UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2010

OR

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

For the transition period from _________________ to _________________

Commission file number 0-15341

DONEGAL GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware	23-2424711
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1195 River Road, Marietta, Pennsylvania	17547
(Address of principal executive offices)	(Zip code)

Registrant’s telephone number, including area code: (888) 877-0600

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

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

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

Indicate by check mark whether the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act: Yes o. No ☑.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes o. No ☑.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☑. No o.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o. No o.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements we incorporate by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” or “smaller reporting company” in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer o	Accelerated filer ☑	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company. Yes o. No ☑.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant’s most recently completed second fiscal quarter. $157,257,918.

Indicate the number of shares outstanding of each of the registrant’s classes of common stock, as of the latest practicable date: 20,013,067 shares of Class A common stock and 5,576,775 shares of Class B common stock outstanding on March 4, 2011.

DOCUMENTS INCORPORATED BY REFERENCE:

1. The registrant incorporates by reference portions of the registrant’s annual report to stockholders for the fiscal year ended December 31, 2010 into Parts I, II and IV of this report.
2. The registrant incorporates by reference portions of the registrant’s proxy statement relating to registrant’s annual meeting of stockholders to be held April 21, 2011 into Part III of this report.

DONEGAL GROUP INC.
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PART I

Item 1. Business.

(a) General Development of Business.

We are an insurance holding company whose insurance subsidiaries offer personal and commercial lines of property and casualty insurance to businesses and individuals in 22 Mid-Atlantic, Midwestern, New England and Southern states. Our insurance subsidiaries provide their policyholders with a selection of insurance products at competitive rates, while pursuing profitability through adherence to a strict underwriting discipline. At December 31, 2010, we had total assets of $1.2 billion and stockholders' equity of $380.1 million. Our net income was $11.5 million for the year ended December 31, 2010 compared to $18.8 million for the year ended December 31, 2009.

Donegal Mutual Insurance Company, or Donegal Mutual, owns approximately 42.0% of our Class A common stock and approximately 75.0% of our Class B common stock. Donegal Mutual's stock ownership in the aggregate represents approximately two-thirds of the voting power of our outstanding common stock. Our insurance subsidiaries and Donegal Mutual have interrelated operations. 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 have the same business philosophy, the same management, the same employees and the same facilities and offer the same types of insurance products. The terms "we," "us" and "our," where the context permits, includes Donegal Mutual, us and our insurance subsidiaries.

Our growth strategies include the acquisition of insurance companies and other financial institutions including banks to expand our business in a given region or to commence operations in a new region. We and Donegal Mutual have the ability to employ a number of acquisition and affiliation methods. Our prior acquisitions and affiliations have taken one of the following forms:

- a purchase of all of the outstanding stock of a stock insurance company;
- a purchase of a book of business;
- a quota-share reinsurance transaction; or
- a two-step acquisition of a mutual insurance company in which:
  - as the first step, Donegal Mutual purchases a surplus note from the mutual insurance company, Donegal Mutual enters into a services agreement with the mutual insurance company and Donegal Mutual's

designees become a majority of the members of the board of directors of the mutual insurance company.

- as the second step, the mutual insurance company enters into a quota-share reinsurance agreement with Donegal Mutual or demutualizes, or converts, into a stock insurance company. Upon the demutualization or conversion, we purchase the surplus note from Donegal Mutual and exchange it for all of the stock of the stock insurance company resulting from the conversion.

We believe that our ability to make direct acquisitions of stock insurance companies and to make indirect acquisitions of mutual insurance companies through a sponsored conversion or a quota-share reinsurance agreement provides us with flexibility that is a competitive advantage in seeking acquisitions. We also believe we have demonstrated our ability to acquire control of an underperforming insurance company, reunderwrite its book of business, reduce its cost structure and return it to sustained profitability.

While Donegal Mutual and we generally engage in preliminary discussions with potential direct or indirect acquisition candidates on an almost continuous basis and are so engaged at the date of this Form 10-K Report, neither Donegal Mutual nor we make any public disclosure regarding a proposed acquisition until Donegal Mutual or we have entered into a definitive acquisition agreement.

We acquired all of the outstanding capital stock of Michigan Insurance Company, a Michigan-domiciled property and casualty insurance company, or MICO, effective as of December 1, 2010 when DGI Acquisition Corp., or DAC, our wholly owned subsidiary, merged with and into MICO with MICO as the surviving corporation. In the merger, all of the outstanding capital stock of MICO converted into the right to receive an aggregate merger consideration payable entirely in cash equal to 122% of the stockholders' equity of MICO as of November 30, 2010 determined in accordance with generally accepted accounting principles, or GAAP, or approximately $42 million. As part of the transaction, Donegal Mutual purchased a surplus note of MICO in the principal amount of $5.0 million, and Donegal Mutual and MICO entered into a 25% quota-share reinsurance agreement. Upon the merger, eight of our designees became directors of MICO along with the president of MICO. We maintain control of MICO through our ownership of all of the outstanding capital stock of MICO and because our designees represent a majority of the members of MICO's board of directors.

(b) Financial Information About Industry Segments.

We have three segments, our investment portfolio, our personal lines of insurance and our commercial lines of insurance. We set forth financial information about these segments

in note 20 to our consolidated financial statements we incorporate by reference in this Form 10-K Report.

(c) Narrative Description of Business.

Who We Are

We are an insurance holding company whose insurance subsidiaries offer personal and commercial lines of property and casualty insurance to small businesses and individuals in 22 Mid-Atlantic, Midwestern, New England and Southern states. Our insurance subsidiaries provide their policyholders with a selection of insurance products at competitive rates, while pursuing profitability by adhering to a strict underwriting discipline.

Our insurance subsidiaries derive a substantial portion of their insurance business from smaller to mid-sized regional communities. We believe this focus provides our insurance subsidiaries with competitive advantages in terms of local market knowledge, marketing, underwriting, claims servicing and policyholder service. At the same time, we believe our insurance subsidiaries have cost advantages over many smaller regional insurers because of the centralized accounting, administrative, data processing, investment and other services available to our insurance subsidiaries on a cost-effective basis because of economies of scale.

Our pending acquisition of Union National Financial Corporation, or UNFC, and its wholly owned subsidiary, Union National Community Bank, or UNCB, in Lancaster, Pennsylvania is currently awaiting the approval of the Office of Thrift Supervision, or the OTS. At December 31, 2010, UNFC had, on a consolidated basis, assets of $448.0 million, loans of $320.5 million and stockholders' equity of $29.0 million and ten branches in Lancaster County, Pennsylvania. We expect to complete the acquisition of UNCB prior to June 30, 2011.

Strategy

The annual net earned premiums of our insurance subsidiaries have increased from $196.8 million in 2003 to $378.0 million in 2010, a compound annual growth rate of 10%. Over the same time period, our insurance subsidiaries have achieved a combined ratio more favorable than that of the property and casualty insurance industry as a whole. Our insurance subsidiaries seek to increase their annual net earned premiums and enhance their profitability by:

- *Achieving underwriting profitability.*

Our insurance subsidiaries focus on achieving a combined ratio of less than 100%. Adverse weather, declining economic activity and a soft insurance market in our marketing

areas in 2009 and 2010 have negatively affected the ability of our insurance subsidiaries to attain a combined ratio of less than 100% in those years, but we remain committed to achieving consistent underwriting profitability. We believe that underwriting profitability is a fundamental component of our long-term financial strength because it allows our insurance subsidiaries to generate profits without relying on their investment income. Our insurance subsidiaries seek to enhance their underwriting results by:

- carefully selecting the product lines they underwrite;
- carefully selecting the individual risks they underwrite;
- minimizing their individual exposure to catastrophe-prone areas; and
- evaluating their claims history on a regular basis to ensure the adequacy of their underwriting guidelines and product pricing.

Our insurance subsidiaries have no material exposures to asbestos and environmental liabilities. Our insurance subsidiaries seek to provide more than one policy to a given personal or commercial customer because this “account selling” strategy diversifies our risk and has historically improved our underwriting results. Finally, our insurance subsidiaries use reinsurance to manage their exposure and limit their maximum net loss from large single risks or risks in concentrated areas. Our insurance subsidiaries believe these practices are key factors in their ability to maintain a combined ratio that has been traditionally more favorable than the combined ratio of the property and casualty insurance industry.

The combined ratio of our insurance subsidiaries and that of the property and casualty insurance industry for the years 2006 through 2010 are shown in the following table:

	2006	2007	2008	2009	2010
Our GAAP combined ratio	89.0%	91.3%	97.2%	102.2%	104.7%
Our SAP combined ratio	87.4	90.2	95.1	101.1	102.9
Industry SAP combined ratio(1)	92.4	95.6	104.7	101.2	103.0

(1) As reported or projected by A.M. Best.

- *Pursuing profitable growth by organic expansion within the traditional operating territories of our insurance subsidiaries through developing and maintaining quality agency representation.*

We believe that continued expansion of our insurance subsidiaries within their existing markets will be a key source of their continued premium growth and that maintaining an effective and growing network of independent agencies is integral to their expansion. Our insurance subsidiaries seek to be among the top three insurers within each of the independent agencies for the lines of business our insurance subsidiaries write by

providing a consistent, competitive and stable market for their products. We believe that the consistency of their product offerings enables our insurance subsidiaries to compete effectively for agents with other insurers whose product offerings fluctuate based on industry conditions. Our insurance subsidiaries offer a competitive compensation program to their independent agents that rewards them for producing profitable growth for our insurance subsidiaries. Our insurance subsidiaries provide their independent agents with ongoing support to enable them to better attract and service customers, including:

- fully automated underwriting and policy issuance systems for both personal, commercial and farm lines of insurance;
- training programs;
- marketing support;
- availability of a service center that provides comprehensive service for our personal lines policyholders; and
- field visitations by marketing and underwriting personnel and senior management of our insurance subsidiaries.

Finally, our insurance subsidiaries appoint independent agencies with a strong underwriting and growth track record. We believe that our insurance subsidiaries, by carefully selecting, motivating and supporting their independent agencies, will drive continued long-term growth.

- *Acquiring property and casualty insurance companies to augment the organic growth of our insurance subsidiaries in existing markets and to expand into new geographic regions.*

We have completed six acquisitions of property and casualty insurance companies or assumed their business by quota-share reinsurance since 1995. We intend to continue our growth by pursuing affiliations and acquisitions that meet our criteria. Our primary criteria include:

- Location in regions where our insurance subsidiaries are currently conducting business or that offer an attractive opportunity to conduct profitable business;
- A mix of business similar to the mix of business of our insurance subsidiaries;
- Premium volume up to $100.0 million; and

- Fair and reasonable transaction terms.

We believe that our interrelationship with Donegal Mutual assists us in pursuing affiliations with and subsequent acquisitions of mutual insurance companies because, through Donegal Mutual, we understand the concerns and issues that mutual insurance companies face. In particular, we have had success affiliating with underperforming mutual insurance companies and acquiring them following their conversion to a stock company by utilizing our strengths and financial position to improve their operations significantly. We evaluate a number of areas for operational synergies when considering acquisitions, including product underwriting, expenses, the cost of reinsurance and technology.

- *Focusing on expense controls and utilization of technology to increase the operating efficiency of our insurance subsidiaries.*

Our insurance subsidiaries maintain stringent expense controls under direct supervision of their senior management. We centralize many processing and administrative activities of our insurance subsidiaries to realize operating synergies and better control expenses. Our insurance subsidiaries utilize technology to automate much of their underwriting and to facilitate agency and policyholder communications on an efficient and cost-effective basis. We operate on a paperless basis. As a result of our focus on expense control, our insurance subsidiaries have reduced their expense ratio from 36.6% in 1999 to 32.0% in 2010. Our insurance subsidiaries have also increased their annual premium per employee, a measure of efficiency that our insurance subsidiaries use to evaluate their operations, from approximately $470,000 in 1999 to approximately $791,000 in 2010.

Our insurance subsidiaries maintain technology comparable to that of the largest of their competitors. "Ease of doing business" is an increasingly important component of an insurer's value to an independent agency. Our insurance subsidiaries provide a fully automated personal lines underwriting and policy issuance system called "WritePro®." WritePro® is a web-based user interface that substantially eases data entry and facilitates the quoting and issuance of policies for the independent agents of our insurance subsidiaries. Our insurance subsidiaries also provide a similar commercial business system called "WriteBiz®." WriteBiz® is a web-based user interface that provides the independent agents of our insurance subsidiaries with an online ability to quote and issue commercial automobile, workers' compensation, business owners and tradesman policies automatically. WriteFarm® is a web-based user interface that provides the independent agents of our insurance subsidiaries with an online ability to quote and issue farm policies automatically. As a result, applications of the independent agents for our insurance subsidiaries can become policies without further re-entry of information. These systems download the policy information to the policy management systems of the independent agents of our insurance subsidiaries.

- *Providing responsive and friendly customer and agent service to enable our insurance subsidiaries to attract new policyholders and retain existing policyholders.*

We believe that excellent policyholder service is important in attracting new policyholders and retaining existing policyholders. Our insurance subsidiaries work closely with their independent agents to provide a consistently responsive level of claims service, underwriting and customer support. Our insurance subsidiaries seek to respond expeditiously and effectively to address customer and independent agent inquiries, including:

- Availability of a state-of-the-art customer call center for claims reporting;
- Availability of a secure website for access to policy information and documents, payment processing and other features;
- Quick replies to information requests and policy submissions; and
- Prompt responses to and processing of claims.

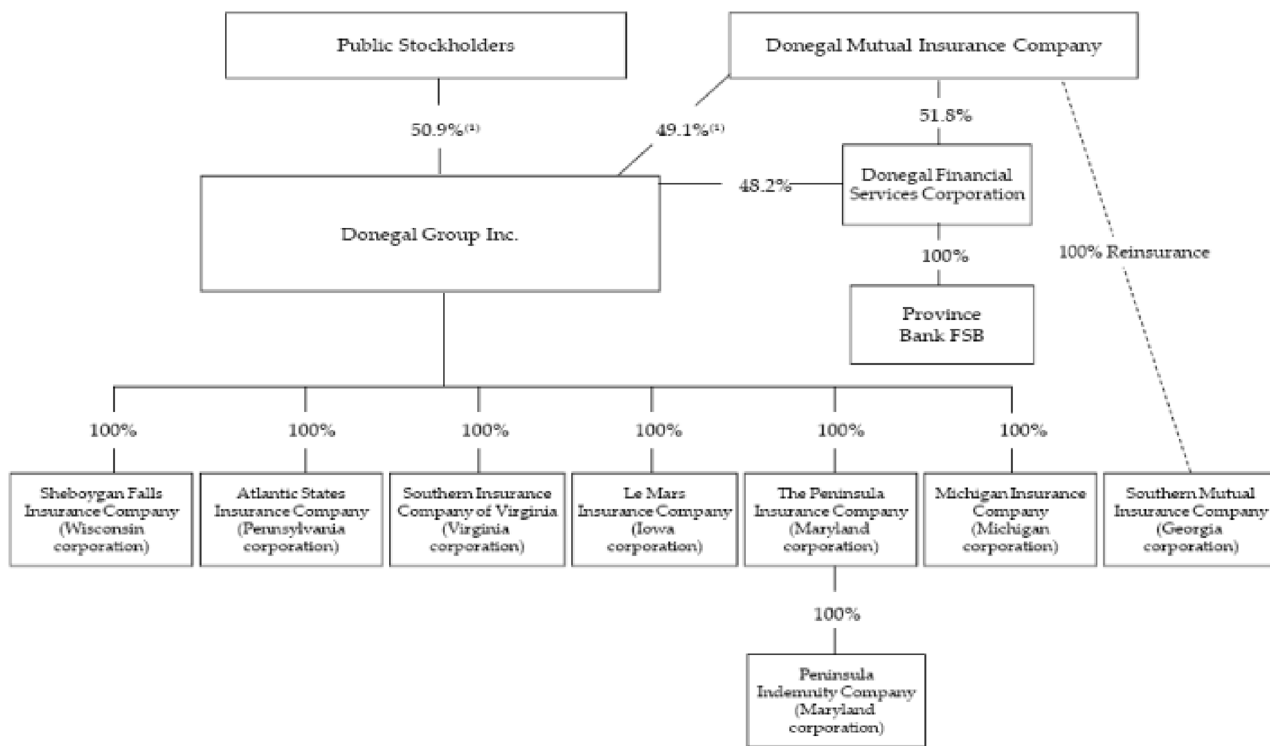
Our insurance subsidiaries periodically conduct policyholder surveys to evaluate the effectiveness of their service to policyholders. The management of our insurance subsidiaries meets frequently with the personnel of the independent insurance agents our insurance subsidiaries appoint to seek service improvement recommendations, react to service issues and better understand local market conditions.

- *Maintaining premium rate adequacy to enhance the underwriting results of our insurance subsidiaries, while maintaining their existing book of business and preserving their ability to write new business.*

Our insurance subsidiaries seek discipline in their pricing by effecting rate increases to maintain or improve their underwriting profitability without unduly affecting their customer retention. In addition to appropriate pricing, our insurance subsidiaries seek to ensure that their premium rates are adequate relative to the amount of risk they insure. Our insurance subsidiaries review loss trends on a periodic basis to identify changes in the frequency and severity of their claims and to assess the adequacy of their rates and underwriting standards. Our insurance subsidiaries also carefully monitor and audit the information they use to price their policies for the purpose of enabling them to receive an adequate level of premiums for their risk. For example, our insurance subsidiaries inspect substantially all commercial lines risks and a substantial number of personal lines property risks before they commit to insure them to determine the adequacy of the insured amount to the value of the insured property, assess property conditions and identify any liability exposures. Our insurance subsidiaries audit the payroll data of their workers' compensation customers to verify that the assumptions used to price a particular policy were accurate. By implementing appropriate rate increases and understanding the risks our insurance subsidiaries agree to insure, they are able to achieve their strategy of achieving consistent underwriting profitability.

Our Organizational Structure

We have seven insurance subsidiaries: Atlantic States Insurance Company, or Atlantic States, Southern Insurance Company of Virginia, or Southern, Le Mars Insurance Company, or Le Mars, The Peninsula Insurance Company and its wholly owned subsidiary, Peninsula Indemnity Company, or collectively, the Peninsula Group, Sheboygan Falls Insurance Company, or Sheboygan, and MICO. In addition, we benefit from Donegal Mutual's 100% quota-share reinsurance agreement with Southern Mutual Insurance Company, or Southern Mutual, and Donegal Mutual's placement of its assumed business from Southern Mutual into the pooling agreement. We also own 48.2% of Donegal Financial Services Corporation, or DFSC, a registered savings and loan holding company that owns Province Bank FSB, or Province Bank, a federal savings bank that began operations in 2000. Donegal Mutual owns the remaining 51.8% of DFSC. Upon DFSC's acquisition of UNFC, on a pro forma basis as of December 31, 2010, Province Bank would have total assets of approximately $571.0 million, loans of approximately $371.0 million and stockholders equity of $67.0 million at December 31, 2010. We believe the combined banks will complement the product offerings of our insurance subsidiaries. The following chart summarizes our organizational structure and includes all of our property and casualty insurance subsidiaries and Southern Mutual:



(1) Because of the different relative voting power of our Class A common stock and our Class B common stock, our public stockholders hold approximately 33.6% of the aggregate voting power of our Class A common stock and Class B common stock and Donegal Mutual holds approximately 66.4% of the aggregate voting power of our Class A common stock and Class B common stock.

In the mid-1980s, Donegal Mutual recognized its need, as a mutual insurance company, to develop additional sources of capital and surplus to remain competitive and to have the capacity to expand its business and assure its long-term viability. Donegal Mutual determined to implement a downstream holding company structure as one of its strategic responses. Accordingly, in 1986, Donegal Mutual formed us as a downstream holding company. Initially, Donegal Mutual owned all of our outstanding capital stock. We in turn formed Atlantic States as our wholly owned subsidiary. We subsequently effected a public offering to provide the surplus necessary to support the business Atlantic States began to receive on October 1, 1986 as its share under a proportional reinsurance agreement, or pooling agreement, between Donegal Mutual and Atlantic States that became effective on that date.

Under this pooling agreement, Donegal Mutual and Atlantic States pool substantially all of their respective premiums, losses and loss expenses. Donegal Mutual then cedes 80% of the pooled business to Atlantic States.

