bodily injury claims during the past several years. In addition, the COVID-19 pandemic and related government mandates and restrictions resulted in various changes from historical claims reporting and settlement trends during 2020 and resulted in significant increases in loss costs in 2021 and 2022 due to a number of factors, including supply chain disruption, higher used automobile values, increases in the cost of replacement automobile parts and rising labor rates. These trend changes give rise to greater uncertainty as to the pattern of future loss settlements. Related uncertainties regarding future trends include social inflation, availability and cost of building materials, availability of skilled labor, the rate of plaintiff attorney involvement in claims and the cost of medical technologies and procedures. Assumptions related to our insurance subsidiaries' external environment include the absence of significant changes in tort law and the legal environment that increase liability exposure, consistency in judicial interpretations of insurance coverage and policy provisions and the rate of loss cost inflation. Internal assumptions include consistency in the recording of premium and loss statistics, consistency in the recording of claims, payment and case reserving methodology, accurate measurement of the impact of rate changes and changes in policy provisions, consistency in the quality and characteristics of business written within a given line of business and consistency in reinsurance coverage and collectability of reinsured losses, among other items. To the extent our insurance subsidiaries determine that underlying factors impacting their assumptions have changed, our insurance subsidiaries make adjustments in their reserves that they consider appropriate for such changes. Accordingly, our insurance subsidiaries' ultimate liability for unpaid losses and loss expenses will likely differ from the amount recorded at March 31, 2022. For every 1% change in our insurance subsidiaries' loss and loss expense reserves, net of reinsurance recoverable, the effect on our pre-tax results of operations would be approximately \$6.3 million.

The establishment of appropriate liabilities is an inherently uncertain process and we can provide no assurance that our insurance subsidiaries' ultimate liability will not exceed our insurance subsidiaries' loss and loss expense reserves and have an adverse effect on our results of operations and financial condition. Furthermore, we cannot predict the timing, frequency and extent of adjustments to our insurance subsidiaries' estimated future liabilities, because the historical conditions and events that serve as a basis for our insurance subsidiaries' estimates of ultimate claim costs may change. As is the case for substantially all property and casualty insurance companies, our insurance subsidiaries have found it necessary in the past to increase their estimated future liabilities for losses and loss expenses in certain periods and, in other periods, their estimated future liabilities for losses and loss expenses have exceeded their actual liabilities for losses and loss expenses. Changes in our insurance subsidiaries' estimates of their liability for losses and loss expenses generally reflect actual payments and their evaluation of information received subsequent to the prior reporting period.

Excluding the impact of severe weather events and the COVID-19 pandemic, our insurance subsidiaries have noted stable amounts in the number of claims incurred and the number of claims outstanding at period ends relative to their premium base in recent years across most of their lines of business. However, the amount of the average claim outstanding has increased gradually over the past several years due to various factors such as rising inflation and increased litigation trends. We have also experienced a general slowing of settlement rates in litigated claims and lengthening of repair completion times for property and automobile claims. Our insurance subsidiaries could have to make further adjustments to their estimates in the future. However, on the basis of our insurance subsidiaries' internal procedures, which analyze, among other things, their prior assumptions, their 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, we believe that our insurance subsidiaries have made adequate provision for their liability for losses and loss expenses.

Atlantic States' participation in the pool with Donegal Mutual exposes Atlantic States to adverse loss development on the business of Donegal Mutual that the pool includes. However, pooled business represents the predominant percentage of the net underwriting activity of both companies, and Donegal Mutual and Atlantic States share proportionately any adverse risk development relating to the pooled business. The business in the pool is homogeneous and each company has a pro-rata share of the entire pool. Since the predominant percentage of the business of Atlantic States and Donegal Mutual is pooled and the results shared by each company according to its participation level under the terms of the pooling agreement, the intent of the underwriting pool is to produce a more uniform and stable underwriting result from year to year for each company than either would experience individually and to spread the risk of loss between the companies.