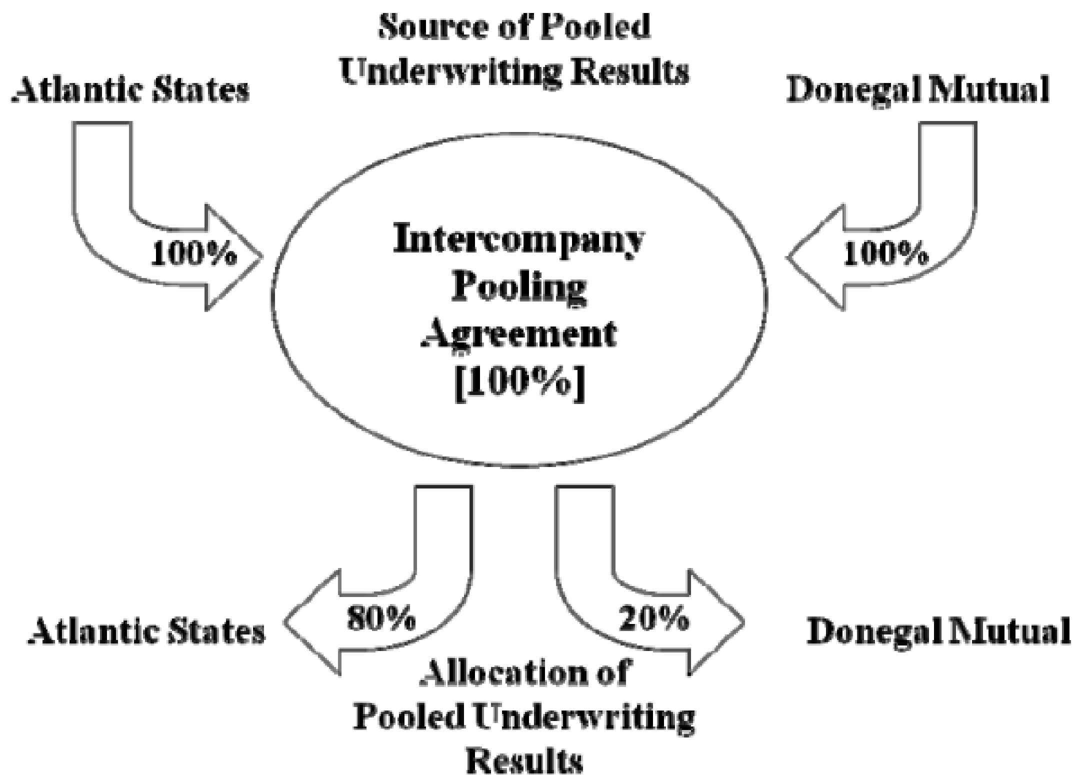
As the capital of Atlantic States has increased, its underwriting capacity has increased proportionately. Therefore, as we originally planned in the mid-1980s, Atlantic States has successfully raised the capital necessary to support the growth of its direct business as well as accept increases in its allocation of business from the underwriting pool, which has increased from an initial allocation of 35% in 1986 to an 80% allocation since March 1, 2008. The size of the underwriting pool has increased substantially. We do not anticipate any further changes in the pooling agreement between Atlantic States and Donegal Mutual in the foreseeable future, including any change in the percentage participation of Atlantic States in the underwriting pool.

Since we established our downstream holding company structure in 1986, Donegal Mutual and our insurance subsidiaries have conducted business together while retaining their separate legal and corporate existences. As such, Donegal Mutual and our insurance subsidiaries share the same business philosophies, the same management, the same employees, the same facilities and we offer the same types of insurance products.

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 Donegal Mutual and our insurance subsidiaries offer are generally complementary, which permits 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 often generally relate to specific risk profiles targeted within similar classes of business, such as preferred tier versus standard tier products, but we and Donegal Mutual do not allocate all of the standard risk gradients to one company. As a result, the underwriting profitability of the business the individual

companies write directly will vary. However, since the underwriting pool homogenizes the risk characteristics of all business Donegal Mutual and Atlantic States write directly, Donegal Mutual and Atlantic States share the underwriting results in proportion to their respective participation in the pool. We receive 80% of the underwriting results of the pool because Atlantic States has an 80% participation in the pool. The business Atlantic States derives from the pool represents the predominant percentage of our total revenues.

The following chart depicts the underwriting pool as effective since March 1, 2008:



Donegal Mutual provides facilities, personnel and other services to us and our insurance subsidiaries. Donegal Mutual allocates certain related expenses to Atlantic States in relation to the relative participation of Donegal Mutual and Atlantic States in the pooling agreement. Our insurance subsidiaries other than Atlantic States reimburse Donegal Mutual for their respective personnel costs and bear their proportionate share of information services costs based on their respective percentage of the total written premiums of the Donegal Insurance Group. Charges for these services totaled $64.0 million, $60.2 million and $56.8 million for 2010, 2009 and 2008, respectively.

We and Donegal Mutual have maintained a coordinating committee since our formation in 1986. The coordinating committee consists of two members of our board of directors, neither of whom is a member of Donegal Mutual’s board of directors, and two members of Donegal Mutual’s board of directors, neither of whom is a member of our board of directors. The purpose of the coordinating committee is to establish and maintain a process for an annual evaluation of the transactions between Donegal Mutual, our insurance

subsidiaries and us. The coordinating committee considers the fairness of each intercompany transaction to Donegal Mutual and its policyholders and to us and our stockholders.

A new agreement or any change to a previously approved agreement must receive coordinating committee approval. The coordinating committee approval process for a new agreement between Donegal Mutual and us or one of our insurance subsidiaries or a change in such an agreement is as follows:

- both of our members on the coordinating committee must determine that the new agreement or the change in an existing agreement is fair and equitable to us and in the best interests of our stockholders;
- both of Donegal Mutual's members on the coordinating committee must determine that the new agreement or the change in an existing agreement is fair and equitable to Donegal Mutual and its policyholders;
- the new agreement or the change in an existing agreement must be approved by our board of directors; and
- the new agreement or the change in an existing agreement must be approved by the Donegal Mutual board of directors.

The coordinating committee also meets annually to review each existing agreement between Donegal Mutual and us or our insurance subsidiaries, including a number of reinsurance agreements between Donegal Mutual and our insurance subsidiaries. The purpose of this annual review is to examine the results of the reinsurance agreements over the past year and over a five-year period and to determine if the results of the existing agreements remain fair and equitable to us and our stockholders and fair and equitable to Donegal Mutual and its policyholders or if Donegal Mutual and we should mutually agree to certain adjustments. In the case of these reinsurance agreements, the adjustments typically relate to the reinsurance premiums, losses and reinstatement premiums. These agreements are ongoing in nature and will continue in effect throughout 2011 in the ordinary course of business.

Our members on the coordinating committee, as of the date of this Form 10-K Annual Report, are Robert S. Bolinger and John J. Lyons. Donegal Mutual's members on the coordinating committee as of such date are Dennis J. Bixenman and John E. Hiestand. Reference is made to our proxy statement for our annual meeting of stockholders on April 21, 2011 for further information about the members of the coordinating committee.

We believe our relationships with Donegal Mutual offer us and our insurance subsidiaries a number of competitive advantages, including the following:

- Facilitating the stable management, consistent underwriting discipline, external growth and long-term profitability of our insurance subsidiaries;
- Creating operational and expense synergies given the combined resources and operating efficiencies of Donegal Mutual, us and our insurance subsidiaries;
- Enhancing our opportunities to expand by acquisition because of the ability of Donegal Mutual to acquire control of other mutual insurance companies and thereafter demutualize them and then sell them to us at a price that is based on a fairness opinion;
- Producing more uniform and stable underwriting results for our insurance subsidiaries that we, over extended periods of time, could achieve without the relationship between Donegal Mutual and our insurance subsidiaries; and
- Providing Atlantic States with a significantly larger underwriting capacity because of the underwriting pool Donegal Mutual and Atlantic States have maintained since 1986.

Acquisitions

The following table highlights our history of acquisitions and affiliations since 1988:

Company Name	State of Domicile	Year Control Acquired(2)	Method of Acquisition/Affiliation
Southern Mutual Insurance Company and now Southern Insurance Company of Virginia	Virginia	1984	Surplus note investment by Donegal Mutual in 1984; demutualization in 1988; acquisition of stock by us in 1988.
Pioneer Mutual Insurance Company and then Pioneer Insurance Company (1)	Ohio	1992	Surplus note investment by Donegal Mutual in 1992; demutualization in 1993; acquisition of stock by us in 1997.
Delaware Mutual Insurance Company and then Delaware Atlantic Insurance Company (1)	Delaware	1993	Surplus note investment by Donegal Mutual in 1993; demutualization in 1994; acquisition of stock by us in

Company Name	State of Domicile	Year Control Acquired(2)	Method of Acquisition/Affiliation
			1995.
Pioneer Mutual Insurance Company and then Pioneer Insurance Company (1)	New York	1995	Surplus note investment by Donegal Mutual in 1995; demutualization in 1998; acquisition of stock by us in 2001.
Southern Heritage Insurance Company (1)	Georgia	1998	Purchase of stock by us in 1998.
Le Mars Mutual Insurance Company of Iowa and now Le Mars Insurance Company	Iowa	2002	Surplus note investment by Donegal Mutual in 2002; demutualization in 2004; acquisition of stock by us in 2004.
Peninsula Insurance Group	Maryland	2004	Purchase of stock by us in 2004.
Sheboygan Falls Mutual Insurance Company and now Sheboygan Falls Insurance Company	Wisconsin	2007	Contribution note investment by Donegal Mutual in 2007; demutualization in 2008; acquisition of stock by us in 2008.
Southern Mutual Insurance Company (2)	Georgia	2009	Surplus note investment by Donegal Mutual and quota-share reinsurance in 2009.
Michigan Insurance Company	Michigan	2010	Purchase of stock by us and surplus note investment by Donegal Mutual in 2010.

(1) To reduce administrative and compliance costs and expenses, these subsidiaries subsequently merged into one of our existing insurance subsidiaries.

(2) Control acquired by Donegal Mutual.

Distribution

Our insurance subsidiaries market their products primarily in the Mid-Atlantic, Midwestern, New England and Southern regions through approximately 2,200 independent insurance agencies. At December 31, 2010, the Donegal Insurance Group actively wrote business in 22 states (Alabama, Delaware, Georgia, Indiana, Iowa, Maine, Maryland, Michigan, Nebraska, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Vermont, Virginia, West Virginia and Wisconsin). We believe the relationships of our insurance subsidiaries with their independent agents are valuable in identifying, obtaining and retaining profitable business. Our insurance subsidiaries maintain a stringent agency selection procedure that emphasizes appointing agencies with proven marketing strategies for the development of profitable business, and our insurance subsidiaries only appoint agencies with a strong underwriting history and potential growth capabilities. Our insurance subsidiaries also regularly evaluate the independent agencies that represent them based on their profitability and performance in relation to the objectives of our insurance subsidiaries. Our insurance subsidiaries seek to be among the top three insurers within each of their agencies for the lines of business they write.

The following table sets forth the percentage of direct premiums our insurance subsidiaries write, including 80% of the direct premiums Donegal Mutual and Atlantic States write, in each of the states where they conducted a significant portion of their business in 2010:

State	%
Pennsylvania	45.1%
Maryland	11.4
Virginia	10.3
Georgia	6.9
Delaware	6.3
Ohio	3.7
Iowa	3.3
Wisconsin	2.8
Michigan	1.9*
Tennessee	1.7
Nebraska	1.7
South Dakota	1.4
Other	3.5
Total	100.0%

* Michigan represents the direct premiums MICO wrote following our acquisition of it on December 1, 2010.

We believe our insurance subsidiaries employ a number of policies and procedures that enable them to attract, retain and motivate their independent agents. The consistency, competitiveness and stability of the product offerings of our insurance subsidiaries assist them in competing effectively for independent agents with other insurers whose product offerings may fluctuate based upon industry conditions. Our insurance subsidiaries have a competitive profit sharing plan for their independent agents consistent with applicable state laws and regulations, under which the independent agents may earn additional commissions based upon the volume of premiums produced and the profitability of the business our insurance subsidiaries receive from that agency. Our insurance subsidiaries provide their independent agents ongoing support that better enables the agents to attract and retain customers, including:

- fully automated underwriting and policy issuance systems for both personal and commercial lines;
- training programs;
- marketing support;
- the availability of a service center that provides comprehensive service for our personal lines policyholders; and
- field visitations from marketing and underwriting personnel and senior management of our insurance subsidiaries.

Finally, our insurance subsidiaries encourage their independent agents to focus on "account selling," or serving all of a particular insured's property and casualty insurance needs, which our insurance subsidiaries believe generally results in more favorable loss experience than covering a single risk for an individual insured.

Products

The personal lines our insurance subsidiaries write consist primarily of private passenger automobile and homeowners insurance. The commercial lines our insurance subsidiaries write consist primarily of commercial automobile, commercial multi-peril and workers' compensation insurance. We describe these lines of insurance in greater detail below:

Personal

- Private passenger automobile — policies that provide protection against liability for bodily injury and property damage arising from automobile accidents, and protection against loss from damage to automobiles owned by the insured.

- Homeowners — policies that provide coverage for damage to residences and their contents from a broad range of perils, including fire, lightning, windstorm and theft. These policies also cover liability of the insured arising from injury to other persons or their property while on the insured's property and under other specified conditions.

Commercial

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

The following table sets forth the net premiums written of our insurance subsidiaries by line of insurance for the periods indicated:

	Year Ended December 31,					
(dollars in thousands)	2008		2009		2010	
	Amount	%	Amount	%	Amount	%
Net Premiums Written:						
Personal lines:						
Automobile	$154,091	42.2%	$161,932	44.6%	$171,497	43.8%
Homeowners	72,195	19.8	77,420	21.3	83,415	21.3
Other	13,254	3.6	13,135	3.6	13,135	3.4
Total personal lines	$239,540	65.6	$252,487	69.5	$268,047	68.5
Commercial lines:						
Automobile	$ 35,959	9.9	$ 34,054	9.4	$ 37,094	9.5
Workers' compensation	36,459	10.0	28,921	8.0	34,920	8.9
Commercial multi-peril	49,004	13.4	44,000	12.1	47,411	12.1
Other	3,979	1.1	3,767	1.0	4,050	1.0
Total commercial lines	$125,401	34.4	$110,742	30.5	123,475	31.5
Total business	$364,941	100.0%	$363,229	100.0%	$391,522	100.0%

Underwriting

The personal lines and commercial lines underwriting departments of our insurance subsidiaries evaluate and select those risks that they believe will enable our insurance subsidiaries to achieve an underwriting profit. The underwriting departments have

significant interaction with the independent agents regarding the underwriting philosophy and the underwriting guidelines of our insurance subsidiaries. Our underwriting personnel also assist the research and development department in the development of quality products at competitive prices to promote growth and profitability.

In order to achieve underwriting profitability on a consistent basis, our insurance subsidiaries:

- assess and select quality standard and preferred risks;
- adhere to disciplined underwriting and reunderwriting guidelines;
- inspect substantially all commercial lines risks and a substantial number of personal lines property risks; and
- utilize various types of risk management and loss control services.

Our insurance subsidiaries also review their existing policies and accounts to determine whether those risks continue to meet their underwriting guidelines. If a given policy or account no longer meets those underwriting guidelines, our insurance subsidiaries will take appropriate action regarding that policy or account, including raising premium rates or non-renewing the policy to the extent applicable law permits.

As part of the effort of our insurance subsidiaries to maintain acceptable underwriting results, they conduct annual reviews of agencies that have failed to meet their underwriting profitability criteria. The review process includes an analysis of the underwriting and reunderwriting practices of the agency, the completeness and accuracy of the applications the agency has submitted, the adequacy of the training of the agency's staff and the agency's record of adherence to the underwriting guidelines and service standards of our insurance subsidiaries. Based on the results of this review process, the marketing and underwriting personnel of our insurance subsidiaries develop, together with the agency, a plan to improve its underwriting profitability. Our insurance subsidiaries monitor the agency's compliance with the plan, and take other measures as required in the judgment of our insurance subsidiaries, including the termination of agencies that are unable to achieve acceptable underwriting profitability to the extent applicable law permits.

Claims

The management of claims is a critical component of the philosophy of our insurance subsidiaries to achieve underwriting profitability on a consistent basis and is fundamental to the successful operations of our insurance subsidiaries and their dedication to excellent service.

The claims departments of our insurance subsidiaries rigorously manage claims to assure that they settle legitimate claims quickly and fairly and that they identify questionable claims for defense. In the majority of cases, the personnel of our insurance subsidiaries, who have significant experience in the property and casualty insurance industry and know the service philosophy of our insurance subsidiaries, adjust claims. Our insurance subsidiaries provide various means of claims reporting on 24-hours a day, seven-day a week basis, including toll-free numbers and electronic reporting through our website. Our insurance subsidiaries strive to respond to notifications of claims promptly, generally within the day reported. Our insurance subsidiaries believe that, by responding promptly to claims, they provide quality customer service and minimize the ultimate cost of the claims. Our insurance subsidiaries engage independent adjusters as needed to handle claims in areas in which the volume of claims is not sufficient to justify our hiring of internal claims adjusters. Our insurance subsidiaries also employ private adjusters and investigators, structural experts and various outside legal counsel to supplement our in-house staff and to assist in the investigation of claims. Our insurance subsidiaries have a special investigative unit staffed by former law enforcement officers that attempts to identify and prevent fraud and abuse and to control questionable claims.

The management of the claims departments of our insurance subsidiaries develops and implements policies and procedures for the establishment of adequate claim reserves. Our insurance subsidiaries employ an actuarial staff that regularly reviews their reserves for incurred but not reported claims. The management and staff of the claims departments resolve policy coverage issues, manage and process reinsurance recoveries and handle salvage and subrogation matters. The litigation and personal injury sections of our insurance subsidiaries manage all claims litigation, and branch office claims above certain thresholds require home office review and settlement authorization. Our insurance subsidiaries provide their claims adjusters reserving and settlement authority based upon their experience and demonstrated abilities. Larger or more complicated claims require consultation and approval of senior department management.

The field office staff of our insurance subsidiaries receives support from home office technical, litigation, material damage, subrogation and medical audit personnel.

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 policyholder claims based on facts and circumstances then known. 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 and 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 of liability. We reflect any adjustments to our insurance subsidiaries' liabilities for losses and loss expenses in our operating results in the period in which our insurance subsidiaries record the changes in 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 their 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 closely monitor their liabilities 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.

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 as to our insurance subsidiaries' internal operations. For example, our insurance subsidiaries have experienced a decrease in claims frequency on workers' compensation claims during the past several years while claims severity has gradually increased. These trend changes give rise to greater uncertainty as to the pattern of future loss settlements on workers' compensation claims. Related uncertainties regarding future trends include the cost of medical technologies and procedures and changes in the utilization of medical procedures. Assumptions related to our insurance subsidiaries' external environment include the absence of significant changes in tort law and legal decisions 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 the 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 attempt to make appropriate adjustments for such changes in their reserves. Accordingly, our insurance subsidiaries' ultimate liability for unpaid losses and loss expenses will likely differ from the amount recorded at December 31, 2010. 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 $2.2 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, since 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 estimates have exceeded their actual liabilities. Changes in our insurance subsidiaries' estimate of their liability for losses and loss expenses generally reflect actual payments and the evaluation of information received since the prior reporting date. Our insurance subsidiaries recognized a (decrease) increase in their liability for losses and loss expenses of prior years of $(2.9) million, $9.8 million and $2.7 million in 2010, 2009 and 2008, respectively. Our insurance subsidiaries made no significant changes in their reserving philosophy, key reserving assumptions or claims management personnel, and there have been no significant offsetting changes in estimates that increased or decreased their loss and loss expense reserves in those years. The majority of the 2010 loss development related to decreases in the liability for losses and loss expenses of prior years for Atlantic States and the Peninsula Group. The 2010 development represented 1.6% of our December 31, 2009 net carried reserves and resulted primarily from less-than-expected severity in the private passenger automobile liability and homeowners lines of business in accident years prior to 2009. The 2009 development represented 6.0% of our December 31, 2008 net carried reserves and resulted primarily from higher-than-expected severity in the private passenger automobile liability, homeowners and workers' compensation lines of business in accident year 2008. The 2008 development represented 1.2% of our December 31, 2007 net carried reserves and resulted primarily from higher-than-expected severity in the private passenger automobile liability line of business in accident year 2007.

Excluding the impact of isolated catastrophic weather events, our insurance subsidiaries have noted stable amounts in the number of claims incurred and slight downward trends in 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 as the property and casualty insurance industry has experienced increased litigation trends and economic conditions that have extended the estimated length of disabilities and contributed to increased medical loss costs and a general slowing of settlement rates in litigated claims. Our insurance subsidiaries could be required 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.

Differences between liabilities reported in our financial statements prepared on a GAAP basis and our insurance subsidiaries' financial statements prepared on a statutory accounting basis, or SAP, result from anticipating salvage and subrogation recoveries for GAAP but not for SAP. These differences amounted to $8.7 million, $9.2 million and $10.0 million at December 31, 2008, 2009 and 2010, respectively.

The following table sets forth a reconciliation of the beginning and ending GAAP net liability of our insurance subsidiaries for unpaid losses and loss expenses for the periods indicated:

(in thousands)	Year Ended December 31, 2008	2009	2010
Gross liability for unpaid losses and loss expenses at beginning of year	$226,432	$239,809	$263,599
Less reinsurance recoverable	76,280	78,502	83,337
Net liability for unpaid losses and loss expenses at beginning of year	150,152	161,307	$180,262
Acquisition of Sheboygan	2,173	—	—
Acquisition of Michigan	—	—	26,960
Provision for net losses and loss expenses for claims incurred in the current year	221,617	241,012	277,194
Change in provision for estimated net losses and loss expenses for claims incurred in prior years	2,684	9,823	(2,885)
Total incurred	224,301	250,835	274,309
Net losses and loss payments for claims incurred during:			
The current year	143,369	152,293	179,069
Prior years	71,950	79,587	84,565
Total paid	215,319	231,880	263,634
Net liability for unpaid losses and loss expenses at end of year	161,307	180,262	217,897
Plus reinsurance recoverable	78,502	83,337	165,422
Gross liability for unpaid losses and loss expenses at end of year	$239,809	$263,599	$383,319

The following table sets forth the development of the liability for net unpaid losses and loss expenses of our insurance subsidiaries from 2000 to 2010. Loss data in the table includes business ceded to Atlantic States from the underwriting pool.

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

The “Net liability reestimated as of” portion of the table shows the reestimated amount of the previously recorded liability based on experience for each succeeding year. The estimate increases or decreases as payments are made and more information becomes known about the severity of the remaining unpaid claims. For example, the 2005 liability has developed a redundancy after five years because we expect the reestimated net losses and loss expenses to be $22.9 million less than the estimated liability we initially established in 2005 of $173.0 million.

The “Cumulative (excess) deficiency” shows the cumulative excess or deficiency at December 31, 2010 of the liability estimate shown on the top line of the corresponding column. An excess in liability means that the liability established in prior years exceeded actual net losses and loss expenses or our insurance subsidiaries reevaluated the liability at less than the original estimate. A deficiency in liability means that the liability established in prior years was less than actual net losses and loss expenses or our insurance subsidiaries reevaluated the liability at more than the original estimate.

The “Cumulative amount of liability paid through” portion of the table shows the cumulative net losses and loss expense payments made in succeeding years for net losses incurred prior to the balance sheet date. For example, the 2005 column indicates that as of December 31, 2010 payments equal to $139.9 million of the currently reestimated ultimate liability for net losses and loss expenses of $150.1 million had been made.

Amounts shown in the 2004 column of the table include information for Le Mars and the Peninsula Group for all accident years prior to 2004. Amounts shown in the 2008 column of the table include information for Sheboygan for all accident years prior to 2008. Amounts shown in the 2010 column of the table include information for MICO for the month of December 2010.

(in thousands)	Year Ended December 31, 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Net liability at end of year for unpaid losses and loss expenses	$ 102,709	$ 114,544	$ 131,108	$ 138,896	$ 171,431	$ 173,009	$ 163,312	$ 150,152	$ 161,307	$ 180,262	$ 217,896
Net liability reestimated as of:											
One year later	110,744	121,378	130,658	136,434	162,049	159,393	153,299	152,836	171,130	177,377	
Two years later	112,140	120,548	128,562	130,030	152,292	153,894	150,934	154,435	167,446		
Three years later	110,673	118,263	124,707	123,399	148,612	151,792	150,078	152,315			
Four years later	108,766	114,885	119,817	120,917	147,280	150,183	148,745				
Five years later	107,561	113,070	118,445	119,968	145,874	150,087					
Six years later	106,950	112,614	118,605	119,731	146,101						
Seven years later	106,298	112,921	118,905	120,425							
Eight years later	106,835	113,350	119,635								
Nine years later	107,474	113,862									
Ten years later	107,882										
Cumulative (excess) deficiency	5,173	(682)	(11,473)	(18,471)	(25,330)	(22,922)	(14,567)	2,163	6,139	(2,885)	
Cumulative amount of liability paid through:											
One year later	$ 43,053	$ 45,048	$ 46,268	$ 51,965	$ 67,229	$ 71,718	72,499	71,950	79,592	84,565	
Two years later	67,689	70,077	74,693	81,183	102,658	107,599	104,890	105,576	116,035		
Three years later	82,268	87,198	93,288	99,910	123,236	125,926	121,711	124,659			
Four years later	92,127	97,450	105,143	109,964	133,844	133,805	132,698				
Five years later	98,007	104,551	111,523	113,684	136,377	139,935					
Six years later	101,664	108,136	114,145	114,499	139,847						
Seven years later	103,767	110,193	114,641	116,727							
Eight years later	105,046	110,447	116,663								
Nine years later	104,990	111,797									
Ten years later	105,865										

	Year Ended December 31 2002	2003	2004	2005	2006	2007	2008	2009	2010
					(in thousands)				
Gross liability at end of year	$210,692	$217,914	$267,190	$265,730	$259,022	$226,432	$239,809	$263,599	$383,317
Reinsurance recoverable	79,584	79,018	95,759	92,721	95,710	76,280	78,502	83,337	165,421
Net liability at end of year	131,108	138,896	171,431	173,009	163,312	150,152	161,307	180,262	217,896
Gross reestimated liability	209,355	210,005	239,839	240,998	239,810	232,995	253,221	264,836	
Reestimated recoverable	89,720	89,580	93,738	90,911	91,065	80,680	85,775	87,459	
Net reestimated liability	119,635	120,425	146,101	150,087	148,745	152,315	167,446	177,377	
Gross cumulative deficiency (excess)	(1,337)	(7,909)	(27,351)	(24,732)	(19,212)	6,563	13,412	1,237	

Technology

Donegal Mutual owns the majority of the technology systems our insurance subsidiaries use. The technology systems consist primarily of an integrated central processing computer, a series of server-based computer networks and various communications systems that allow the home office of our insurance subsidiaries and their branch offices to utilize the same systems for the processing of business. Donegal Mutual maintains backup facilities and systems at the office of one of our insurance subsidiaries and through a contract with a leading provider of computer disaster recovery sites and tests these backup facilities and systems on a regular basis. Our insurance subsidiaries bear their proportionate share of information services expenses based on their respective percentage of the total net written premiums of the Donegal Insurance Group.

The business strategy of our insurance subsidiaries depends on the use, development and implementation of integrated technology systems. These systems enable our insurance subsidiaries to provide a high level of service to agents and policyholders by processing business in a timely and efficient manner, communicating and sharing data with agents, providing a variety of methods for the payment of premiums and allowing for the accumulation and analysis of information for the management of our insurance subsidiaries.

We believe the availability and use of these technology systems has resulted in improved service to agents and policyholders, increased efficiencies in processing the business of our insurance subsidiaries and lower operating costs. Four key components of these integrated technology systems are the agency interface system, the WritePro®, WriteBiz® and WriteFarm® systems, a claims processing system and an imaging system. The agency interface system provides our insurance subsidiaries with a high level of data sharing both to and from agents' systems and also provides agents with an integrated means of processing new business. The WritePro®, WriteBiz® and WriteFarm® systems are fully automated underwriting and policy issuance systems that provide agents with the ability to generate underwritten quotes and automatically issue policies that meet the underwriting guidelines of our insurance subsidiaries with limited or no intervention by their personnel. The claims processing system allows our insurance subsidiaries to process claims efficiently and in an automated environment. The imaging system eliminates the need to handle paper files, while providing greater access to the same information by a variety of personnel.

Third-Party Reinsurance

Our insurance subsidiaries and Donegal Mutual purchase certain third-party reinsurance on a combined basis. Le Mars, the Peninsula Group, Sheboygan and MICO also have separate reinsurance programs that provide certain coverage that is commensurate with their relative size and exposures. Our insurance subsidiaries use several different reinsurers, all of which, consistent with the requirements of our insurance subsidiaries and Donegal

Mutual, have 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 external reinsurance our insurance subsidiaries and Donegal Mutual purchase includes:

- “excess of loss reinsurance,” under which their losses are automatically reinsured, through a series of contracts, over a set retention (generally $750,000 for 2010 and 2011); and
- “catastrophic reinsurance,” under which they recover, through a series of contracts, 100% of an accumulation of many losses resulting from a single event, including natural disasters, over a set retention (generally $3.0 million for 2010 and $5.0 million for 2011).

The amount of coverage each of these types of reinsurance provides depends upon the amount, nature, size and location of the risk being reinsured.

In 2010, the principal third-party reinsurance agreement that our insurance subsidiaries maintained was a multi-line per risk excess of loss reinsurance agreement that provided 100% coverage up to $1.0 million for both property and liability losses over the set retention.

For property insurance, our insurance subsidiaries also have excess of loss treaties that provide for additional coverage over the multi-line treaty of $4.0 million per loss ($2.5 million for 2010). For liability insurance, our insurance subsidiaries have excess of loss treaties that provide for additional coverage over the multi-line treaty of $39.0 million per occurrence. For workers’ compensation insurance, our insurance subsidiaries have excess of loss treaties that provide for additional coverage over the multi-line treaty of $9.0 million on any one life.

Our insurance subsidiaries and Donegal Mutual have property catastrophe coverage through a series of layered treaties up to aggregate losses of $95.0 million ($97.0 million for 2010) for any single event over the set retention.

Our insurance subsidiaries and Donegal Mutual also purchase facultative reinsurance to cover exposures from property and casualty losses that exceed the limits provided by their respective treaty reinsurance.

Competition

The property and casualty insurance industry is highly competitive on the basis of both price and service. Numerous companies compete for business in the geographic areas where our insurance subsidiaries operate. Many of these other insurance companies have

substantially larger and have greater financial resources than those of our insurance subsidiaries. In addition, because our insurance subsidiaries and Donegal Mutual market their respective insurance products exclusively through independent insurance agencies, most of which represent more than one insurance company, our insurance subsidiaries face competition within agencies as well as competition to retain qualified independent agents.

Investments

Return on invested assets is an important element of the financial results of our insurance subsidiaries. The investment strategy of our insurance subsidiaries is to generate an appropriate amount of after-tax income on invested assets while minimizing credit risk through investments in high-quality securities. As a result, our insurance subsidiaries seek to invest a high percentage of their assets in diversified, highly rated and marketable fixed-maturity instruments. The fixed-maturity portfolios of our insurance subsidiaries consist of both taxable and tax-exempt securities. Our insurance subsidiaries maintain a portion of their portfolios in short-term securities, such as investments in commercial paper, to provide liquidity for the payment of claims and operation of their businesses. Our insurance subsidiaries maintain a negligible percentage (less than 1.5% at December 31, 2010) of their portfolios in equity securities.

At December 31, 2010, 99.0% of all debt securities our insurance subsidiaries held had an investment-grade rating. The investment portfolios of our insurance subsidiaries did not contain any mortgage loans or any non-performing assets at December 31, 2010.

The following table shows the composition of the debt securities (at carrying value) in the investment portfolios of our insurance subsidiaries, excluding short-term investments, by rating as of December 31, 2010:

(dollars in thousands)	December 31, 2010	
Rating(1)	Amount	Percent
U.S. Treasury and U.S. agency securities(2)	$ 148,789	22.3%
Aaa or AAA	78,088	11.7
Aa or AA	360,503	53.9
A	74,433	11.1
BBB	6,059	1.0
BB	250	—
B	491	—
Total	$ 668,613	100.0%

(1) Ratings assigned by Moody’s Investors Services, Inc. or Standard & Poor’s Corporation.

(2) Includes residential mortgage-backed securities of $90.4 million.

Our insurance subsidiaries invest in both taxable and tax-exempt securities as part of their strategy to maximize after-tax income. This strategy considers, among other factors, the alternative minimum tax. Tax-exempt securities made up approximately 75.8%, 71.0% and 67.2% of the debt securities in the combined investment portfolios of our insurance subsidiaries at December 31, 2008, 2009 and 2010, respectively.

The following table shows the classification of our investments and the investments of our insurance subsidiaries (at carrying value) at December 31, 2008, 2009 and 2010:

	December 31,					
	2008		2009		2010	
(dollars in thousands)	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Fixed maturities(1):						
Held to maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 8,517	1.4%	$ 2,000	0.3%	$ 1,000	0.1%
Obligations of states and political subdivisions	76,451	12.1	61,736	9.3	59,852	8.2
Corporate securities	8,341	1.3	6,243	0.9	3,247	0.5
Residential mortgage-backed securities	6,569	1.0	3,828	0.6	667	0.1
Total held to maturity	99,878	15.8	73,807	11.1	64,766	8.9
Available for sale:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	6,630	1.0	40,630	6.1	57,316	7.9
Obligations of states and political subdivisions	337,003	53.3	358,367	53.7	389,629	53.5
Corporate securities	23,936	3.8	27,766	4.2	67,095	9.2
Residential mortgage-backed securities	78,247	12.4	90,941	13.6	89,807	12.3
Total available for sale	445,816	70.5	517,704	77.6	603,847	82.9
Total fixed maturities	545,694	86.3	591,511	88.7	668,613	91.8
Equity securities(2)	5,895	0.9	9,915	1.5	10,161	1.4
Investments in affiliates(3)	8,594	1.4	9,309	1.4	8,992	1.2
Short-term investments(4)	71,953	11.4	56,100	8.4	40,776	5.6
Total investments	$ 632,136	100.0%	$ 666,835	100.0%	$ 728,542	100.0%

(1) See notes 1 and 5 to our consolidated financial statements that we incorporate by reference in this Form 10-K Report. We value fixed maturities classified as held to maturity at amortized cost; we value those fixed maturities classified as available for sale at fair value. Total fair value of fixed maturities classified as held to maturity was $101.5 million at December 31, 2008, $77.0 million at December 31, 2009 and $67.8 million at December 31, 2010. The amortized cost of fixed maturities classified as available for sale was $449.0 million at December 31, 2008, $503.7 million at December 31, 2009 and $601.3 million at December 31, 2010.

(2) We value equity securities at fair value. Total cost of equity securities was $2.9 million at December 31, 2008, $3.8 million at December 31, 2009 and $2.5 million at December 31, 2010.

(3) We value investments in affiliates at cost, adjusted for our share of earnings and losses of our affiliates as well as changes in equity of our affiliates due to unrealized gains and losses.

(4) We value short-term investments at cost, which approximates fair value.

The following table sets forth the maturities (at carrying value) in fixed maturity and short-term investment portfolios of our insurance subsidiaries at December 31, 2008, December 31, 2009 and December 31, 2010:

	December 31,					
	2008		2009		2010	
(dollars in thousands)	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Due in(1):						
One year or less	$ 14,008	2.6%	$ 16,410	2.8%	$ 12,968	1.9%
Over one year through three years	33,772	6.2	35,007	5.9	54,028	8.1
Over three years through five years	44,579	8.2	46,392	7.8	66,720	10.0
Over five years through ten years	174,130	31.9	166,352	28.1	201,523	30.1
Over ten years through fifteen years	89,889	16.5	121,308	20.5	147,512	22.1
Over fifteen years	104,500	19.1	111,273	18.9	95,389	14.3
Residential mortgage-backed securities	84,816	15.5	94,769	16.0	90,473	13.5
	$ 545,694	100.0%	$ 591,511	100.0%	$ 668,613	100.0%

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

As shown above, our insurance subsidiaries held investments in residential mortgage-backed securities having a carrying value of $90.5 million at December 31, 2010. The mortgage-backed securities consist primarily of investments in governmental agency balloon pools with stated maturities between one and 24 years. The stated maturities of these investments limit the exposure of our insurance subsidiaries to extension risk should interest rates rise and prepayments decline. Our insurance subsidiaries perform an analysis of the underlying loans when evaluating a residential mortgage-backed security for purchase, and they select those securities that they believe will provide a return that properly reflects the prepayment risk associated with the underlying loans.

The following table sets forth the investment results of our insurance subsidiaries for the years ended December 31, 2008, 2009 and 2010:

(dollars in thousands)	Year Ended December 31, 2008	2009	2010
Invested assets(1)	$619,003	$649,486	$697,689
Investment income(2)	22,756	20,631	19,950
Average yield	3.7%	3.2%	2.9%
Average tax-equivalent yield	4.9	4.4	4.0

(1) Average of the aggregate invested amounts at the beginning and end of the period.

(2) Investment income is net of investment expenses and does not include realized investment gains or losses or provision for income taxes.

A.M. Best Rating

Donegal Mutual and our insurance subsidiaries have an A.M. Best rating of A (Excellent), based upon their respective current financial condition and historical statutory results of operations. We believe that the A.M. Best rating of Donegal Mutual and our insurance subsidiaries is an important factor in their marketing of their products to their agents and customers. A.M. Best's ratings are industry ratings based on a comparative analysis of the financial condition and operating performance of insurance companies. A.M. Best's classifications are A++ and A+ (Superior), A and A- (Excellent), B++ and B+ (Very Good), B and B- (Good), C++ and C+ (Fair), C and C- (Marginal), D (Below Minimum Standards) and E and F (Liquidation). A.M. Best bases its ratings upon factors relevant to the payment of claims of policyholders and are not directed toward the protection of investors in insurance companies. According to A.M. Best, the "Excellent" rating that the Donegal Insurance Group maintains is assigned to those companies that, in A.M. Best's opinion, have an excellent ability to meet their ongoing obligations to policyholders.

Regulation

The supervision and regulation of insurance companies consists primarily of the laws and regulations of the various states in which the insurance companies transact business, with the primary regulatory authority being the insurance regulatory authorities in the state of domicile of the insurance company. Such supervision and regulation relate to numerous aspects of an insurance company's business and financial condition. The primary purpose of such supervision and regulation is the protection of policyholders. The authority of the state insurance departments includes the establishment of standards of solvency that insurers must meet and maintain, the licensing of insurers and insurance agents to do business, the nature of, and limitations on, investments, premium rates for property and casualty insurance, the provisions that insurers must make for current losses and future liabilities, the deposit of securities for the benefit of policyholders, the approval of policy forms, notice

requirements for the cancellation of policies and the approval of certain changes in control. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to the financial condition of insurance companies.

In addition to state-imposed insurance laws and regulations, the National Association of Insurance Commissioners, or the NAIC, has established a risk-based capital system for assessing the adequacy of statutory capital and surplus that augments the states' current fixed dollar minimum capital requirements for insurance companies. At December 31, 2010, our insurance subsidiaries and Donegal Mutual each exceeded the minimum levels of statutory capital the risk-based capital rules require by a substantial margin.

Generally, every state has guaranty fund laws under which insurers licensed to do business in that state can be assessed on the basis of premiums written by the insurer in that state in order to fund policyholder liabilities of insolvent insurance companies. Under these laws in general, an insurer is subject to assessment, depending upon its market share of a given line of business, to assist in the payment of policyholder claims against insolvent insurers. Our insurance subsidiaries and Donegal Mutual have made accruals for their portion of assessments related to such insolvencies based upon the most current information furnished by the guaranty associations.

We are part of an insurance holding company system of which Donegal Mutual is the ultimate controlling person. All of the states in which our insurance companies and Donegal Mutual maintain a domicile have legislation that regulates insurance holding company systems. Each insurance company in the insurance holding company system must register with the insurance supervisory agency of its state of domicile and furnish information concerning the operations of companies within the insurance holding company system that may materially affect the operations, management or financial condition of the insurers within the system. Pursuant to these laws, the respective insurance departments in which our subsidiaries and Donegal Mutual maintain a domicile may examine our insurance subsidiaries or Donegal Mutual at any time, require disclosure of material transactions by the holding company with another member of the insurance holding company system and require prior notice or prior approval of certain transactions, such as "extraordinary dividends" from the insurance subsidiaries to the holding company. We have insurance subsidiaries domiciled in Pennsylvania, Maryland, Virginia, Iowa, Wisconsin and Michigan.