Our insurance subsidiaries' liabilities for losses and loss expenses by major line of business at March 31, 2022 and December 31, 2021 consisted of the following:

	March 31, 2022	December 31, 2021
	(in thousands)	
Commercial lines:		
Automobile	\$ 172,242	\$ 172,302
Workers' compensation	122,025	122,398
Commercial multi-peril	169,743	168,445
Other	21,705	18,530
Total commercial lines	<u>485,715</u>	<u>481,675</u>
Personal lines:		
Automobile	107,595	109,915
Homeowners	27,741	26,169
Other	6,810	8,600
Total personal lines	<u>142,146</u>	<u>144,684</u>
Total commercial and personal lines	627,861	626,359
Plus reinsurance recoverable	443,726	451,261
Total liabilities for losses and loss expenses	<u>\$ 1,071,587</u>	<u>\$ 1,077,620</u>

We have evaluated the effect on our insurance subsidiaries' loss and loss expense reserves and our stockholders' equity in the event of reasonably likely changes in the variables we consider in establishing the loss and loss expense reserves of our insurance subsidiaries. We established the range of reasonably likely changes based on a review of changes in accident-year development by line of business and applied those changes to our insurance subsidiaries' loss and loss expense reserves as a whole. The range we selected does not necessarily indicate what could be the potential best or worst case or the most likely scenario. The following table sets forth the estimated effect on our insurance subsidiaries' loss and loss expense reserves and our stockholders' equity in the event of reasonably likely changes in the variables we considered in establishing the loss and loss expense reserves of our insurance subsidiaries:

Percentage Change in Loss and Loss Expense Reserves Net of Reinsurance	Adjusted Loss and Loss Expense Reserves Net of Reinsurance at March 31, 2022	Percentage Change in Stockholders' Equity at March 31, 2022(1)	Adjusted Loss and Loss Expense Reserves Net of Reinsurance at December 31, 2021	Percentage Change in Stockholders' Equity at December 31, 2021(1)
		(dollars in thousands)		
(10.0)%	\$565,075	9.5%	\$563,723	9.3%
(7.5)	580,771	7.1	579,382	7.0
(5.0)	596,468	4.7	595,041	4.7
(2.5)	612,164	2.4	610,700	2.3
Base	627,861	—	626,359	—
2.5	643,558	(2.4)	642,018	(2.3)
5.0	659,254	(4.7)	657,677	(4.7)
7.5	674,951	(7.1)	673,336	(7.0)
10.0	690,647	(9.5)	688,995	(9.3)

(1) Net of income tax effect.

Non-GAAP Information

We prepare our consolidated financial statements on the basis of GAAP. Our insurance subsidiaries also prepare financial statements based on statutory accounting principles state insurance regulators prescribe or permit ("SAP"). SAP financial measures are considered non-GAAP financial measures under applicable SEC rules because the SAP financial measures include or exclude certain items that the most comparable GAAP financial measures do not ordinarily include or exclude. Our calculation of non-GAAP financial measures may differ from similar measures other companies use, so investors should exercise caution when comparing our non-GAAP financial measures to the non-GAAP financial measures other companies use.

Because our insurance subsidiaries do not prepare GAAP financial statements, we evaluate the performance of our personal lines and commercial lines segments utilizing SAP financial measures that reflect the growth trends and underwriting results of our insurance subsidiaries. The SAP financial measures we utilize are net premiums written and statutory combined ratio.

Net Premiums Written

We define net premiums written as the amount of full-term premiums our insurance subsidiaries record for policies effective within a given period less premiums our insurance subsidiaries cede to reinsurers. Net premiums earned is the most comparable GAAP financial measure to net premiums written. Net premiums earned represent the sum of the amount of net premiums written and the change in net unearned premiums during a given period. Our insurance subsidiaries earn premiums and recognize them as revenue over the terms of their policies, which are one year or less in duration. Therefore, increases or decreases in net premiums earned generally reflect increases or decreases in net premiums written in the preceding 12-month period compared to the comparable period one year earlier.