The Pennsylvania Insurance Holding Companies Act, which generally applies to Donegal Mutual, us and our insurance subsidiaries, requires that all transactions within an insurance holding company system to which an insurer is a party must be fair and reasonable and that any charges or fees for services performed must be reasonable. Any management agreement, service agreement, cost sharing arrangement and reinsurance agreement must be filed with the Pennsylvania Insurance Department, or the Department, and is subject to Department review. We have filed the pooling agreement between Donegal Mutual and

Atlantic States that established the underwriting pool and the reinsurance agreements between Donegal Mutual and our insurance subsidiaries with the Department.

Approval of the applicable insurance commissioner is also required prior to consummation of transactions affecting the control of an insurer. In virtually all states, including Pennsylvania, Iowa, Maryland, Virginia, Wisconsin and Michigan, where our insurance subsidiaries have states of domicile, the acquisition of 10% or more of the outstanding capital stock of an insurer or its holding company or the intent to acquire such an interest creates a rebuttable presumption of a change in control. Pursuant to an order issued in April 2003, the Department approved Donegal Mutual's ownership of up to 70% of our outstanding Class A common stock and up to 100% of our outstanding Class B common stock.

Our insurance subsidiaries have the legal obligation under state insurance laws to participate in involuntary insurance programs for automobile insurance, as well as other property and casualty insurance lines, in the states in which they conduct business. These programs include joint underwriting associations, assigned risk plans, fair access to insurance requirements plans, reinsurance facilities, windstorm plans and tornado plans. Legislation establishing these programs requires all companies that write lines covered by these programs to provide coverage, either directly or through reinsurance, for insureds who are unable to obtain insurance in the voluntary market. The legislation creating these programs usually allocates a pro rata portion of risks attributable to such insureds to each company on the basis of the direct premiums it has written in that state or the number of automobiles it insures in that state. Generally, state law requires participation in these programs as a condition to obtaining a certificate of authority. Our loss ratio on insurance we write under these involuntary programs has traditionally been significantly greater than our loss ratio on insurance we voluntarily write in those states.

The insurance laws of the respective states of domicile of our insurance subsidiaries restrict the amount of dividends or other distributions our insurance subsidiaries may pay to us without the prior approval of the insurance regulatory authorities of that state. Generally, the maximum amount that an insurance subsidiary may pay to us during any year after notice to, but without prior approval of, the insurance commissioners of these states is limited to a stated percentage of that subsidiary's statutory capital and surplus as of December 31 of the preceding fiscal year or the net income of that subsidiary for its preceding fiscal year. As of December 31, 2010, the amount of dividends our insurance subsidiaries could pay us during 2011, without the prior approval of their domiciliary insurance commissioners, was:

Name of Insurance Subsidiary	Ordinary Dividend Amount
Atlantic States	$ 19.2 million
Southern	None
Le Mars	2.6 million
Peninsula Group	4.2 million
Sheboygan	None
MICO	3.7 million
Total	$ 29.7 million

Donegal Mutual

Donegal Mutual organized as a mutual fire insurance company in Pennsylvania in 1889. At December 31, 2010, Donegal Mutual had admitted assets of $338.4 million and policyholders' surplus of $178.8 million. At December 31, 2010, Donegal Mutual had total liabilities of $159.7 million, including debt of $13.0 million, reserves for net losses and loss expenses of $41.8 million and unearned premiums of $31.3 million. Donegal Mutual's investment portfolio of $217.6 million at December 31, 2010 consisted primarily of investment-grade bonds of $15.2 million and its investment in our common stock. At December 31, 2010, Donegal Mutual owned 8,355,184 shares, or approximately 42% of our Class A common stock, which Donegal Mutual carried on its books at $112.0 million, and 4,198,339 shares, or approximately 75%, of our Class B common stock which Donegal Mutual carried on its books at $56.3 million. We present Donegal Mutual's financial information in accordance with SAP as required by the NAIC Accounting Practices and Procedures Manual. Donegal Mutual does not, nor is it required to, prepare financial statements in accordance with GAAP.

Donegal Financial Services Corporation

Because Donegal Mutual and we together own all of the outstanding capital stock of DFSC, the OTS, regulates Donegal Mutual and us as unitary savings and loan holding companies. As a result, Donegal Mutual and we are subject to regulation by the OTS under the holding company provisions of the federal Home Owners' Loan Act. Province Bank, as a federally chartered and insured stock savings association, is subject to regulation and supervision by the OTS and by the Federal Deposit Insurance Corporation. The primary purpose of the federal statutory and regulatory supervision of financial institutions is to protect depositors, the financial institutions and the financial system as a whole rather than the shareholders of financial institutions or their holding companies.

Sections 23A and 23B of the Federal Reserve Act impart quantitative and qualitative restrictions on transactions between a savings association and its "affiliates." Affiliates of a savings association include, among other entities, the savings association's holding company and non-banking companies under common control with the savings association such as

Donegal Mutual and us. These restrictions on transactions with affiliates apply to transactions between DFSC and Province Bank, on the one hand, Donegal Mutual and us and our insurance subsidiaries, on the other hand. These restrictions also apply to transactions among DFSC, Province Bank and Donegal Mutual.

Cautionary Statement Regarding Forward-Looking Statements

This Form 10-K Annual Report and the documents we incorporate by reference in this Form 10-K Annual Report contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include certain discussions relating to underwriting, premium and investment income volumes, business strategies, reserves, profitability and business relationships and our other business activities during 2010 and beyond. In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expect," "plan," "intend," "anticipate," "believe," "estimate," "objective," "project," "predict," "potential," "goal" and other expressions of similar import. These forward-looking statements reflect our current views about future events, our current assumptions and are subject to known and unknown risks and uncertainties that may cause our results, performance or achievements to differ materially from those we anticipate or imply by our forward-looking statements. We cannot control or predict many of the factors that could determine our future financial conditions or results of operations. Such factors may include those we describe under "Risk Factors." The forward-looking statements contained in this annual report reflect our views and assumptions only as of the date of this Form 10-K Report. Except as required by law, we do not intend to update, and we assume no responsibility for updating, any forward-looking statements we have made. We qualify all of our forward-looking statements by these cautionary statements.

Available Information

You may obtain our Annual Reports on Form 10-K, including this Form 10-K Annual Report, our quarterly reports on Form 10-Q, our current reports on Form 8-K and our other filings pursuant to the Securities Exchange Act of 1934, or the Exchange Act, without charge by viewing our website, www.donegalgroup.com. You may also view our Code of Business Conduct and Ethics and the charters of our executive committee, our audit committee, our compensation committee and our nominating committee on our website. Upon request to our corporate secretary, we will also provide printed copies of any of these documents to you without charge. We have provided the address of our website solely for the information of investors. We do not intend the reference to our website address to be an active link or to otherwise incorporate the contents of our website into this Form 10-K Annual Report.

Item 1A. Risk Factors.

Risk Factors

Risks Relating to Us and Our Business

Donegal Mutual is our controlling stockholder, and it and its directors and executive officers have potential conflicts of interest between the best interests of our stockholders and the best interests of the policyholders of Donegal Mutual.

Donegal Mutual controls the election of all of the members of our board of directors. Following our 2011 annual meeting of stockholders, six of the 11 members of our board of directors will also be directors of Donegal Mutual. Donegal Mutual and we have the same executive officers. These common directors and executive officers have a fiduciary duty to our stockholders and also have a fiduciary duty to the policyholders of Donegal Mutual. Among the potential conflicts of interest that could arise from these separate fiduciary duties are the following:

- We and Donegal Mutual periodically review the percentage participation of Atlantic States and Donegal Mutual in the underwriting pool that Donegal Mutual and we have maintained since 1986;
- Our insurance subsidiaries and Donegal Mutual annually review and then establish the terms of certain reinsurance agreements between them with the objective over the long-term of having an approximately equal balance between payments and recoveries;
- We and Donegal Mutual periodically allocate certain shared expenses among ourselves and our insurance subsidiaries in accordance with various inter-company expense-sharing agreements; and
- Our insurance subsidiaries may enter into other transactions or contractual relationships with Donegal Mutual, including, for example, our purchases from time to time from Donegal Mutual of the surplus note of a mutual insurance company that will convert into a stock insurance company and ultimately become one of our wholly owned subsidiaries.

Donegal Mutual has sufficient voting power to determine the outcome of all matters submitted to our stockholders for approval.

Each share of our Class A common stock has one-tenth of a vote per share and votes as a single class with our Class B common stock, which has one vote per share except for matters that would uniquely affect the rights of holders of our Class A common stock. Donegal Mutual has the right to vote approximately 66% of the aggregate voting power of

our Class A common stock and our Class B common stock and has sufficient voting control to:

- elect all of the members of our board of directors, who determine our management and policies; and
- control the outcome of any corporate transaction or other matter submitted to our stockholders for approval, including mergers or other acquisition proposals and the sale of all or substantially all of our assets, in each case regardless of how our other stockholders vote their shares.

The interests of Donegal Mutual in maintaining this greater than majority control of us may have an adverse effect on the price of our Class A common stock and our Class B common stock because of the absence of any potential “takeover” premium and may be inconsistent with the interests of our stockholders other than Donegal Mutual.

Donegal Mutual’s voting control, certain provisions of our certificate of incorporation and by-laws and certain provisions of Delaware law make it remote that anyone could acquire control of us unless Donegal Mutual were in favor of the acquisition of control.

Donegal Mutual’s voting control, certain anti-takeover provisions in our certificate of incorporation and by-laws and certain provisions of the Delaware General Corporation Law or the DGCL, could delay or prevent the removal of members of our board of directors and could make a merger, tender offer or proxy contest involving us to be expensive as well as unlikely to succeed, even if such events were in the best interests of our stockholders other than Donegal Mutual. These factors could also discourage a third party from attempting to acquire control of us. In particular, our certificate of incorporation and by-laws include the following anti-takeover provisions:

- our board of directors is classified into three classes, so that our stockholders elect only one-third of the members of our board of directors each year;
- our stockholders may remove our directors only for cause;
- our stockholders may not take stockholder action except at an annual or special meeting of our stockholders;
- the request of stockholders holding at least 20% of the aggregate voting power of our Class A common stock and our Class B common stock is required to call a special meeting of our stockholders;
- our bylaws require that stockholders provide us with advance notice to us to nominate candidates for election to our board of directors or to make a stockholder proposal at a stockholders’ meeting;

- we do not permit cumulative voting rights in the election of our directors;
- our certificate of incorporation does not provide for pre-emptive rights in connection with the securities we issue; and
- our board of directors may issue, without stockholder approval unless otherwise required by law, preferred stock with such terms as our board of directors may determine.

Moreover, the DGCL contains certain provisions that prohibit certain business combination transactions with an interested stockholder under certain circumstances.

We have authorized preferred stock that we could issue without stockholder approval to make it more difficult for a third party to acquire us.

We have 2,000,000 authorized shares of preferred stock that we could issue in one or more series without further stockholder approval, unless DGCL otherwise requires, and upon such terms and conditions, and having such rights, privileges and preferences, as our board of directors may determine our potential issuance of preferred stock and that may make it difficult for a third party to acquire control of us.

Because we are an insurance holding company, no person can acquire or seek to acquire a 10% or greater interest in us without first obtaining approval of the insurance commissioners of the states of domicile of our insurance subsidiaries.

We own insurance subsidiaries domiciled in the states of Pennsylvania, Maryland, Virginia, Iowa, Wisconsin and Michigan, and Donegal Mutual controls an insurance company domiciled in Georgia. The insurance laws of each of these states provide that no person can acquire or seek to acquire a 10% or greater interest in us without first filing specified information with the insurance commissioner of that state and obtaining the prior approval of the proposed acquisition of a 10% or greater interest in us by the state insurance commissioner based on statutory standards designed to protect the safety and soundness of the insurance holding company and its subsidiary.

Our insurance subsidiaries currently conduct business in a limited number of states, with a concentration of business in Pennsylvania, Maryland and Virginia. Any single catastrophe occurrence or other condition affecting losses in these states could adversely affect the results of operations of our insurance subsidiaries.

Our insurance subsidiaries conduct business in 22 states located primarily in the Mid-Atlantic, Midwestern, New England and Southern states. A substantial portion of their business consists of private passenger and commercial automobile, homeowners and workers' compensation insurance in Pennsylvania, Maryland and Virginia. While our insurance subsidiaries and Donegal Mutual actively manage our respective exposure to

catastrophes through their underwriting process and the purchase of reinsurance, a single catastrophic occurrence, destructive weather pattern, general economic trend, terrorist attack, regulatory development or other condition affecting one or more of the states in which our insurance subsidiaries conduct substantial business could materially adversely affect their business, financial condition and results of operations. Common catastrophic events include hurricanes, earthquakes, tornadoes, wind and hail storms, fires, explosions and severe winter storms.

If the independent agents who market the products of our insurance subsidiaries do not maintain their current levels of premium writing with us, fail to comply with established underwriting guidelines of our insurance subsidiaries or otherwise inappropriately market the products of our insurance subsidiaries, the business, financial condition and results of operations of our insurance subsidiaries could be adversely affected.

Our insurance subsidiaries market their insurance products solely through a network of approximately 2,200 independent insurance agencies. This agency force is one of the most important components of the competitive profile of our insurance subsidiaries. As a result, our insurance subsidiaries depend to a material extent upon the independent agents they use, each of whom has the authority to bind our insurance subsidiaries to insurance policies. To the extent that our independent agents' marketing efforts cannot maintain their current levels of volume and quality or they bind our insurance subsidiaries to unacceptable insurance risks, fail to comply with the established underwriting guidelines of our insurance subsidiaries or otherwise inappropriately market the products of our insurance subsidiaries, the business, financial condition and results of operations of our insurance subsidiaries could suffer.

The business of our insurance subsidiaries may not continue to grow and may be materially adversely affected if they cannot retain existing, and attract new, independent agents or if insurance consumers increase their use of insurance marketing systems other than independent agents.

Our ability to retain existing and to attract new independent agents is essential to the continued growth of the business of our insurance subsidiaries. If independent agents find it easier to do business with the competitors of our insurance subsidiaries, our insurance subsidiaries could find it difficult to retain their existing business or to attract new business. While our insurance subsidiaries believe they maintain good relationships with the independent agents they appoint, our insurance subsidiaries cannot be certain that these independent agents will continue to sell the products of our insurance subsidiaries to the consumers these independent agents represent. Some of the factors that could adversely affect the ability of our insurance subsidiaries to retain existing and attract new independent agents include:

- the significant competition among insurance companies to attract independent agents;

- the intense and time-consuming process of selecting new independent agents;
- the insistence of our insurance subsidiaries that independent agents adhere to consistent underwriting standards; and
- the ability of our insurance subsidiaries to pay competitive and attractive commissions, bonuses and other incentives to independent agents.

While our insurance subsidiaries sell insurance to policyholders solely through their network of independent agencies, many competitors of our insurance subsidiaries sell insurance through a variety of delivery methods, including independent agencies, captive agencies, the Internet and direct sales. To the extent that these policyholders change their marketing system preference, the business, financial condition and results of operations of our insurance subsidiaries may be adversely affected.

We are dependent on dividends from our insurance subsidiaries for the payment of our operating expenses, our debt service and dividends to our stockholders; however, there are regulatory restrictions and business considerations that regulate the amount of dividends our insurance subsidiaries may pay to us.

As a holding company, we rely primarily on dividends from our insurance subsidiaries as a source of funds to meet our corporate obligations and to pay dividends to our stockholders. The amount of dividends our insurance subsidiaries can pay to us is subject to regulatory restrictions and depends on the amount of surplus our subsidiaries maintain. From time to time, the NAIC and various state insurance regulators consider modifying the method of determining the amount of dividends that an insurance company may pay without prior regulatory approval. The maximum amount of ordinary dividends that our insurance subsidiaries can pay to us in 2011 without prior regulatory approval is approximately $29.7 million. Other business and regulatory considerations, such as the impact of dividends on surplus that could affect the ratings, competitive conditions, the investment results of our subsidiaries and the amount of premiums that our insurance subsidiaries can write could also adversely impact the ability of our insurance subsidiaries to pay dividends to us.

If A.M. Best downgrades the rating it has assigned to Donegal Mutual or our insurance subsidiaries, it would adversely affect their competitive position.

Industry ratings are a factor in establishing and maintaining the competitive position of insurance companies. A.M. Best, an industry-accepted source of insurance company financial strength ratings, rates Donegal Mutual and our insurance subsidiaries. A.M. Best ratings provide an independent opinion of an insurance company's financial health and its ability to meet its obligations to its policyholders. We believe that the financial strength rating of A.M. Best is material to the operations of Donegal Mutual and our insurance

subsidiaries. Currently, Donegal Mutual and our insurance subsidiaries each have an A (Excellent) rating from A.M. Best. If A.M. Best were to downgrade the rating of Donegal Mutual or any of our insurance subsidiaries, it would adversely affect the competitive position of Donegal Mutual and our insurance subsidiaries and make it more difficult for them to market their products and retain their existing policyholders.

Our strategy to grow in part through acquisitions of smaller insurance companies exposes us to risks that could adversely affect our results of operations and financial condition.

The affiliation with and acquisition of smaller and other undercapitalized insurance companies involves risks that could adversely affect our results of operations and financial condition. The risks associated with these affiliations and acquisitions include:

- the potential inadequacy of reserves for loss and loss expenses;
- the need to supplement management with additional experienced personnel;
- conditions imposed by regulatory agencies that make the realization of cost-savings through integration of operations more difficult;
- a need for additional capital that was not anticipated at the time of the acquisition; and
- the use of more of our management's time than we originally anticipated.

If we cannot obtain sufficient capital to fund the organic growth of our insurance subsidiaries and to make acquisitions, we may not be able to expand our business.

Our strategy is to expand our business through the organic growth of our insurance subsidiaries and through our strategic acquisitions of regional insurance companies. Our insurance subsidiaries will require additional capital in the future to support this strategy. If we cannot obtain sufficient capital on satisfactory terms and conditions, we may not be able to expand the business of our insurance subsidiaries or to make future acquisitions. Our ability to obtain additional financing will depend on a number of factors, many of which are beyond our control. For example, we may not be able to obtain additional debt or equity financing because we or our insurance subsidiaries may already have substantial debt at the time, because we or our insurance subsidiaries do not have sufficient cash flow to service or repay our existing or additional debt or because financial institutions are not making financing available. In addition, any equity capital we obtain in the future could be dilutive to our existing stockholders.

Many of the competitors of our insurance subsidiaries have greater financial strength than our insurance subsidiaries, and these competitors may be able to offer their products at lower prices than our insurance subsidiaries can afford to do.

The property and casualty insurance industry is intensely competitive. Competition can be based on many factors, including:

- the perceived financial strength of the insurer;
- premium rates;
- policy terms and conditions;
- policyholder service;
- reputation; and
- experience.

Our insurance subsidiaries compete with many regional and national property and casualty insurance companies, including direct sellers of insurance products, insurers having their own agency organizations and other insurers represented by independent agents. Many of these insurers have greater capital than our insurance subsidiaries, have substantially greater financial, technical and operating resources and have equal or higher ratings from A.M. Best than our insurance subsidiaries. In addition, our competition may become increasingly better capitalized in the future as the traditional barriers between insurance companies and other financial institutions erode and as the property and casualty insurance industry continues to consolidate.

The greater capitalization of many of the competitors of our insurance subsidiaries enables them to operate with lower profit margins and, therefore, allows them to market their products more aggressively, to take advantage more quickly of new marketing opportunities and to offer lower premium rates. Our insurance subsidiaries may not be able to maintain their current competitive position in the markets in which they operate if their competitors offer prices on products that are lower than the prices our insurance subsidiaries are prepared to offer. Moreover, if these competitors lower the price of their products and our insurance subsidiaries meet their pricing, the profit margins and revenues of our insurance subsidiaries may decrease and their ratios of claims and expenses to premiums may increase. All of these factors could materially adversely affect the financial condition and results of operations of our insurance subsidiaries.

Because the investment portfolios of our insurance subsidiaries consist primarily of fixed-income securities, their investment income and the fair value of their investment portfolios could decrease as a result of a number of factors.

Our insurance subsidiaries invest the premiums they receive from their policyholders and maintain investment portfolios that consist primarily of fixed-income securities. The management of these investment portfolios is an important component of the profitability of

our insurance subsidiaries and a significant portion of the operating income of our insurance subsidiaries generate derives from the income they receive on their invested assets. A number of factors offset the quality and/or yield of their portfolios, including the general economic and business environment, government monetary policy, changes in the credit quality of the issuers of the fixed-income securities our insurance subsidiaries own, changes in market conditions and regulatory changes. The fixed-income securities our insurance subsidiaries own consist primarily of securities issued by domestic entities that are backed either by the credit or collateral of the underlying issuer. Factors such as an economic downturn, disruption in the credit market or the availability of credit, a regulatory change pertaining to a particular issuer's industry, a significant deterioration in the cash flows of the issuer or a change in the issuer's marketplace may adversely affect the ability of our insurance subsidiaries to collect principal and interest from the issuer.