The following table provides a reconciliation of our net premiums earned to our net premiums written for the three months ended March 31, 2022 and 2021:

	Three Months Ended March 31,	
	2022	2021
	(in thousands)	
Net premiums earned	\$ 199,249	\$ 187,252
Change in net unearned premiums	19,193	28,610
Net premiums written	<u>\$ 218,442</u>	<u>\$ 215,862</u>

Statutory Combined Ratio

The combined ratio is a standard measurement of underwriting profitability for an insurance company. The combined ratio does not reflect investment income, net investment gains or losses, federal income taxes or other non-operating income or expense. A combined ratio of less than 100% generally indicates underwriting profitability.

The statutory combined ratio is a non-GAAP financial measure that is based upon amounts determined under SAP. We calculate our statutory combined ratio as the sum of:

- the statutory loss ratio, which is the ratio of calendar-year net incurred losses and loss expenses, excluding anticipated salvage and subrogation recoveries, to net premiums earned;
- the statutory expense ratio, which is the ratio of expenses incurred for net commissions, premium taxes and underwriting expenses to net premiums written; and
- the statutory dividend ratio, which is the ratio of dividends to holders of workers' compensation policies to net premiums earned.

The calculation of our statutory combined ratio differs from the calculation of our GAAP combined ratio. In calculating our GAAP combined ratio, we do not deduct installment payment fees from incurred expenses, and we base the expense ratio on net premiums earned instead of net premiums written. Differences between our GAAP loss ratio and our statutory loss ratio result from anticipating salvage and subrogation recoveries for our GAAP loss ratio but not for our statutory loss ratio.

Combined Ratios

The following table presents comparative details with respect to our GAAP and statutory combined ratios for the three months ended March 31, 2022 and 2021:

	Three Months Ended March 31,	
	2022	2021
GAAP Combined Ratios (Total Lines)		
Loss ratio (non-weather)	55.2%	60.0%
Loss ratio (weather-related)	4.0	3.7
Expense ratio	35.8	34.1
Dividend ratio	0.8	0.7
Combined ratio	<u>95.8%</u>	<u>98.5%</u>
Statutory Combined Ratios		
Commercial lines:		
Automobile	89.1%	102.3%
Workers' compensation	97.0	95.4
Commercial multi-peril	99.7	107.7
Other	72.4	60.1
Total commercial lines	93.5	99.3
Personal lines:		
Automobile	93.5	93.4
Homeowners	108.0	94.7
Other	43.8	76.9
Total personal lines	94.8	92.6
Total commercial and personal lines	94.1	96.5

Results of Operations - Three Months Ended March 31, 2022 Compared to Three Months Ended March 31, 2021

Net Premiums Earned. Our insurance subsidiaries' net premiums earned for the first three months of 2022 were \$199.2 million, an increase of \$11.9 million, or 6.4 %, compared to \$187.3 million for the first three months of 2021, primarily reflecting the inclusion of the business of the Mountain States Insurance Group in the underwriting pool beginning with policies effective in 2021, as well as solid premium retention and renewal premium increases.

Net Premiums Written. Our insurance subsidiaries' net premiums written for the three months ended March 31, 2022 were \$218.4 million, an increase of \$2.5 million, or 1.2%, from the \$215.9 million of net premiums written for the first three months of 2021. Commercial lines net premiums written increased \$2.4 million, or 1.7%, for the first three months of 2022 compared to the first three months of 2021. We attribute the increase in commercial lines net premiums written primarily to modest new business growth, solid premium retention and renewal premium increases. Personal lines net premiums written increased slightly for the first three months of 2022 compared to the first three months of 2021.

Investment Income. Our net investment income was \$7.9 million for the first three months of 2022, compared to \$7.5 million for the first three months of 2021. We attribute the increase primarily to an increase in average invested assets.

Net Investment (Losses) Gains. Net investment losses for the first three months of 2022 were \$76,247, compared to net investment gains of \$2.5 million for the first three months of 2021. The net investment losses and gains for the first three months of 2022 and 2021, respectively, resulted primarily from the net change in unrealized gains and losses within our equity securities portfolio at March 31, 2022 and 2021, respectively. We did not recognize any impairment losses in our investment portfolio during the first three months of 2022 or 2021.