The investments of our insurance subsidiaries are also subject to risk resulting from interest rate fluctuations. Increasing interest rates or a widening in the spread between interest rates available on U.S. Treasury securities and corporate debt or asset-backed securities, for example, will typically have an adverse impact on the market values of fixed-rate securities. If interest rates decline, as was the case in 2010 and which is currently continuing, our insurance subsidiaries would generally have a lower overall rate of return on investments of cash their operations generate. In addition, in the event of the call or maturity of investments in a declining interest rate environment, our insurance subsidiaries may not be able to reinvest the proceeds in securities with comparable interest rates. Changes in interest rates may reduce both the profitability and the return on the invested capital of our insurance subsidiaries.

We and our insurance subsidiaries depend on key personnel. The loss of any member of their senior management or our executive management could negatively affect the implementation of their business strategies and achievement of their growth objectives.

The loss of, or failure to attract, key personnel could significantly impede the financial plans, growth, marketing and other objectives of us and our insurance subsidiaries. Their continued success depends to a substantial extent on the ability and experience of their senior management. Our insurance subsidiaries and we believe that our future success is dependent on our ability to attract and retain additional skilled and qualified personnel and to expand, train and manage our employees. We and our insurance subsidiaries may be unable to do so because of the intense competition for experienced personnel in the insurance industry. With limited exceptions, we and our insurance subsidiaries do not have employment agreements with our key personnel.

The reinsurance agreements on which our insurance subsidiaries rely do not relieve our insurance subsidiaries from their primary liability to their policyholders, and our insurance subsidiaries face a risk of non-payment from their reinsurers as well as the non-availability of reinsurance in the future.

Our insurance subsidiaries rely on reinsurance agreements to limit their maximum net loss from large single catastrophic risks or excess of loss risks in areas where our insurance subsidiaries may have a concentration of policyholders. Reinsurance also enables our insurance subsidiaries to increase their capacity to write insurance because it has the effect of leveraging the surplus of our insurance subsidiaries. Although the reinsurance our insurance subsidiaries maintain provides that the reinsurer is liable to them for any reinsured losses, the reinsurance does not relieve our insurance subsidiaries from their primary liability to their policyholders if the reinsurer fails to pay our insurance subsidiaries. To the extent that a reinsurer is unable to pay losses for which it is liable to our insurance subsidiaries, our insurance subsidiaries remain liable for such losses. As of December 31, 2010, our insurance subsidiaries had approximately $100.5 million of reinsurance receivables from third-party reinsurers relating to paid and unpaid losses. Any insolvency or inability of these reinsurers to make timely payments to our insurance subsidiaries under the terms of their reinsurance agreements would adversely affect the results of operations of our insurance subsidiaries.

In addition, our insurance subsidiaries face a risk of the non-availability of reinsurance or an increase in reinsurance costs that could adversely affect their ability to write business or their results of operations. Market conditions beyond the control of our insurance subsidiaries, such as the amount of surplus in the reinsurance market and the frequency and severity of natural and man-made catastrophes, affect both the availability and the cost of the reinsurance our insurance subsidiaries purchase. If our insurance subsidiaries can not maintain their current level of reinsurance or purchase new reinsurance protection in amounts that our insurance subsidiaries consider sufficient, our insurance subsidiaries would either have to be willing to accept an increase in their net risk retention or reduce their insurance writings which would adversely affect them.

Risks Relating to the Property and Casualty Insurance Industry

Industry trends, such as increased litigation against the insurance industry and individual insurers, the willingness of courts to expand covered causes of loss, rising jury awards, escalating medical costs and increasing loss severity may contribute to increased costs and to the deterioration of the reserves of our insurance subsidiaries.

Loss severity in the property and casualty insurance industry has increased in recent years, principally driven by larger court judgments and increasing medical costs. In addition, many classes of complainants have brought legal actions and proceedings that tend to increase the size of judgments. The propensity of policyholders and third-party claimants to litigate and the willingness of courts to expand causes of loss and the size of awards to eliminate exclusions and to increase coverage limits may make the loss reserves of our insurance subsidiaries inadequate for current and future losses.

Loss or significant restriction of the use of credit scoring in the pricing and underwriting of the personal lines insurance products by our insurance subsidiaries could adversely affect their future profitability.

Our insurance subsidiaries use credit scoring as a factor in making risk selection and pricing decisions where allowed by state law for personal lines insurance products. Recently, some consumer groups and regulators have questioned whether the use of credit scoring unfairly discriminates against people with low incomes, minority groups and the elderly. These consumer groups and regulators often call for the prohibition or restriction on the use of credit scoring in underwriting and pricing. Laws or regulations enacted in a number of states that significantly curtail the use of credit scoring in the underwriting process could reduce the future profitability of our insurance subsidiaries.

Changes in applicable insurance laws or regulations or changes in the way regulators administer those laws or regulations could adversely affect the operating environment of our insurance subsidiaries and increase their exposure to loss or put them at a competitive disadvantage.

Property and casualty insurers are subject to extensive supervision in their domiciliary states and in the states in which they do business. This regulatory oversight includes matters relating to:

- licensing and examination;
- approval of premium rates;
- market conduct;
- policy forms;
- limitations on the nature and amount of certain investments;
- claims practices;
- mandated participation in involuntary markets and guaranty funds;
- reserve adequacy;
- insurer solvency;
- transactions between affiliates;
- the amount of dividends that insurers may pay; and
- restrictions on underwriting standards.

Such regulation and supervision are primarily for the benefit and protection of policyholders rather than stockholders. For instance, our insurance subsidiaries are subject to involuntary participation in specified markets in various states in which they operate, and the premium rates our insurance subsidiaries may charge do not always correspond with the underlying costs of providing that coverage.

The NAIC and state insurance regulators are re-examining existing laws and regulations, specifically focusing on:

- insurance company investments;
- issues relating to the solvency of insurance companies;
- risk-based capital guidelines;
- restrictions on the terms and conditions included in insurance policies;
- certain methods of accounting;
- reserves for unearned premiums, losses and other purposes;
- the values at which insurance companies may carry investment securities and the definition of other-than-temporary impairment;
- interpretations of existing laws and the development of new laws. Changes in state laws and regulations, as well as changes in the way state regulators view related-party transactions in particular, could change the operating environment of our insurance subsidiaries and have an adverse effect on their business.

The state insurance regulatory framework has recently come under increased federal scrutiny partly as a result of the substantial emergency funding the federal government provided AIG and other distressed financial institutions. Congress is considering proposals that it should create an optional federal charter for insurers. Federal chartering has the potential to create an uneven playing field for insurers by subjecting federally-chartered and state-chartered insurers to different regulatory requirements. Federal chartering also raises the possibility of duplicative or conflicting federal and state requirements. In addition, if federal legislation repeals the partial exemption for the insurance industry from federal antitrust laws, our ability to collect and share loss cost data with the industry could adversely affect the results of operations of our insurance subsidiaries.

Insurance companies are subject to assessments, based on their market share in a given line of business, to assist in the payment of unpaid claims and related costs of insolvent insurance companies. Such assessments could adversely affect the financial condition of our insurance subsidiaries.

Our insurance subsidiaries must pay assessments pursuant to the guaranty fund laws of the various states in which they conduct business. Generally, under these laws, our insurance subsidiaries can be assessed, depending upon the market share of our insurance subsidiaries in a given line of insurance business, to assist in the payment of unpaid claims and related costs of insolvent insurance companies in those states. We cannot predict the number and magnitude of future insurance company failures in the states in which our insurance subsidiaries conduct business, but future assessments could adversely affect the business, financial condition and results of operations of our insurance subsidiaries.

Our insurance subsidiaries must establish premium rates and loss and loss expense reserves from forecasts of the ultimate costs they expect will arise from risks underwritten during the policy period, and the profitability of our insurance subsidiaries could be adversely affected if their premium rates or reserves are insufficient to satisfy their ultimate costs.

One of the distinguishing features of the property and casualty insurance industry is that it prices its products before it knows its costs since insurers generally establish their premium rates before they know the amount of losses they will incur. Accordingly, our insurance subsidiaries establish premium rates from forecasts of the ultimate costs they expect to arise from risks they have underwritten during the policy period. These premium rates may not be sufficient to cover the ultimate losses incurred. Further, our insurance subsidiaries must establish reserves for losses and loss expenses as balance sheet liabilities based upon estimates involving actuarial and statistical projections at a given time of what our insurance subsidiaries expect their ultimate liability to be. Significant periods of time often elapse from the occurrence of an insured loss to the reporting of the loss and the payment of that loss. It is possible that their ultimate liability could exceed these estimates because of the future development of known losses, the existence of losses that have occurred but are currently unreported and larger than historical settlements on pending and unreported claims. The process of estimating reserves is inherently judgmental and can be influenced by variable factors including:

- trends in claim frequency and severity;
- changes in operations;
- emerging economic and social trends;
- inflation; and
- changes in the regulatory and litigation environments.

If our insurance subsidiaries have insufficient premium rates or reserves, insurance regulatory authorities may require increases to these reserves. An increase in reserves results in an increase in losses and a reduction in net income for the period in which the deficiency

in reserves exists. Accordingly, if an increase in reserves is not sufficient, it may adversely impact their business, liquidity, financial condition and results of operations.

The financial results of our insurance subsidiaries depend primarily on the ability to underwrite risks effectively and to charge adequate rates to policyholders.

The financial condition, cash flows and results of operations of our insurance subsidiaries depend on their ability to underwrite and set rates accurately for a full spectrum of risks, across a number of lines of insurance. Rate adequacy is necessary to generate sufficient premium to pay losses, loss adjustment expenses and underwriting expenses and to earn a profit.

The ability to underwrite and set rates effectively is subject to a number of risks and uncertainties, including:

- the availability of sufficient, reliable data;
- the ability to conduct a complete and accurate analysis of available data;
- the ability to recognize in a timely manner changes in trends and to project both the severity and frequency of losses with reasonable accuracy;
- uncertainties generally inherent in estimates and assumptions;
- the ability to project changes in certain operating expense levels with reasonable certainty;
- the development, selection and application of appropriate rating formulae or other pricing methodologies;
- the use of modeling tools to assist with correctly and consistently achieving the intended results in underwriting and pricing ;
- the ability to innovate with new pricing strategies, and the success of those innovations on implementation;
- the ability to secure regulatory approval of premium rates on an adequate and timely basis;
- the ability to predict policyholder retention accurately;
- unanticipated court decisions, legislation or regulatory action;
- unanticipated changes in our claim settlement practices;

- changing driving patterns for auto exposures; changing weather patterns for property exposures;
- changes in the medical sector of the economy;
- unanticipated changes in auto repair costs, auto parts prices and used car prices;
- impact of inflation and other factors on the cost of construction materials and labor;
- the ability to monitor property concentration in catastrophe-prone areas, such as hurricane, earthquake and wind/hail regions; and
- the general state of the economy in the states in which we operate.

Such risks may result in the premium rates of our insurance subsidiaries being based on inadequate or inaccurate data or inappropriate assumptions or methodologies, and may cause our estimates of future changes in the frequency or severity of claims to be incorrect. As a result, our insurance subsidiaries could underprice risks, which would negatively affect our margins, or we could overprice risks, which could reduce our volume and competitiveness. In either event, underpricing or overpricing risks could adversely impact their operating results, financial condition and cash flows.

The cyclical nature of the property and casualty insurance industry may reduce the revenues and profit margins of our insurance subsidiaries.

The property and casualty insurance industry is highly cyclical with respect to both individual lines of business and the overall insurance industry. Premium rate levels relate to the availability of insurance coverage, which varies according to the level of surplus available in the insurance industry. The level of surplus in the industry varies with returns on invested capital and regulatory barriers to withdrawal of surplus. Increases in surplus may result in increased price competition among property and casualty insurers. If our insurance subsidiaries find it necessary to reduce premiums or limit premium increases due to these competitive pressures on pricing, our insurance subsidiaries may experience a reduction in their profit margins and revenues, an increase in their ratios of losses and expenses to premiums and, therefore, lower profitability.

Risks Relating to Our Class A Common Stock

The price of our Class A common stock may be adversely affected by its low trading volume.

Our Class A common stock has limited liquidity. Reported average daily trading volume in our Class A common stock for the year ended December 31, 2010 was

approximately 30,414 shares. This limited liquidity could subject our shares of Class A common stock to greater price volatility.

Donegal Mutual's ownership of our stock, anti-takeover provisions of our certificate of incorporation and by-laws and certain state laws make it unlikely anyone could acquire control of us unless Donegal Mutual were in favor of the acquisition of control.

Donegal Mutual's ownership of our Class A common stock and Class B common stock, certain anti-takeover provisions of our certificate of incorporation and by-laws, certain provisions of Delaware law and the insurance laws and regulations of Pennsylvania, Maryland, Michigan, Iowa, Virginia, Wisconsin and Georgia could delay or prevent the removal of members of our board of directors and could make it more difficult for a merger, tender offer or proxy contest involving us to succeed, even if our stockholders other than Donegal Mutual believed any of such events would be beneficial to them. These factors could also discourage a third party from attempting to acquire control of us. The classification of our board of directors could also have the effect of delaying or preventing a change in our control.

In addition, we have 2,000,000 authorized shares of preferred stock that we could issue in one or more series without stockholder approval, to the extent applicable law permits, and upon such terms and conditions, and having such rights, privileges and preferences, as our board of directors may determine. Our ability to issue preferred stock could make it difficult for a third party to acquire us. We have no current plans to issue any preferred stock.

Moreover, the DGCL contains certain provisions that prohibit certain business combination transactions under certain circumstances. In addition, state insurance laws and regulations generally prohibit any person from acquiring, or seeking to acquire, a 10% or greater interest in an insurance company without the prior approval of the state insurance commissioner of the state of domicile of the insurer.

Item 1B. Unresolved Staff Comments.

We have no unresolved written comments from the SEC staff regarding our filings under the Exchange Act.

Item 2. Properties.

We and our insurance subsidiaries share administrative headquarters with Donegal Mutual in a building in Marietta, Pennsylvania that Donegal Mutual owns. Donegal Mutual charges us and our insurance subsidiaries for an appropriate portion of the building expenses under an inter-company allocation agreement. The Marietta headquarters has approximately 230,000 square feet of office space. Southern owns a facility of approximately 10,000 square feet in Glen Allen, Virginia. Le Mars owns a facility of approximately 25,500 square feet in Le

Mars, Iowa, the Peninsula Group owns a facility of approximately 14,600 square feet in Salisbury, Maryland and Sheboygan owns a facility of approximately 8,800 square feet in Sheboygan Falls, Wisconsin.

Item 3. Legal Proceedings.

Our insurance subsidiaries are parties to routine litigation that arises in the ordinary course of their insurance business. We believe that the resolution of these lawsuits will not have a material adverse effect on the financial condition or results of operations of our insurance subsidiaries.

Item 4. Reserved.

Not applicable.

Executive Officers of the Company

The following table sets forth information regarding the executive officers of Donegal Mutual and us, each of whom has served with us for more than 10 years:

Name	Age	Position
Donald H. Nikolaus	68	President and Chief Executive Officer of Donegal Mutual since 1981; President and Chief Executive Officer of us since 1986.
Robert G. Shenk	57	Senior Vice President, Claims, of Donegal Mutual and us since 1997; other positions from 1986 to 1997.
Cyril J. Greenya	66	Senior Vice President and Chief Underwriting Officer, of Donegal Mutual and us since 2005, Senior Vice President, Underwriting of Donegal Mutual from 1997 to 2005; other positions from 1986 to 2005.
Daniel J. Wagner	50	Senior Vice President and Treasurer of Donegal Mutual and us since 2005; Vice President and Treasurer of Donegal Mutual and us from 2000 to 2005; other positions from 1993 to 2005.
Jeffrey D. Miller	46	Senior Vice President and Chief Financial Officer of Donegal Mutual and us since 2005; Vice President and Controller of Donegal Mutual and us from 2000 to 2005; other positions from 1995 to 2005.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

We incorporate the response to this Item in part by reference to page 44 of our Annual Report to Stockholders for the year ended December 31, 2010, or our 2010 Annual Report. We include our 2010 Annual Report as Exhibit (13) to this Form 10-K Report.

As of March 4, 2011, we had approximately 1,247 holders of record of our Class A common stock and approximately 393 holders of record of our Class B common stock.

We declared dividends of $0.45 per share on our Class A common stock and $0.40 per share on our Class B common stock in 2009 and $0.46 per share on our Class A common stock and $0.41 per share on our Class B common stock in 2010.

Between October 1, 2010 and December 31, 2010, we and Donegal Mutual purchased shares of our Class A common stock and Class B common stock as set forth in the table below.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans of Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs(1)
Month #1	Class A — —	Class A — $—	Class A — —	
October 1-31, 2010	Class B — 5,450	Class B — $20.00	Class B — 5,450	
Month #2	Class A — —	Class A — $—	Class A — —	
November 1-30, 2010	Class B — 2,616	Class B — $20.00	Class B — 2,616	
Month #3	Class A — —	Class A — $—	Class A — —	
December 1-31, 2010	Class B — 301	Class B — $17.26	Class B — 301	
Total	Class A — —	Class A — $—	Class A — —	
	Class B — 8,367	Class B — $19.90	Class B — 8,367	

(1) Donegal Mutual purchased these shares pursuant to its announcement on August 17, 2004 that it will, at its discretion, purchase shares of our Class A common stock and Class B common stock at market prices prevailing from time to time in the open market subject to the provisions of SEC Rule 10b-18 and in privately negotiated transactions. Such announcement did not stipulate a maximum number of shares that may be purchased under this stock repurchase program.

Our performance graph is included on page 43 of our 2010 Annual Report.

Item 6. Selected Financial Data.

We incorporate the response to this Item by reference to page 8 of our 2010 Annual Report.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

We incorporate the response to this Item by reference to pages 10 through 19 of our 2010 Annual Report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

We have exposure to the impact of changes in interest rates, changes in fair values of investments and credit risk because each them maintains a substantial investment portfolio in relation to its total assets.

In the normal course of business, we and our insurance subsidiaries employ established policies and procedures to manage and mitigate exposure to changes in interest rates, fluctuations in the fair market value of debt and equity securities and credit risk.

Interest Rate Risk

Our insurance subsidiaries monitor interest rate exposure through regular reviews of their respective asset and liability positions. Our insurance subsidiaries regularly monitor their cash flow estimates and the impact of interest rate fluctuations on their investment portfolio. Our insurance subsidiaries generally do not hedge their exposure to interest rate risk because each of them has the capacity to, and does, hold fixed-maturity investments to maturity.

The following table presents the principal cash flows and related weighted-average interest rates by expected maturity dates for financial instruments sensitive to interest rates of our insurance subsidiaries:

(amounts in thousands)	As of December 31, 2010 Principal cash flows	Weighted-average interest rate
Fixed maturities and short-term investments:		
2011	$ 53,551	1.14%
2012	24,891	4.10
2013	27,004	4.02
2014	25,261	3.94
2015	42,080	4.08
Thereafter	523,954	4.42
Total	$ 696,741	
Fair value	$ 712,431	
Debt:		
2011	$ 617	0.50%
2013	$ 35,000	2.25
Thereafter	$ 20,465	4.35
Total	$ 56,082	
Fair Value	$ 56,082	

The actual cash flows of our insurance subsidiaries and Donegal Mutual from investments may differ from those indicated above because of calls and prepayments.

Equity Price Risk

Our insurance subsidiaries carry their portfolios of marketable equity securities on their consolidated balance sheets at estimated fair value. These securities have exposure to equity price risk. We define equity price risk as the risk of potential loss in the estimated fair value of these securities resulting from an adverse change in prices of these securities. Our insurance subsidiaries seek to mitigate equity price risk and exposure by earning competitive relative returns on diverse portfolios of high-quality and liquid securities.

Credit Risk

The fixed-maturity securities portfolios our insurance subsidiaries maintain and, to a lesser extent, their short-term investments of our insurance subsidiaries are subject to credit risk. We define credit risk as the potential loss in market value resulting from adverse changes in a borrower’s ability to repay its debt. Our insurance subsidiaries seek to manage this risk through pre-investment underwriting analysis and regular reviews by our internal investment staff. Each of our insurance subsidiaries seeks to limit its credit risk by limiting the amount of its fixed-maturity investments in the securities of any one issuer.

Our insurance subsidiaries provide property and casualty insurance coverages through independent insurance agencies located throughout the states in which Donegal Mutual and our insurance subsidiaries conduct business. Our insurance subsidiaries bill the majority of this business directly to the policyholder, although our insurance subsidiaries bill

a portion of their commercial business through the agents of our insurance subsidiaries. Our insurance subsidiaries extend credit to agents in the normal course of their business.

Our insurance subsidiaries place reinsurance with Donegal Mutual and with major unaffiliated authorized reinsurers. Although our insurance subsidiaries as a matter of law retain ultimate responsibility to our policyholders if a reinsurer fails for any reason to pay an insurance risk we have ceded, we do not regard this legal conclusion as a material risk because each of our insurance subsidiaries has an A.M. Best rating of A.

Item 8. Financial Statements and Supplementary Data.

We incorporate the response to this Item by reference to pages 8 through 43 of our 2010 Annual Report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

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) as of December 31, 2010 covered by this Form 10-K Report. Based on such evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of December 31, 2010, our disclosure controls and procedures are 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 are 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.

Internal Control over Financial Reporting

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we include a report of our management's assessment of the design and effectiveness of our internal control over financial reporting as part of our 2010 Annual Report. KPMG LLP, an independent registered public accounting firm, audited the effectiveness of our internal control over financial reporting as of December 31, 2010 based on criteria established by Internal Control —

Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission which we incorporate by reference in the Form 10-K Report. We include the report of KPMG LLP dated March 14, 2011 as part of our 2010 Annual Report.

Changes in Internal Control over Financial Reporting

We did not make any changes to our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fourth quarter of 2010 that have materially affected, or are reasonably likely to affect materially, our internal control over financial reporting.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance of the Registrant.

We incorporate the response to this Item by reference to our proxy statement we will file with the SEC on or about March 18, 2011 relating to our annual meeting of stockholders that we will hold on April 21, 2011, or our Proxy Statement. We respond to this Item with respect to our executive officers by reference to Part I of this Form 10-K Report.

We incorporate the full text of our Code of Business Conduct and Ethics by reference to Exhibit 14 to this Form 10-K Report.

Item 11. Executive Compensation.

We incorporate the response to this Item by reference to our Proxy Statement. Neither the Report of our Compensation Committee nor the Report of our Audit Committee included in our Proxy Statement shall constitute or be deemed to constitute a filing with the SEC under the Securities Act or the Exchange Act or be deemed incorporated by reference into any filing we make under the Securities Act or the Exchange Act, except to the extent we specifically incorporate the Report of Our Compensation Committee or the Report of Our Audit Company by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

We incorporate the response to this Item by reference to our Proxy Statement.

Item 13. Certain Relationships and Related Transactions and Director Independence.

We incorporate the response to this Item by reference to our Proxy Statement.

Item 14. Principal Accountant Fees and Services.

We incorporate the response to this Item by reference to our Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedule.

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

(a) Consolidated Financial Statements

	Page*
Reports of Independent Registered Public Accounting Firm	40, 42
Donegal Group Inc. and Subsidiaries:	
Consolidated Balance Sheets as of December 31, 2010 and 2009	20
Consolidated Statements of Income and Comprehensive Income for each of the years in the three-year period ended December 31, 2010, 2009 and 2008	21
Consolidated Statements of Stockholders' Equity for each of the years in the three-year period ended December 31, 2010, 2009 and 2008	22
Consolidated Statements of Cash Flows for each of the years in the three-year period ended December 31, 2010, 2009 and 2008	23
Notes to Consolidated Financial Statements	24
Report and Consent of Independent Registered Public Accounting Firm	Exhibit 23

(b) Financial Statement Schedule

	Page
Donegal Group Inc. and Subsidiaries	
Schedule III — Supplementary Insurance Information	S-1

We have omitted all other schedules since they are not required, not applicable or the information is included in the financial statements or notes to the financial statements.

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* Refers to pages of our 2010 Annual Report to Stockholders. We incorporate by reference to pages 20 through 42 of our 2010 Annual Report, our Consolidated Financial Statements, Notes to Consolidated Financial Statements, Report of Independent Registered Public Accounting Firm on consolidated financial statements, Management's Report on

Internal Control over Financial Reporting and Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting. With the exception of the portions of our 2010 Annual Report we incorporate by reference in our response to this Item 15(b) and incorporate by reference Items 5, 6, 7 and 8 of this Form 10-K Report, our 2010 Annual Report shall not be deemed filed as part of this Form 10-K Report or otherwise subject to the liabilities of Section 18 of the Exchange Act.

(c) Exhibits

Exhibit No.	Description of Exhibits	Reference
(3)(i)	Certificate of Incorporation of Donegal Group Inc., as amended.	(a)
(3)(ii)	Amended and Restated By-laws of Donegal Group Inc.	(r)
Management Contracts and Compensatory Plans or Arrangements		
(10)(B)	Donegal Group Inc. 2001 Equity Incentive Plan for Employees.	(c)
(10)(C)	Donegal Group Inc. 2001 Equity Incentive Plan for Directors.	(c)
(10)(D)	Donegal Group Inc. 2001 Employee Stock Purchase Plan, as amended.	(d)
(10)(E)	Donegal Group Inc. Amended and Restated 2001 Agency Stock Purchase Plan.	(e)
(10)(F)	Donegal Mutual Insurance Company 401(k) Plan.	(f)
(10)(G)	Amendment No. 1 effective January 1, 2000 to Donegal Mutual Insurance Company 401(k) Plan.	(f)
(10)(H)	Amendment No. 2 effective January 6, 2000 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(I)	Amendment No. 3 effective July 23, 2001 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(J)	Amendment No. 4 effective January 1, 2002 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(K)	Amendment No. 5 effective December 31, 2001 to Donegal Mutual Insurance Company 401(k) Plan.	(b)

Exhibit No.	Description of Exhibits	Reference
(10)(L)	Amendment No. 6 effective July 1, 2002 to Donegal Mutual Insurance Company 401(k) Plan.	(p)
(10)(M)	Donegal Group Inc. 2007 Equity Incentive Plan for Employees.	(s)
(10)(N)	Donegal Group Inc. 2007 Equity Incentive Plan for Directors.	(s)
(10)(O)	Donegal Group Inc. Incentive Compensation Program.	(u)
Other Material Contracts		
(10)(O)	Amended and Restated Tax Sharing Agreement dated as of October 19, 2006 among Donegal Group Inc., Atlantic States Insurance Company, Southern Insurance Company of Virginia, Le Mars Insurance Company, The Peninsula Insurance Company and Peninsula Indemnity Company.	(p)
(10)(P)	Amended and Restated Services Allocation Agreement dated July 20, 2006 among Donegal Group Inc., Atlantic States Insurance Company, Southern Insurance Company, Le Mars Insurance Company, The Peninsula Insurance Company, Peninsula Indemnity Company and Donegal Mutual Insurance Company.	(b)
(10)(Q)	Proportional Reinsurance Agreement dated September 29, 1986 between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(h)
(10)(R)	Amendment dated October 1, 1988 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(i)
(10)(S)	Amendment dated July 16, 1992 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(j)
(10)(T)	Amendment dated as of December 21, 1995 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(k)
(10)(U)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Southern Insurance Company of Virginia.	(g)
(10)(V)	Amendment dated as of April 20, 2000 to Proportional	(l)

Exhibit No.	Description of Exhibits	Reference
	Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	
(10)(W)	Lease Agreement dated as of September 1, 2000 between Donegal Mutual Insurance Company and Province Bank FSB.	(c)
(10)(X)	Plan of Conversion of Le Mars Mutual Insurance Company of Iowa adopted August 11, 2003.	(n)
(10)(Y)	Stock Purchase Agreement dated as of October 28, 2003 between Donegal Group Inc. and Folksamerica Holding Company, Inc.	(m)
(10)(Z)	Credit Agreement dated as of November 25, 2003 between Donegal Group Inc. and Manufacturers and Traders Trust Company.	(n)
(10)(AA)	First Amendment to Credit Agreement dated as of July 20, 2006 between Donegal Group Inc. and Manufacturers and Traders Trust Company.	(b)
(10)(BB)	Amended and Restated Services Allocation Agreement dated October 19, 2006 among Donegal Group Inc., Atlantic States Insurance Company, Southern Insurance Company of Virginia, Le Mars Insurance Company, The Peninsula Insurance Company, Peninsula Indemnity Company and Donegal Mutual Insurance Company.	(q)
(10)(CC)	Amendment dated as of February 11, 2008 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(t)
(10)(DD)	Contribution Note Purchase Agreement dated as of December 27, 2006 between Donegal Mutual Insurance Company and Sheboygan Falls Mutual Insurance Company.	(v)

Exhibit No.	Description of Exhibits	Reference
(10)(EE)	Plan of Conversion of Sheboygan Falls Mutual Insurance Company adopted October 14, 2008.	(v)
(10)(FF)	Surplus Note Purchase Agreement dated as of September 8, 2009 between Donegal Mutual Insurance Company and Southern Mutual Insurance Company.	(w)
(10)(GG)	Quota-share Reinsurance Agreement dated as of October 30, 2009 but effective as of 11:59 p.m. on October 31, 2009 between Donegal Mutual Insurance Company and Southern Mutual Insurance Company.	(w)
(10)(HH)	Services and Affiliation Agreement dated as of October 30, 2009 between Donegal Mutual Insurance Company and Southern Mutual Insurance Company.	(w)
(10)(II)	Technology License Agreement dated as of October 30, 2009 between Donegal Mutual Insurance Company and Southern Mutual Insurance Company.	(w)
(10)(JJ)	Amended and Restated Proportional Reinsurance Agreement dated March 1, 2010 between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(w)
(10)(KK)	Agreement and Plan of Merger dated as of April 19, 2010, and as amended as of May 20, 2010, among Donegal Acquisition Inc., Donegal Financial Services Corporation, Donegal Group Inc. and Union National Financial Corporation; amended dated as of September 1, 23010; amended dated December 8, 2010.	(x)
(10)(LL)	Amended and Restated Agreement and Plan of Merger dated as of December 6, 2010 among Michigan Insurance Company, West Bend Mutual Insurance Company, Donegal Group Inc. and DGI Acquisition Corp.	(y)
(10)(MM)	Surplus Note Purchase Agreement dated as of July 15, 2010 between Donegal Mutual Insurance Company and West Bend Mutual Insurance Company.	Filed herewith
(10)(NN)	Amended and Restated Tax Sharing Agreement dated December 1, 2010 among Donegal Group, Inc., Atlantic States Insurance Company, Southern Insurance Company of Virginia, Le Mars Insurance Company, The Peninsula	Filed herewith

Exhibit No.	Description of Exhibits	Reference
	Insurance Company, Peninsula Indemnity Company and Michigan Insurance Company.	
(10)(OO)	Amended and Restated Services Allocation Agreement dated as of December 1, 2010 among Donegal Group Inc., Atlantic States Insurance Company, Southern Insurance Company of Virginia, Le Mars Insurance Company, The Peninsula Insurance Company, Peninsula Indemnity Company and Michigan Insurance Company.	Filed herewith
(10)(PP)	Quota-share Reinsurance Agreement dated as of December 1, 2010 between Donegal Mutual Insurance Company and Michigan Insurance Company.	Filed herewith
(10)(QQ)	Donegal Group Inc. 2011 Employee Stock Purchase Plan.	Filed herewith
(10)(RR)	Donegal Group Inc. 2011 Equity Incentive Plan for Employees.	Filed herewith
(10)(SS)	Donegal Group Inc. 2011 Agency Stock Purchase Plan.	Filed herewith
(10)(TT)	Donegal Group Inc. 2011 Equity Incentive Plan for Directors.	Filed herewith
(13)	2010 Annual Report to Stockholders (electronic filing contains only those portions incorporated by reference into this Form 10-K Report).	Filed herewith
(14)	Code of Business Conduct and Ethics	(o)
(21)	Subsidiaries of Registrant.	Filed herewith
(23)	Report and Consent of Independent Registered Public Accounting Firm	Filed herewith
(31.1)	Rule 13a-14(a)/15(d)-14(a) Certification of Chief Executive Officer	Filed herewith
(31.2)	Rule 13a-14(a)/15(d)-14(a) Certification of Chief Financial Officer	Filed herewith
(32.1)	Section 1350 Certification of Chief Executive Officer	Filed herewith

Exhibit No.	Description of Exhibits	Reference
(32.2)	Section 1350 Certification of Chief Financial Officer	Filed herewith

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(a) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form S-3 Registration Statement No. 333-59828 filed April 30, 2001.

(b) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 2001.

(c) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 2000.

(d) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form S-8 Registration Statement No. 333-62974 filed June 14, 2001.

(e) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 333-63102 declared effective February 8, 2002.

(f) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1999.

(g) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1996.

(h) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form S-1 Registration Statement No. 33-8533 declared effective October 29, 1986.

(i) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1988.

(j) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1992.

(k) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 8-K Report dated December 21, 1995.

(l) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 8-K Report dated May 31, 2000.

(m) We incorporate such exhibit by reference to the like-described exhibits in Registrant's Form 8-K Report dated November 3, 2003.

(n) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 8-K Report dated December 1, 2003.

(o) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Annual Report for the year ended December 31, 2003.

(p) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 8-K Report dated October 23, 2006.

(q) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-Q Quarterly Report for the quarter ended September 30, 2006.

(r) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 8-K Report dated December 22, 2006.

(s) We incorporate such exhibit by reference to the like-numbered exhibit in Registrant's Form 8-K Report dated April 20, 2007.

(t) We incorporate such exhibit by reference to the like-numbered exhibit in Registrant's Form 8-K Report dated February 13, 2008.

(u) We incorporate such exhibit by reference to the description of such plan in Registrant's definitive proxy statement for its Annual Meeting of Stockholders to be held on April 21, 2011.

(v) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Annual Report for the year ended December 31, 2009.

(w) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 10-K Annual Report for the year ended December 31, 2010.

(x) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form S-4 registration statement filed June 25, 2010, Registrant's Form 8-K Report dated September 1, 2010 and Registrant's Form 8-K Report dated December 8, 2010.

(y) We incorporate such exhibit by reference to the like-described exhibit in Registrant's Form 8-K dated December 8, 2010.

SIGNATURES

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

DONEGAL GROUP INC.

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus, President

Date: March 14, 2011

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

Signature	Title	Date
/s/ Donald H. Nikolaus Donald H. Nikolaus	President and a Director (principal executive officer)	March 14, 2011
/s/ Jeffrey D. Miller Jeffrey D. Miller	Senior Vice President and Chief Financial Officer (principal financial and accounting officer)	March 14, 2011
/s/ Robert S. Bolinger Robert S. Bolinger	Director	March 14, 2011
/s/ Philip A. Garcia Philip A. Garcia	Director	March 14, 2011

Signature	Title	Date
/s/ Patricia A. Gilmartin Patricia A. Gilmartin	Director	March 14, 2011
/s/ Philip H. Glatfelter, II Philip H. Glatfelter, II	Director	March 14, 2011
/s/ Kevin M. Kraft, Sr. Kevin M. Kraft, Sr.	Director	March 14, 2011
/s/ John J. Lyons John J. Lyons	Director	March 14, 2011
/s/ Jon M. Mahan Jon M. Mahan	Director	March 14, 2011
/s/ S. Trezevant Moore, Jr. S. Trezevant Moore, Jr.	Director	March 14, 2011
/s/ R. Richard Sherbahn R. Richard Sherbahn	Director	March 14, 2011
/s/ Richard D. Wampler, II Richard D. Wampler, II	Director	March 14, 2011

DONEGAL GROUP INC. AND SUBSIDIARIES
SCHEDULE III — SUPPLEMENTARY INSURANCE INFORMATION
($ in thousands)

Years Ended December 31, 2010, 2009 and 2008

Segment	Net Earned Premiums	Net Investment Income	Net Losses And Loss Expenses	Amortization of Deferred Policy Acquisition Costs	Other Underwriting Expenses	Net Premiums Written
Year Ended December 31, 2010						
Personal lines	$ 260,469	$ —	$ 196,008	$ 45,719	$ 37,596	$ 268,047
Commercial lines	117,561	—	78,301	20,635	16,969	123,475
Investments	—	19,950	—	—	—	—
	$ 378,030	$ 19,950	$ 274,309	$ 66,354	$ 54,565	$ 391,522
Year Ended December 31, 2009						
Personal lines	$ 241,844	$ —	$ 178,040	$ 41,071	$ 34,634	$ 252,487
Commercial lines	113,181	—	72,795	19,221	16,209	110,742
Investments	—	20,631	—	—	—	—
	$ 355,025	$ 20,631	$ 250,835	$ 60,292	$ 50,843	$ 363,229
Year Ended December 31, 2008						
Personal lines	$ 225,024	$ —	$ 155,573	$ 37,821	$ 34,482	$ 239,540
Commercial lines	121,551	—	68,728	20,429	18,626	125,401
Investments	—	22,756	—	—	—	—
	$ 346,575	$ 22,756	$ 224,301	$ 58,250	$ 53,108	$ 364,941

DONEGAL GROUP INC. AND SUBSIDIARIES
SCHEDULE III — SUPPLEMENTARY INSURANCE INFORMATION, CONTINUED
($ in thousands)

	At December 31,			
Segment	Deferred Policy Acquisition Costs	Liability For Losses And Loss Expenses	Unearned Premiums	Other Policy Claims and Benefits Payable
2010				
Personal lines	$ 22,872	$ 184,760	$ 197,389	$ —
Commercial lines	11,574	198,559	99,883	—
Investments	—	—	—	—
	$ 34,446	$ 383,319	$ 297,272	$ —
2009				
Personal lines	$ 22,925	$ 130,745	$ 168,791	$ —
Commercial lines	9,919	132,854	73,030	—
Investments	—	—	—	—
	$ 32,844	$ 263,599	$ 241,821	$ —

See accompanying Report and Consent of Independent Registered Public Accounting Firm.

Exhibit (10)(MM)

SURPLUS NOTE PURCHASE AGREEMENT

Between

DONEGAL MUTUAL INSURANCE COMPANY

and

WEST BEND MUTUAL INSURANCE COMPANY

DATED AS OF JULY 15, 2010

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SURPLUS NOTE PURCHASE AGREEMENT

THIS SURPLUS NOTE PURCHASE AGREEMENT (this “Agreement”) made as of this 15th day of July, 2010 between DONEGAL MUTUAL INSURANCE COMPANY, a Pennsylvania mutual fire insurance company (“DMIC”) and WEST BEND MUTUAL INSURANCE COMPANY, a Wisconsin mutual insurance company (“WBM”).

WITNESSETH:

WHEREAS, in connection with, and subject to the closing of, the transactions the Merger Agreement (as defined in Section 5.1(d)) contemplates, WBM proposes to sell a surplus note (the “Note”) issued by Michigan Insurance Company, a Michigan stock insurance company (“MICO”) in the form of Appendix A to this Agreement, the repayment of which would be subordinated to the claims of policyholders of MICO and otherwise be in compliance with applicable provisions of the Michigan Insurance Code and the regulations of the Commissioner of Insurance of the State of Michigan, in the principal amount of Five Million Dollars ($5,000,000);

WHEREAS, DMIC proposes to purchase the Note;

WHEREAS, the Board of Directors of DMIC has approved this Agreement and the purchase of the Note by resolutions duly adopted; and

WHEREAS, the Boards of Directors of WBM and MICO have approved this Agreement and the sale of the Note by resolutions duly adopted;

NOW, THEREFORE, in consideration of the mutual covenants set forth in this Agreement and intending to be legally bound hereby, DMIC and WBM agree as follows:

ARTICLE I

SALE AND PURCHASE OF NOTE

1.1 Sale and Purchase of Note. Upon the terms, conditions, representations and warranties set forth in this Agreement, WBM hereby agrees to sell the Note to DMIC and DMIC hereby agrees to purchase the Note from WBM.

1.2 Payment of Purchase Price and Delivery of Note. The purchase price of the Note shall be Five Million Dollars ($5,000,000) an amount equal to the sum of the unpaid principal amount of the Note plus accrued but unpaid interest on the Note on the closing

date (the "Closing Date") for the sale and purchase of the Note. The entire purchase price of the Note is to be paid in cash by DMIC to WBM on the Closing Date against delivery of the Note.