Losses and Loss Expenses. Our insurance subsidiaries' loss ratio, which is the ratio of incurred losses and loss expenses to premiums earned, was 59.2% for the first three months of 2022, a decrease from our insurance subsidiaries' loss ratio of 63.7% for the first three months of 2021. We attribute this decrease primarily to favorable prior year loss development and lower fire losses. Weather-related losses of \$8.0 million, or 4.0 percentage points of the loss ratio, for the first three months of 2022, increased from \$6.8 million, or 3.7 percentage points of the loss ratio, for the first three months of 2021. Weather-related loss activity for the first three months of 2022 was lower than our previous five-year average of \$10.3 million for first quarter weather-related losses. On a statutory basis, our insurance subsidiaries' commercial lines loss ratio was 57.2% for the first quarter of 2022, compared to 66.3% for the first three months of 2021, primarily due to decreases in the commercial automobile, commercial multi-peril and workers' compensation loss ratios. The personal lines statutory loss ratio of our insurance subsidiaries increased to 63.0% for the first three months of 2022, compared to 61.0% for the first three months of 2021. We attribute this increase primarily to an increase in large homeowner fire losses, which we define as individual fire losses in excess of \$50,000. During the first quarter of 2022, our insurance subsidiaries experienced \$6.2 million of large homeowner fire losses, compared to \$2.9 million for the first quarter of 2021. Our insurance subsidiaries experienced favorable loss reserve development for the first quarter of 2022 of approximately \$16.5 million, or 8.3 percentage points of the loss ratio, compared to \$8.2 million that decreased the loss ratio for the first quarter of 2021 by 4.4 percentage points. Our insurance subsidiaries experienced favorable development in all lines of business in the first quarter of 2022, with the majority of the impact relating to reserves for accident years 2021 and 2020 in the commercial automobile, personal automobile, commercial multi-peril and workers' compensation lines of business.

Underwriting Expenses. The expense ratio for an insurance company is the ratio of policy acquisition costs and other underwriting expenses to premiums earned. The expense ratio of our insurance subsidiaries was 35.8% for the first three months of 2022, compared to 34.1% for the first three months of 2021. The increase in the expense ratio primarily reflected an increase in our underwriting-based incentive costs for our agents and employees and higher technology system-related expenses due to an increased allocation of costs from Donegal Mutual to our insurance subsidiaries related to our ongoing systems modernization project.

Combined Ratio. The combined ratio represents the sum of the loss ratio, the expense ratio and the dividend ratio, which is the ratio of policyholder dividends incurred to premiums earned. Our insurance subsidiaries' combined ratios were 95.8% and 98.5% for the three months ended March 31, 2022 and 2021, respectively. We attribute the decrease in the combined ratio primarily to a decrease in the loss ratio for the first three months of 2022 compared to the first three months of 2021.

Interest Expense. Our interest expense for the first three months of 2022 was \$153,033, compared to \$312,326 for the first three months of 2021. We attribute the decrease to lower average borrowings under our lines of credit during the first three months of 2022 compared to the first three months of 2021.

Income Tax Expense. We recorded income tax expense of \$3.1 million for the first three months of 2022, representing an effective tax rate of 19.0%. We recorded income tax expense of \$2.2 million for the first three months of 2021, representing an effective tax rate of 17.4%. The income tax expense for the first three months of 2022 and 2021 represented estimates based on our projected annual taxable income and effective tax rates.

Net Income and Income Per Share. Our net income for the first three months of 2022 was \$13.1 million, or \$.43 per share of Class A common stock on a diluted basis and \$.39 per share of Class B common stock, compared to net income of \$10.5 million, or \$.35 per share of Class A common stock on a diluted basis and \$.32 per share of Class B common stock, for the first three months of 2021. We had 25.8 million and 25.0 million Class A shares outstanding at March 31, 2022 and 2021, respectively. We had 5.6 million Class B shares outstanding at the end of both periods.

Liquidity and Capital Resources

Liquidity is a measure of an entity's ability to secure enough cash to meet its contractual obligations and operating needs as such obligations and needs arise. Our major sources of funds from operations are the net cash flows we generate from our insurance subsidiaries' underwriting results, investment income and investment maturities.

Our operations have historically generated sufficient net positive cash flow to fund our commitments and add to our investment portfolio, thereby increasing future investment returns and enhancing our liquidity. The impact of the pooling agreement between Donegal Mutual and Atlantic States has historically been cash-flow positive because of the consistent underwriting profitability of the pool. Donegal Mutual and Atlantic States settle their respective obligations to each other under the pool monthly, thereby resulting in cash flows substantially similar to the cash flows that would result from each company writing the business directly. We have not experienced any unusual variations in the timing of claim payments associated with the loss reserves of our insurance subsidiaries. We maintain significant liquidity in our investment portfolio in the form of readily marketable fixed maturities, equity securities and short-term investments. We structure our fixed-maturity investment portfolio following a "laddering" approach, so that projected cash flows from investment income and principal maturities are evenly distributed from a timing perspective, thereby providing an additional measure of liquidity to meet our obligations should an unexpected variation occur in the future. Our operating activities provided net cash flows in the first three months of 2022 and 2021 of \$20.7 million and \$29.9 million, respectively.

At March 31, 2022, we had no outstanding borrowings under our line of credit with M&T and had the ability to borrow up to \$20.0 million at interest rates equal to the then-current LIBOR rate plus 2.00%. At March 31, 2022, Atlantic States had a \$35.0 million outstanding advance with the FHLB of Pittsburgh that carries a fixed interest rate of 1.74%.

We estimate the timing of claim payments associated with the liabilities for losses and loss expenses of our insurance subsidiaries based on historical experience and expectations of future payment patterns. We show these liabilities net of reinsurance recoverable on unpaid losses and loss expenses to reflect expected future cash flows related to such liabilities. Amounts Atlantic States assumes pursuant to the pooling agreement with Donegal Mutual represent a substantial portion of our insurance subsidiaries' gross liabilities for losses and loss expenses, and amounts Atlantic States cedes pursuant to the pooling agreement represent a substantial portion of our insurance subsidiaries' reinsurance recoverable on unpaid losses and loss expenses. We include cash settlement of Atlantic States' assumed liabilities from the pool in monthly settlements of pooled activity, as we net amounts ceded to and assumed from the pool. Although Donegal Mutual and we do not anticipate any changes in the pool participation levels in the foreseeable future, any such change would be prospective in nature and therefore would not impact the timing of expected payments by Atlantic States for its percentage share of pooled losses occurring in periods prior to the effective date of such change.

We discuss in Note 7 – Borrowings our estimate of the timing of the amounts payable for the borrowings under our lines of credit based on their contractual maturities.

On July 18, 2013, our board of directors authorized a share repurchase program pursuant to which we have the authority to purchase up to 500,000 shares of our Class A common stock at prices prevailing from time to time in the open market subject to the provisions of applicable rules of the SEC and in privately negotiated transactions. We did not purchase any shares of our Class A common stock under this program during the three months ended March 31, 2022 or 2021. We have purchased a total of 57,658 shares of our Class A common stock under this program from its inception through March 31, 2022.