1.3 Closing Date.

(a) Subject to the fulfillment of the conditions precedent specified in Article V, the transactions contemplated by this Agreement shall be consummated (the "Closing") at 10:00 a.m. on the date on which the parties to the Merger Agreement consummate the transactions the Merger Agreement contemplates. Unless otherwise mutually agreed by DMIC and WBM, the Closing shall be held at the offices of Duane Morris LLP, 190 South LaSalle Street, Chicago, IL 60603-3433.

(b) At the Closing, WBM shall deliver to DMIC (i) copies of each resolution adopted by the Board of Directors of WBM approving and adopting this Agreement and the sale of the Note, certified by the Secretary of WBM that each such resolution is then in full force and effect and without amendment; (ii) any Officers' Certificates specified in Section 5.2 duly executed by WBM and (iii) the Note duly executed by WBM.

(c) At the Closing, DMIC shall deliver to WBM (i) copies of each resolution adopted by the Board of Directors of DMIC approving and adopting this Agreement and the purchase of the Note and (ii) any Officers' Certificates specified in Section 5.3 duly executed by DMIC.

ARTICLE II

REPRESENTATIONS AND WARRANTIES OF WBM

As an inducement to DMIC to enter into this Agreement and to consummate the transactions contemplated in this Agreement, WBM represents and warrants to DMIC and agrees as follows:

2.1 Organization and Standing.

(a) WBM is a corporation duly organized and validly existing under the laws of the State of Wisconsin.

(b) WBM has the corporate power and authority and other authorizations necessary or required in order for it to own the Note and to carry on its business as now conducted.

2.2 Authorization. WBM has the requisite corporate power and authority to execute and deliver this Agreement and sell the Note and to consummate the transactions contemplated hereby. The execution and delivery of this Agreement and delivery of the

Note, have been duly approved and authorized by the Board of Directors of WBM. No other corporate proceedings on the part of WBM are necessary to authorize this Agreement and the sale of the Note other than the approval of the sale of the Note to DMIC by the Commissioner of Insurance of the State of Michigan. This Agreement, when executed and delivered by WBM and assuming the due execution thereof by the other parties thereto, will constitute the valid, legal and binding agreements of WBM enforceable in accordance with its terms, except that (i) such enforcement may be subject to bankruptcy, rehabilitation, liquidation, conservation, dissolution, insolvency, reorganization, moratorium or other similar Laws now or hereafter in effect relating to creditors' rights generally and (ii) the remedy of specific performance and injunctive and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any Proceeding therefor may be brought. Neither the execution nor the delivery of this Agreement or the Note nor the consummation of the transactions this Agreement contemplates, nor compliance with nor fulfillment of the terms and provisions hereof or thereof, will (x) conflict with or result in a breach of the terms, conditions or provisions of or constitute a default under the Articles of Incorporation or the Bylaws of WBM, or any instrument, agreement, mortgage, judgment, Order, award, decree or other restriction to which WBM is a party; (y) give any party to or with rights under any such instrument, agreement, mortgage, judgment, Order, award, decree or other restriction the right to terminate, modify or otherwise change the rights or obligations of WBM under such instrument, agreement, mortgage, judgment, Order, award, decree or other restriction or (iii) require the approval, consent or authorization of or any filing with or notification to any federal, state or local court or Governmental Authority, except the approval of the Commissioner of Insurance of the State of Michigan.

2.3 Title to the Note. WBM has good and marketable title to the Note

2.4 No Omissions. None of the representations or warranties of WBM contained in this Agreement and, to the knowledge of WBM, none of the other information or documents furnished to DMIC or its representatives by WBM in connection with this Agreement is false or misleading in any material respect or omits to state a fact herein or therein necessary to make the statements herein or therein not misleading in any material respect.

2.5 Finders. WBM has not paid or become obligated to pay any fee or commission to any broker, finder or intermediary with the exception of Keefe, Bruyette & Woods, Inc. WBM shall be responsible for the payment of all fees and expenses payable for or on account of the transactions provided for in this Agreement based on actions taken or agreements entered into by WBM.

2.6 Representations and Warranties to Be True on the Closing Date. All of the representations and warranties set forth in this Article II shall be true and correct on the Closing Date.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF DMIC

DMIC represents and warrants to WBM as follows:

3.1 Organization and Standing. DMIC is a mutual fire casualty insurance company duly organized, validly existing and in good standing under the Laws of the Commonwealth of Pennsylvania and has the requisite corporate power and authority to conduct its business as it is currently being conducted.

3.2 Authorization. DMIC has the requisite corporate power and authority to execute and deliver this Agreement and to purchase the Note. The execution and delivery of this Agreement and the purchase of the Note have been duly approved and authorized by the Board of Directors of DMIC. No other corporate proceedings on the part of DMIC are necessary to authorize this Agreement and the purchase of the Note. This Agreement when executed and delivered by DMIC and assuming the due execution thereof by WBM, will constitute the valid, legal and binding obligations of DMIC enforceable against DMIC in accordance with its terms, except that (i) such enforcement may be subject to bankruptcy, rehabilitation, liquidation, conservation, dissolution, insolvency, reorganization, moratorium or other similar Laws now or hereafter in effect relating to creditors' rights generally and (ii) the remedy of specific performance and injunctive and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any Proceeding therefor may be brought.

3.3 Consents and Approvals of Government Agencies. Other than approval of the purchase of the Note by the Insurance Commissioner of the State of Michigan, no consent, approval, Order or authorization of, or registration, application, declaration or filing with any Person is required with respect to DMIC in connection with the execution and delivery of this Agreement and the purchases of the Note, nor compliance with nor fulfillment of the terms and provisions hereof and thereof, will (i) conflict with or result in a breach of the terms, conditions or provisions of or constitute a default under the Amended Articles of Incorporation or the Amended and Restated By-laws of DMIC, or any instrument, agreement, mortgage, judgment, Order, award, decree or other restriction to which DMIC is party; (ii) give any party to or with rights under any such instrument, agreement, mortgage, judgment, Order, award, decree or other restriction or (iii) require the approval, consent or authorization of or any filing with or notification to any federal, state or local court, Governmental Authority.

3.4 Transferability. The Note will be acquired by DMIC for its own account and not with a view to, and not in connection with, a public distribution or resale thereof and will not be transferred except in a transaction registered or exempt from registration under the

Securities Act of 1933 as amended. It is understood that DMIC's investments are at all times within its control and direction.

3.5 No Omissions. None of the representations or warranties of DMIC contained in this Agreement, and none of the other information or documents furnished to WBM or its representatives by DMIC in connection with this Agreement is false or misleading in any material respect or omits to state a fact herein or therein necessary to make the statements herein or therein not misleading in any material respect. To the Knowledge of DMIC, there is no fact that adversely affects, or in the future is reasonably likely to affect adversely, the business or Assets of DMIC that has not been disclosed in writing to WBM.

3.6 Finders. DMIC has not paid or become obligated to pay any fee or commission to any broker, finder or intermediary on account of the transactions provided for in this Agreement, except for Sanders. DMIC shall be responsible for the payment of all fees and expenses payable for or on account of the transactions provided for in this Agreement and other such fees based on actions taken or agreements entered into by DMIC.

3.7 Representations and Warranties to Be True on the Closing Date. All of the representations and warranties set forth in this Article IV shall be true and correct on the Closing Date.

ARTICLE IV

CERTAIN COVENANTS

The parties covenant and agree to take the following action between the date hereof and the Closing Date:

4.1 Preserve Accuracy of Representations and Warranties.

(a) WBM shall refrain from taking any action that would render any representation or warranty contained in Article II of this Agreement inaccurate as of the Closing Date. WBM will promptly notify DMIC of any lawsuits, claims, proceedings or investigations that, to the Knowledge of WBM, may be threatened, brought, asserted or commenced against WBM, its officers or its directors (i) involving in any way the transactions this Agreement contemplates.

(b) DMIC shall refrain from taking any action that would render any representation or warranty contained in Article III of this Agreement inaccurate as of the Closing Date. DMIC will promptly notify WBM of any lawsuits, claims, proceedings or investigations that, to the Knowledge of DMIC, may be threatened, brought, asserted or commenced against DMIC, its officers or its directors (i) involving in any way the transactions this Agreement contemplates.

4.2 Required Filings. As promptly as practical after the date of this Agreement, WBM and DMIC shall promptly commence and make all required filings with the appropriate Governmental Authority required by Law to be made by any of them in order to consummate the transactions this Agreement contemplates. Between the date of this Agreement and the Closing Date, each party shall cooperate with the other party with respect to all required filings that a party elects to make or is required by Law to make in connection with the transactions this Agreement contemplates.

ARTICLE V

CONDITIONS

5.1 Conditions to Each Party's Obligations. The respective obligations of each party to effect the purchase and sale of the Note under this Agreement shall be subject to the fulfillment at or prior to the Closing Date of the following conditions:

(a) All required filings and approvals required to be obtained prior to the Closing Date solely for this Agreement and the purchase and sale of the Note have been obtained and not rescinded or adversely modified.

(b) No Order entered or Law promulgated or enacted by any Governmental Authority shall be in effect that would prevent the consummation of the purchase or sale of the Note or the other transactions this Agreement contemplates and no proceeding brought by a Governmental Authority shall have been commenced and be pending that seeks to restrain, prevent or materially delay or restructure the transactions this Agreement contemplates or that otherwise questions the validity or legality of any such transaction; and

(c) There shall be no pending or threatened litigation initiated by a private party seeking to restrain, prevent, rescind or change the terms of this Agreement or the purchase and sale of the Note or to obtain damages in connection with this Agreement or the consummation of the purchase and sale of the Note.

(d) Closing under the Agreement and Plan of Merger (the "Merger Agreement") dated as of July 15, 2010 among WBM, MICO, Donegal Group Inc. and DGI Acquisition Corp. shall occur simultaneously with the closing of the transactions this Agreement contemplates. Capitalized terms used in this Agreement without definition shall have the respective meanings assigned to them in the Merger Agreement.

5.2 Conditions to Obligations of DMIC. The obligations of DMIC to purchase and pay for the Note on or prior to the Closing Date, shall be subject to the following conditions:

(a) WBM shall have performed or complied in all material respects with all agreements required to be performed and complied with by it under this Agreement, including the delivery of the Note at or prior to the Closing Date.

(b) Each of the representations and warranties of WBM contained in this Agreement that is qualified by materiality shall be true and correct on the Closing Date as though made on the Closing Date and each of the representations and warranties of WBM that is not so qualified shall be true and correct in all material respects on the Closing Date as though made on the Closing Date, other than representations and warranties that address matters only as of a certain date, which shall be true and correct in all material respects as of such certain date, and there shall have been delivered to DMIC an Officer's Certificate or Certificates to that effect, dated as of the Closing Date, and signed on behalf of WBM;

5.3 Conditions to Obligations of WBM. The obligation of WBM to sell the Note and to perform its other obligations under this Agreement to be performed on the Closing Date shall, at the option of WBM, be subject to the fulfillment on or prior to the Closing Date, of the following conditions:

(a) DMIC shall have performed or complied in all material respects with all obligations and agreements required to be performed and complied with by it under this Agreement, including the payment of the purchase price of the Note to WBM at or prior to the Closing Date.

(b) Each of the representations and warranties of DMIC contained in this Agreement that is qualified by materiality shall be true and correct on the Closing Date as though made on the Closing Date and each of the representations and warranties of DMIC that is not so qualified shall be true and correct in all material respects on the Closing Date as though made on the Closing Date, other than representations and warranties that address matters only as of a certain date and which shall be true and correct in all material respects as of such certain date, and there shall have been delivered to WBM an Officer's Certificate or Certificates to that effect, dated as of the Closing Date, and signed on behalf of DMIC.

ARTICLE VI

TERMINATION

6.1 Termination. This Agreement may be terminated and the purchase and sale of the Note and the other transactions this Agreement contemplates be abandoned at any time prior to the Closing Date:

(a) by mutual consent of WBM and DMIC;

(b) by either WBM or DMIC by one day's written notice to DMIC or WBM, as the case may be, if the Closing shall not have been consummated on or before December 31, 2010; provided that the right to terminate this Agreement under this Section 6.1(b) shall not be available to any party whose failure to fulfill any obligation under this Agreement has been the cause of, or resulted in, the failure of the purchase and sale of the Note to have been consummated on or before such date;

(c) by either DMIC or WBM by one day's written notice to WBM or DMIC, as the case may be, if any of the conditions to such party's obligations to consummate the transactions contemplated by this Agreement shall in the reasonable opinion of the notifying party have become impossible to satisfy; or

(d) by DMIC if WBM is in breach at any time prior to the Closing Date of any of the representations and warranties made by WBM as though made on and as of such date; or

(e) by WBM if DMIC is in breach at any time prior to the Closing Date of any of the representations and warranties made by DMIC as though made on and as of such date.

6.2 Effect of Termination. In the event of the termination of this Agreement by either WBM or DMIC, as provided in Section 6.1, this Agreement shall thereafter become void and there shall be no Liability on the part of any party hereto against any other party to this Agreement, or their respective directors, officers, policyholders or agents, except that (i) any such termination shall be without prejudice to the rights of any party hereto arising out of the willful breach by any other party of any covenant or agreement contained in this Agreement.

ARTICLE VII

AMENDMENT, WAIVER AND INDEMNIFICATION

7.1 Amendment. This Agreement may be amended or modified in whole or in part any time by an agreement in writing executed in the same manner as this Agreement, provided, however, that no amendment shall be made that changes the terms of this Agreement in any material respect and that requires the further approval or proceedings of any insurance Governmental Authority without such approval having first been obtained or such proceedings having been first completed.

7.2 Extension; Waiver. At any time prior to the Closing Date, either party hereto may:

(a) extend the time for the performance of any of the obligations or other acts of the other party hereto,

(b) waive any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto, and

(c) waive compliance with any of the agreements or conditions contained herein.

Any agreement on the part of a party to any such extension or waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party by its President. The failure of any party hereto to enforce at any time any provision of this Agreement shall not be construed to be a waiver of such provision, nor in any way to affect the validity of this Agreement or any part hereof or the right of such party hereafter to enforce each and every such provision. No waiver of any breach of this Agreement shall be held to constitute a waiver of any other or subsequent breach.

7.3 Survival of Obligations. All certifications, representations and warranties made in this Agreement by WBM and DMIC and their obligations to be performed pursuant to the terms of this Agreement, shall survive the Closing Date hereunder, notwithstanding any notice of any inaccuracy, breach or failure to perform not waived in writing and notwithstanding the consummation of the transactions contemplated herein with knowledge of such inaccuracy, breach or failure. All representations and warranties contained herein shall terminate upon the repayment in full of the principal amount of the Note and all accrued but unpaid interest thereon.

ARTICLE VIII

MISCELLANEOUS

8.1 Notices. All notices or other communications required or permitted hereunder shall be in writing and shall be given by confirmed facsimile or registered mail, postage prepaid, addressed as follows:

if to DMIC, to:

Donegal Mutual Insurance Company
1195 River Road
Marietta, Pennsylvania 17547
Attention: Donald H. Nikolaus, President
Facsimile: 717-426-7009

if to WBM, to:

West Bend Mutual Insurance Company
1900 South 18th Avenue
West Bend, WI 53095
Attention: James J. Pauly, Esq.
Facsimile: 262-338-5058

or to such other address or facsimile number as the Person to whom notice is given may have previously furnished to the other party in writing in accordance herewith.

8.2 Expenses. Except as otherwise provided herein, each party hereto shall pay its own expenses including, without limitation, legal and accounting fees and expenses incident to its negotiation and preparation of this Agreement and to its performance and compliance with the provisions contained herein.

8.3 Governing Law. This Agreement and the Note shall be governed by and construed in accordance with the laws of the State of Michigan without regard to its rules on conflicts of law.

8.4 Partial Invalidity. In case any one or more of the provisions contained herein shall, for any reason, be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement, but this Agreement shall be construed as if such invalid, illegal or unenforceable provision or provisions had never been contained herein unless the deletion of such provision or provisions would result in such a material change as to cause completion of the transactions contemplated herein to be unreasonable or materially and adversely frustrate the objectives of the parties as expressed in this Agreement.

8.5 Execution in Counterparts. This Agreement may be executed in two counterparts, both of which shall be considered one and the same agreement, and shall become a binding agreement when one or more counterparts have been signed by each of the parties and delivered (by facsimile, PDF or otherwise) to the other party.

8.6 Titles and Headings. Titles and headings to Articles and Sections herein are inserted for convenience of reference only and are not intended to be a part of or to affect the meaning or interpretation of this Agreement.

8.7 Entire Agreement. This Agreement, together with the Note, contains the entire understanding of the parties hereto with regard to the subject matter contained in this Agreement.

8.8 Specific Performance. Each of the parties hereto acknowledges and agrees that the other party hereto would be irreparably damaged in the event any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. Accordingly, each of the parties hereto agrees that they each shall be entitled to an injunction or injunctions to prevent breaches of the provisions of this Agreement and to enforce specifically this Agreement and the terms and provisions hereof in any action instituted in any court of the United States or any state thereof having subject matter jurisdiction, in addition to any other remedy to which WBM or DMIC may be entitled, at law or in equity.

IN WITNESS WHEREOF, each party hereto has caused this Agreement to be executed on its behalf as of the date first above written.

DONEGAL MUTUAL INSURANCE COMPANY

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus, President

WEST BEND MUTUAL INSURANCE COMPANY

By: /s/ Kevin A. Steiner
Kevin A. Steiner, President

AMENDED AND RESTATED TAX SHARING AGREEMENT

THIS AMENDED AND RESTATED TAX SHARING AGREEMENT (this “Agreement”) dated as of December 1, 2010 among Donegal Group Inc., a Delaware corporation (“DGI”), Atlantic States Insurance Company, a Pennsylvania stock casualty insurance company (“Atlantic”), Southern Insurance Company of Virginia, a Virginia stock casualty insurance company (“Southern”), Le Mars Insurance Company, an Iowa stock casualty insurance company (“Le Mars”), The Peninsula Insurance Company, a Maryland stock casualty insurance company (“Peninsula”), Peninsula Indemnity Company, a Maryland stock casualty insurance company (“PIC”), Sheboygan Falls Insurance Company, a Wisconsin stock casualty insurance company (“SFIC”), and Michigan Insurance Company, a Michigan stock casualty insurance company (“MICO”). Atlantic, Southern, Le Mars, Peninsula, PIC, SFIC and MICO are each referred to herein as the “Subsidiary.”

WHEREAS, each Subsidiary is a member of an affiliated group (the “Group”) within the meaning of section 1504(a) of the Internal Revenue Code of 1986, as amended (the “Code”) of which DGI is the common parent corporation and each Subsidiary has been a party to a separate tax-sharing agreement with DGI;

WHEREAS, DGI will continue to include each Subsidiary in its consolidated federal income tax returns in accordance with Code sections 1501 and 1502 and wishes to enter into this Agreement so that DGI and each Subsidiary are all parties to the same tax-sharing agreement;

WHEREAS, the parties hereto deem it equitable that, with respect to each taxable year for which a consolidated return is filed on behalf of the Group, each Subsidiary shall pay DGI an amount equal to its Separate Company Tax Liability (as hereinafter defined); and

WHEREAS, the parties wish to provide for the treatment of various other matters that may arise as a result of the filing of consolidated returns, and the parties wish to set forth in this Agreement the agreement between DGI and each Subsidiary with respect to the allocation and settlement of the federal, state and local taxes of the Group with respect to each taxable period ending on or after the date hereof during which such Subsidiary is included in the affiliated group of which DGI is the common parent (the “Affiliation Periods”).

NOW, THEREFORE, in consideration of the mutual covenants contained herein and intending to be legally bound hereby, the parties agree as follows:

1. Filing of Returns. With respect to each Affiliation Period, DGI shall file, and each Subsidiary shall agree to join in the filing of, consolidated federal income tax returns on

behalf of the Group. Each Subsidiary shall execute and file such consents, elections and other documents as DGI reasonably requests with respect to the filing of the Group's consolidated federal income tax returns, and shall, consistently with Section 4, timely provide to DGI such information as may be necessary for the filing of such returns or for the determination of amounts due under this Agreement. Each Subsidiary acknowledges and agrees that the rights conferred upon DGI in connection with the filing of the Group's returns include, without limitation, the right to reasonably determine the allocation of income or loss of DGI and any other subsidiary between the last Affiliation Period and the next taxable period. Each Subsidiary shall file all federal, state, local and foreign tax returns with respect to all periods for which such Subsidiary does not join DGI in filing a consolidated return and the Subsidiary shall be responsible for the payment of all taxes in connection therewith. The Subsidiary shall file any such tax returns in a manner consistent with the manner in which DGI filed its returns for Affiliation Periods except as required by law or to the extent any inconsistency would not adversely affect the tax returns of the Group.