On April 21, 2022, our board of directors declared quarterly cash dividends of 16.50 cents per share of our Class A common stock and 14.75 cents per share of our Class B common stock, payable on May 16, 2022 to our stockholders of record as of the close of business on May 2, 2022. We are not subject to any restrictions on our payment of dividends to our stockholders, although there are state law restrictions on the payment of dividends by our insurance subsidiaries to us. Dividends from our insurance subsidiaries are our principal source of cash for payment of dividends to our stockholders. Our insurance subsidiaries are subject to regulations that restrict the payment of dividends from statutory surplus and may require prior approval of their domiciliary insurance regulatory authorities. Our insurance subsidiaries are also subject to risk based capital (“RBC”) requirements that limit their ability to pay dividends to us. Our insurance subsidiaries’ statutory capital and surplus at December 31, 2021 exceeded the amount of statutory capital and surplus necessary to satisfy regulatory requirements, including the RBC requirements, by a significant margin. Our insurance subsidiaries did not pay any dividends to us during the first three months of 2022. Amounts remaining available for distribution to us as dividends from our insurance subsidiaries without prior approval of their domiciliary insurance regulatory authorities in 2022 are \$27.9 million from Atlantic States, \$6.9 million from Southern, \$4.8 million from Peninsula and \$7.7 million from MICO, or a total of approximately \$47.3 million.

At March 31, 2022, we had no material commitments for capital expenditures.

Equity Price Risk

Our portfolio of marketable equity securities, which we carry on our consolidated balance sheets at estimated fair value, has exposure to the risk of loss resulting from an adverse change in prices. We manage this risk by having our investment personnel perform an analysis of prospective investments and regular reviews of our portfolio of equity securities.

Credit Risk

Our portfolio of fixed-maturity securities and, to a lesser extent, our portfolio of short-term investments is subject to credit risk, which we define as the potential loss in market value resulting from adverse changes in the borrower’s ability to repay its debt. We manage this risk by having our investment personnel perform an analysis of prospective investments and regular reviews of our portfolio of fixed-maturity securities. We also limit the percentage and amount of our total investment portfolio that we invest in the securities of any one issuer.

Our insurance subsidiaries provide property and casualty insurance coverages through independent insurance agencies. We bill the majority of this business directly to the insured, although we bill a portion of our commercial business through licensed insurance agents to whom our insurance subsidiaries extend credit in the normal course of business.

Because the pooling agreement does not relieve Atlantic States of primary liability as the originating insurer, Atlantic States is subject to a concentration of credit risk arising from the business it cedes to Donegal Mutual. Our insurance subsidiaries maintain reinsurance agreements with Donegal Mutual and with a number of other major unaffiliated authorized reinsurers.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our market risk generally represents the risk of gain or loss that may result from the potential change in the fair value of the securities we hold in our investment portfolio as a result of fluctuations in prices and interest rates and, to a lesser extent, our debt obligations. We manage our interest rate risk by maintaining an appropriate relationship between the average duration of our investment portfolio and the approximate duration of our liabilities, i.e., policy claims of our insurance subsidiaries and our debt obligations.

There have been no material changes to our quantitative or qualitative market risk exposure from December 31, 2021 through March 31, 2022.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on such evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, at March 31, 2022, our disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information we are required to disclose in the reports that we file or submit under the Exchange Act, and our disclosure controls and procedures were also effective to ensure that information we disclose in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

Donegal Mutual implemented a new application system that Donegal Mutual and our insurance subsidiaries began to utilize during 2021 for the allocation of expenses and, beginning in 2022, for reinsurance premiums and commissions. The new application system provides for further automation of, and enhanced internal controls over these processes. The implementation of the new system is part of a multi-year accounting systems and process modernization initiative Donegal Mutual is implementing to achieve various benefits for Donegal Mutual and our insurance subsidiaries, including streamlined financial reporting workflows and a more efficient control environment.

Such changes resulted in changes to procedures related to our financial reporting. Prior to the implementation of the new systems, we identified and designed new internal controls that we incorporated into our internal controls over financial reporting. Following the implementation, we validated these new controls according to our established processes. We did not implement these changes in internal controls to respond to any actual or perceived significant deficiencies in our internal control over financial reporting.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

We base all statements contained in this release that are not historic facts on our current expectations. Such statements are forward-looking in nature (as defined in the Private Securities Litigation Reform Act of 1995) and necessarily involve risks and uncertainties. Forward-looking statements we make may be identified by our use of words such as “will,” “expect,” “intend,” “plan,” “anticipate,” “believe,” “seek,” “estimate” and similar expressions. Our actual results could vary materially from our forward-looking statements. The factors that could cause our actual results to vary materially from the forward-looking statements we have previously made include, but are not limited to, prolonged economic challenges resulting from the COVID-19 pandemic, adverse litigation and other trends that could increase our loss costs (including labor shortages and escalating medical, automobile and property repair costs), adverse and catastrophic weather events, our ability to maintain profitable operations (including our ability to underwrite risks effectively and charge adequate premium rates), the adequacy of the loss and loss expense reserves of our insurance subsidiaries, the availability and successful operation of the information technology systems our insurance subsidiaries utilize, the successful development of new information technology systems to allow our insurance subsidiaries to compete effectively, business and economic conditions in the areas in which we and our insurance subsidiaries operate, interest rates, competition from various insurance and other financial businesses, terrorism, the availability and cost of reinsurance, legal and judicial developments including those related to COVID-19 business interruption coverage exclusions, changes in regulatory requirements, our ability to attract and retain independent insurance agents, changes in our A.M. Best rating and the other risks that we describe from time to time in our filings with the Securities and Exchange Commission. We disclaim any obligation to update such statements or to announce publicly the results of any revisions that we may make to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Part II. Other Information

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

Our business, results of operations and financial condition, and, therefore, the value of our Class A common stock and our Class B common stock, are subject to a number of risks. For a description of certain risks, we refer to “Risk Factors” in our 2021 Annual Report on Form 10-K that we filed with the SEC on March 7, 2022. There have been no material changes in the risk factors we disclosed in that Form 10-K Report during the three months ended March 31, 2022.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosure.

Not Applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

<u>Exhibit No.</u>	<u>Description</u>	
Exhibit 31.1	Certification of Chief Executive Officer	Filed herewith
Exhibit 31.2	Certification of Chief Financial Officer	Filed herewith
Exhibit 32.1	Statement of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 of Title 18 of the United States Code	Filed herewith
Exhibit 32.2	Statement of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 of Title 18 of the United States Code	Filed herewith
Exhibit 101.INS	XBRL Instance Document	Filed herewith
Exhibit 101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
Exhibit 101.PRE	XBRL Taxonomy Presentation Linkbase Document	Filed herewith
Exhibit 101.CAL	XBRL Taxonomy Calculation Linkbase Document	Filed herewith
Exhibit 101.LAB	XBRL Taxonomy Label Linkbase Document	Filed herewith
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith
Exhibit 104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)	Filed herewith

Signatures

Pursuant to the requirements 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.

May 5, 2022

By: /s/ Kevin G. Burke
Kevin G. Burke, President and Chief Executive Officer

May 5, 2022

By: /s/ Jeffrey D. Miller
Jeffrey D. Miller, Executive Vice President
and Chief Financial Officer

CERTIFICATION

I, Kevin G. Burke, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended March 31, 2022 of Donegal Group Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 5, 2022

/s/ Kevin G. Burke

Kevin G. Burke,
President and Chief Executive Officer

CERTIFICATION

I, Jeffrey D. Miller, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended March 31, 2022 of Donegal Group Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 5, 2022

/s/ Jeffrey D. Miller

Jeffrey D. Miller, Executive Vice President
and Chief Financial Officer

CERTIFICATION OF
PRESIDENT AND CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Donegal Group Inc. (the "Company"), on Form 10-Q for the quarter ended March 31, 2022, as filed with the Securities and Exchange Commission (the "Report"), Kevin G. Burke, the President and Chief Executive Officer of the Company, does hereby certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to his knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Kevin G. Burke

Kevin G. Burke, President and Chief Executive Officer

Date: May 5, 2022

CERTIFICATION OF
EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Donegal Group Inc. (the "Company"), on Form 10-Q for the quarter ended March 31, 2022, as filed with the Securities and Exchange Commission (the "Report"), Jeffrey D. Miller, the Executive Vice President and Chief Financial Officer of the Company, does hereby certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to his knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jeffrey D. Miller

Jeffrey D. Miller, Executive Vice President
and Chief Financial Officer

Date: May 5, 2022