2. Tax Payments.

(a) Due Dates. Except as otherwise provided in this Agreement: (i) each Subsidiary will pay to DGI the amount due DGI, as determined under Section 2(b), no later than the due date for the filing of any federal income tax return of the Group that includes such Subsidiary, and (ii) DGI will pay to each Subsidiary the amount due such Subsidiary, as determined under Section 2(c), no later than the due date for the filing of any federal income tax return of the Group that includes such Subsidiary; provided, however, that no later than each estimated federal income tax payment date of the Group for which the Group actually incurs a federal income tax liability with respect to an Affiliation Period, each Subsidiary shall pay to DGI the greater of (i) the minimum amount required to be paid to avoid the imposition of any penalties or additions to tax under the Code, determined on the same basis as the total amount due for an Affiliation Period under Section 2(b) or (ii) one-fourth of the amount estimated to be payable by such Subsidiary for such taxable year under Section 2(b). The amount of any overpayment or underpayment pursuant to this Section 2(a) shall be credited against, or added to, as the case may be, the amount otherwise required to be paid for the period within which the amount of such overpayment or underpayment first becomes reasonably ascertainable. The settlements may be satisfied by check, wire transfer or through intercompany accounts as the parties may mutually agree.

(b) Amount Due to DGI. Each Subsidiary shall pay DGI in the time and manner described in Section 2(a) an amount equal to any Separate Company Tax Liability of that Subsidiary. The "Separate Company Tax Liability" for any Affiliation Period shall be the amount, if any, of the federal income tax liability, including, without limitation, liability for any penalty, fine, additions to tax, interest, minimum tax, alternative minimum tax and other items applicable to that Subsidiary in connection with the determination of the Subsidiary's tax liability, which the Subsidiary would have incurred had it filed a separate federal income

tax return for such Affiliation Period, computed in the manner prescribed in Income Tax Regulation section 1.1552-1(a)(2)(ii), except that no carryforward or carryback of losses or credits shall be allowed.

The Separate Company Tax Liability for a Subsidiary shall be determined by DGI, with the cooperation and assistance of the Subsidiary, in a manner consistent with (i) general tax accounting principles, (ii) the Code and regulations thereunder and (iii) so long as a reasonable legal basis exists therefor, prior custom and practice. In addition, transactions or items between DGI and a Subsidiary that are deferred under the federal income tax return shall also be deferred for purposes of this Agreement until such time as they are restored or otherwise triggered into income under the Code or regulations.

(c) Amount due to a Subsidiary. In the event a Subsidiary does not have Separate Company Tax Liability for an Affiliation Period, but instead either incurs net losses or credits for such period, DGI shall pay the Subsidiary in the time and manner prescribed in Section 2(a) the amount by which the Group's federal income tax liability for such period is actually reduced by reason of the actual use of such losses or credits attributable to the Subsidiary in the Group's federal income tax return.

In the event a Subsidiary incurs any tax losses or tax credits that, as permitted under the Code and the regulations, are carried back or forward to one or more Affiliation Periods, DGI shall pay that Subsidiary an amount equal to the amount by which the Group's federal income tax liability is actually reduced by reason of the actual use of such carried over losses or credits in the Group's federal income tax return. Any payment from DGI to the Subsidiary required on account of such carryover shall be paid within 15 days of the date the benefit of the carryover is realized by DGI by reason of the receipt of a refund or credit of taxes.

(d) Paying Agent. DGI agrees to make all required payments to the Internal Revenue Service ("IRS") of the consolidated federal income tax liability, if any, of the Group.

3. Adjustments to Tax Liability.

(a) Adjustment-Related Payments. If the consolidated federal income tax liability of the Group or any of its members is adjusted for any taxable period for any reason other than a loss or credit carryback to the extent already provided for in Section 2(c), whether by means of an amended return, judicial decision, claim for refund or tax audit by the IRS, the Separate Company Tax Liability or the amount of tax benefits realized by the Group by reason of the use of a Subsidiary's losses or credit shall be recomputed to give effect to such adjustment, and the amount of any payments due under Section 2 shall be appropriately adjusted. Any additional payment between DGI and a Subsidiary required by reason of such recomputed Separate Company Tax Liability or Group tax refund or credit shall include an allocable share of any refunded interest received from the IRS, if applicable,

or deficiency interest, penalties and additions to tax, if applicable. Such allocable share of refunded interest or deficiency interest, penalties and additions to tax shall be paid or charged, respectively, to a Subsidiary to the extent such amount relates to (i) reduced Group tax liability due to decreased Separate Company Tax Liability or increased Group tax refund or credit resulting from increased use of a Subsidiary's losses or credits, on the one hand, or (ii) increased Group tax liability due to increased Separate Company Tax Liability or decreased Group tax benefits arising from decreased use of a Subsidiary's losses or credits, on the other hand.

(b) Timing of Payments. Any payments to be paid to or by a Subsidiary under this Section 3 shall be made on or before the earliest to occur of (i) a decision by a court of competent jurisdiction that is not subject to further judicial review by appeal or otherwise and that has become final, (ii) the expiration of the time for (A) filing a claim for refund or (B) instituting suit in respect to a claim for refund disallowed in whole or in part by the IRS or for which the IRS took no action, (iii) the execution of a closing agreement under section 7121 of the Code or the acceptance by the IRS or its counsel of an offer in compromise under section 7122 of the Code or any successor provisions, (iv) the expiration of 30 days after (A) IRS acceptance of a Waiver of Restrictions on Assessment and Collection of Deficiency in Tax on Overassessment on Internal Revenue Form 870 or 870-AD or any successor or comparable form, or (B) the expiration of the ninety-day period after receipt of the statutory notice of deficiency resulting in immediate assessment, unless within such 30 days DGI notifies the Subsidiary of its intent to attempt recovery of any relevant amounts paid under the waiver by filing a timely claim for refund, (v) the expiration of the statute of limitations with respect to the relevant period or (vi) any other event the parties reasonably agree is a final determination of the tax liability at issue.

4. Books and Records. DGI and each Subsidiary agree that the preparation of the federal income and other tax returns, amended returns, claims for refund or IRS examination or litigation relating to the foregoing may require the use of records and information that is within the exclusive possession and control of either of DGI and the Subsidiary. DGI and each Subsidiary will provide such records, information and assistance, which may include making employees of any of the foregoing entities available to provide additional information and explanation material, requested by DGI or the Subsidiary, as the case may be, during regular business hours, in connection with any of the developments described in the preceding sentence; provided, however, that each Subsidiary shall provide DGI with all information necessary to enable DGI to file the Group consolidated federal income tax return for each Affiliation Period as soon as practicable, but in no event later than five months after the last day of such Affiliation Period, and on the date the Group federal income tax returns that include a Subsidiary are filed, DGI shall provide that Subsidiary with those portions of such returns relating to the Subsidiary. Each of the parties agrees that it shall retain, until the expiration of the applicable statute of limitations, including extensions, copies of any tax returns for any Affiliation Periods and for any other periods that might be subject to

adjustment under this Agreement, and supporting work schedules and other records or information, that may be relevant to the tax returns of the parties, and that it will not destroy or otherwise dispose of such records and information without providing the other parties with a reasonable opportunity to review and copy such records and information.

5. Assignment. This Agreement shall not be transferable or assignable by any of the parties without the prior written consent of the other parties. The rights and obligations hereunder of the parties shall be binding upon and inure to the benefit of the parties and their respective permitted successors and assigns. This Agreement shall be binding upon each corporation in which a Subsidiary owns, directly or indirectly, stock meeting the requirements of section 1504(a)(2) of the Code, whether or not the Subsidiary owns stock in such corporation upon the execution of this Agreement or at any time during Affiliation Periods, and the Subsidiary shall cause each such corporation as soon as practicable to assent formally to the terms of this Agreement. Except as herein otherwise specifically provided, nothing in this Agreement shall confer any right or benefit upon any person or entity other than the parties and their respective successors and permitted assigns.

6. Disputes. Any dispute concerning the interpretation of this Agreement or amount of payment due under this Agreement shall be resolved by DGI's regular independent registered public accounting firm for federal income tax matters, whose judgment shall be conclusive and binding on the parties and who shall act in consultation with DGI's tax counsel.

7. Tax Controversies. If any party receives notice of a tax examination, audit or challenge involving amounts subject to this Agreement, such party shall timely notify the other parties of the information and shall provide the other parties a written copy of any relevant letters, forms or schedules received from the IRS or otherwise in its possession and shall provide notice and information relating to all material proceedings in connection therewith. In any audit conference or other proceeding with the IRS or in any judicial proceedings concerning the determination of the federal income tax liabilities of the Group or any of its members, including any Subsidiary, the Group and each of its members shall be represented by persons selected by DGI. Except as otherwise expressly provided in Section 6, the settlement and terms of settlement of any issues relating to such proceeding shall be in the sole discretion of DGI, and each Subsidiary hereby appoints DGI as its agent for the purpose of proposing and concluding any such settlement. Notwithstanding anything to the contrary in this Agreement, in no event shall DGI be obligated to file any amended returns or claims for refund with respect to Affiliation Periods.

8. State and Local Taxes. To the extent appropriate, all provisions of this Agreement shall apply with the same force and effect to any state or local income tax liabilities that are computed on a combined, consolidated or unitary method; provided, however, that appropriate adjustments shall be made to the provisions hereof, including computation of Separate Company Tax Liability, with respect to any period within an

Affiliation Period during which a Subsidiary or a Subsidiary's items were not included on a return of DGI or other members of the Group, or were included on a return of members of the Group other than DGI.

9. Indemnity. If any party to this Agreement other than DGI is required to pay tax to the IRS or any state taxing authority in excess of its Separate Company Tax Liability as determined hereunder, such party shall be entitled to reimbursement of the excess liability payment from the party to whom the excess is properly allocable under this Agreement.

10. Miscellaneous.

(a) Severability. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions set forth herein shall remain in full force and effect and shall in no way be affected, impaired or invalidated unless such invalidity or unenforceability would frustrate the essential purposes of the parties in entering into this Agreement. In the event that any such term, provision, covenant or restriction is held to be invalid, void or unenforceable, the parties hereto shall use their best efforts to find and employ an alternate means to achieve the same or substantially the same result as that contemplated by such term, provision, covenant or restriction.

(b) Parties in Interest. Except as otherwise specifically provided, nothing in this Agreement expressed or implied is intended to confer any right or benefit upon any person, firm or corporation other than the parties and their respective successors and permitted assigns.

(c) Change of Law. If, due to any change in applicable law or regulations or the interpretation thereof by any court of law or other governing body having jurisdiction subsequent to the date of this Agreement, performance of any provision of this Agreement or any transaction contemplated thereby shall become impracticable or impossible, the parties shall use their commercially reasonable efforts to find and employ an alternative means to achieve the same or substantially the same result as that contemplated by such provision.

(d) Confidentiality. Subject to any contrary requirement of law and the right of each party to enforce its rights hereunder in any legal action, each party agrees that it shall keep strictly confidential, and shall cause its employees and agents to keep strictly confidential, any information which it or any of its agents or employees may acquire pursuant to, or in the course of performing its obligations under, any provision of this Agreement; provided, however, that such obligation to maintain confidentiality shall not apply to information which (i) at the time of disclosure was in the public domain not as a result of acts by the receiving party or (ii) was in the possession of the receiving party at the time of disclosure.

(e) Counterparts. For the convenience of the parties, any number of counterparts of this Agreement may be executed by the parties hereto, and each such executed counterpart shall be, and shall be deemed to be, an original instrument.

(f) Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania, without regard to its conflict of law provisions.

(g) Effect of Agreement. This Agreement shall supersede any other tax sharing arrangement or agreement in effect between the parties. Nothing in this Agreement is intended to change or otherwise affect any election made by or on behalf of the Group with respect to the calculation of earnings and profits under section 1552 of the Code.

(h) Interest. Any payment required to be made hereunder and not made when due shall bear interest at the rate per annum determined, from time to time, by the prevailing average rate earned on the investments of the party required to make payment.

(i) Term of Agreement. This Agreement shall become effective as of the date hereof and shall continue, unless earlier terminated by mutual agreement of the parties, until the expiration of the applicable statute of limitations, including extensions, for the Affiliation Period (the “Final Date”); provided that the provisions of Sections 1, 2 and 3 shall continue to apply after the Final Date only to the extent they deal with matters relevant to tax periods that end on or before such Final Date or that begin prior to and end after such Final Date.

(j) Modifications. This Agreement may be modified or amended only pursuant to an instrument in writing executed by all the parties hereto.

(k) Entire Agreement. This Agreement constitutes the entire agreement among the parties relating to the allocation of the consolidated and combined tax liabilities of the Group between or among the parties.

(l) Notices. All notices, consents, requests, instructions, approvals and other communications provided for herein shall be validly given, made or served, if in writing and delivered personally, by e-mail or reputable national delivery service to:

DGI:

1195 River Road
Marietta, PA 17547
Attention: Chief Executive Officer

Atlantic:

1195 River Road
Marietta, PA 17547
Attention: Chief Executive Officer

Southern:

1195 River Road
Marietta, PA 17547
Attention: Chief Executive Officer

Le Mars:

1195 River Road
Marietta, PA 17547
Attention: Chief Executive Officer

Peninsula:

1195 River Road
Marietta, PA 17547
Attention: Chief Executive Officer

PIC:

1195 River Road
Marietta, PA 17547
Attention: Chief Executive Officer

SFIC:

511 Water Street
Sheboygan Falls, WI 53085
Attention: Chief Executive Officer

MICO:

1700 East Beltline N.E., Suite 100
Grand Rapids, MI 49525
Attention: Chief Executive Officer

or to such other address as any party may have furnished to the other parties

in writing in accordance with this Section 13(l).

IN WITNESS WHEREOF, the undersigned parties have caused this Agreement to be executed by their duly authorized officers as of December 1, 2010.

SOUTHERN INSURANCE COMPANY OF VIRGINIA

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus
Chief Executive Officer

DONEGAL GROUP INC.

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus
Chief Executive Officer

LE MARS INSURANCE COMPANY

By: /s/ Daniel J. Wagner
Daniel J. Wagner, Senior Vice President and Treasurer

ATLANTIC STATES INSURANCE COMPANY

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

SHEBOYGAN FALLS INSURANCE COMPANY

By: /s/ Lee F. Wilcox
Lee F. Wilcox, President

THE PENINSULA INSURANCE COMPANY

By: /s/ G. Eric Crouchley, III
G. Eric Crouchley, III, President

PENINSULA INDEMNITY COMPANY

By: /s/ G. Eric Crouchley, III
G. Eric Crouchley, III, President

MICHIGAN INSURANCE COMPANY

By: /s/ Ermil L. Adamson
Ermil L. Adamson, President

AMENDED AND RESTATED SERVICES ALLOCATION AGREEMENT

THIS AMENDED AND RESTATED SERVICES ALLOCATION AGREEMENT (this “Agreement”) dated as of the 1st day of December 2010 among DONEGAL GROUP INC., a Delaware corporation (“DGI”), ATLANTIC STATES INSURANCE COMPANY, a Pennsylvania stock casualty insurance company (“Atlantic States”), SOUTHERN INSURANCE COMPANY OF VIRGINIA, a Virginia stock casualty insurance company (“Southern”), LE MARS INSURANCE COMPANY, an Iowa stock casualty insurance company (“Le Mars”), THE PENINSULA INSURANCE COMPANY, a Maryland stock casualty insurance company (“Peninsula”), PENINSULA INDEMNITY COMPANY, a Maryland stock casualty insurance company (“PIC”), SHEBOYGAN FALLS INSURANCE COMPANY, a Wisconsin stock property and casualty insurance corporation (“SFIC”) and MICHIGAN INSURANCE COMPANY, a Michigan stock casualty insurance corporation (“MICO,” and, together with Atlantic States, Southern, Le Mars, Peninsula, PIC and SFIC, the “Insurance Subsidiaries”) and DONEGAL MUTUAL INSURANCE COMPANY, a Pennsylvania mutual fire insurance company (“Donegal Mutual”).

WITNESSETH:

WHEREAS, DGI, Donegal Mutual and the Insurance Subsidiaries other than MICO entered into an Amended and Restated Services Allocation Agreement dated as of October 15, 2009 (the “Prior Agreement”); and

WHEREAS, Donegal Mutual, DGI and the Insurance Subsidiaries believe it is appropriate to amend Appendix A to the Prior Agreement effective as of 12:01 a.m. on December 1, 2010 by entering into this Agreement; and

WHEREAS, the Boards of Directors of Peninsula and PIC have authorized Peninsula and PIC to enter into this Agreement, subject to the filing of a Form D with respect thereto with the Insurance Administration of the State of Maryland (the “Administration”) and the absence of any disapproval thereof by the Administration; and

WHEREAS, the Board of Directors of MICO have authorized MICO to enter into this Agreement, subject to the filing of a Form D with respect thereto with the Office of Financial and Insurance Regulation of the State of Michigan (the “OFIR”) and the absence of any disapproval thereof by the OFIR;

NOW, THEREFORE, in consideration of the promises and mutual covenants herein contained and intending to be legally bound hereby, Donegal Mutual, DGI and the Insurance Subsidiaries agree as follows:

I. Effective Date. The effective date of this Agreement shall be 12:01 a.m. on December 1, 2010 (the "Effective Date"). This Agreement shall continue in effect unless and until terminated pursuant to Section IV.

II. Services To Be Provided.

A. Donegal Mutual agrees to provide employees who shall perform the services described in Section II.D. for and on behalf of and in the name of Atlantic States, and Donegal Mutual and Atlantic States agree that all of the costs and expenses of Donegal Mutual in providing those services and employees to Atlantic States shall be allocated between Donegal Mutual and Atlantic States in proportion to their respective participation from time to time under the Proportional Reinsurance Agreement dated as of September 29, 1986 and most recently amended as of March 1, 2008 between Donegal Mutual and Atlantic States.

B. Donegal Mutual agrees to provide employees who shall, directly or indirectly, perform the services described in Section II.D. for and on behalf of DGI and the Insurance Subsidiaries other than Atlantic States, and DGI and the Insurance Subsidiaries other than Atlantic States, agree either to reimburse Donegal Mutual or to allocate among Donegal Mutual, on the one hand, and DGI and the Insurance Subsidiaries other than Atlantic States, on the other hand, the costs and expenses of Donegal Mutual in providing such services and employees to DGI and the Insurance Subsidiaries other than Atlantic States.

C. Donegal Mutual, DGI and the Insurance Subsidiaries agree that the fundamental purposes of this Agreement are (i) to secure the provision of the services described in Section II.D. to DGI and the Insurance Subsidiaries and (ii) to assure that Donegal Mutual receives appropriate payments from DGI and the Insurance Subsidiaries so that Donegal Mutual has no net cost for providing the services and employees, or, in the case of Atlantic States, for providing Atlantic States' proportionate share of such services and employees as described in Section II.A., pursuant to this Agreement. Exhibit A to this Agreement provides specific but non-exclusive guidelines as to how such allocations and reimbursements shall be calculated and settled, and Exhibit A may be amended from time to time by the mutual agreement of Donegal Mutual, DGI and the Insurance Subsidiaries.

D. The services are as follows:

1. Underwriting — the development, implementation and administration of policies relating to underwriting and the acceptance of risks, the maintenance of underwriting manuals and guidelines and services relating to the development of insurance products and rates, the provision of all actuarial services necessary or appropriate for the operation of the Insurance Subsidiaries, the analysis of loss trends and reserve developments and risk concentrations and the arranging for insurance, loss control

and other reasonable risk management services in the underwriting process to protect the Insurance Subsidiaries and their respective properties and other assets against loss, damage and liabilities;

2. Claims — the admitting, adjusting, compromising, rejection and settlement of claims under insurance policies issued by the Insurance Subsidiaries and the collection of reinsurance and recoverables;

3. Reinsurance — the review, negotiation, monitoring and coordination of all reinsurance contracts and placements, including the determination of the amounts, terms, types and structure of reinsurance to be obtained and the selection of the reinsurers;

4. Investments — the investment of all available funds in the name of DGI and the Insurance Subsidiaries pursuant to their respective investment policies, and the management of the respective investments of DGI and the Insurance Subsidiaries;

5. Information Services — the purchase and maintenance of computer hardware and software systems and the creation, implementation and maintenance of computer programs utilized within those systems. Such systems shall include, but not be limited to, accounting and bookkeeping systems, automated underwriting and policy issuance systems, claims processing systems, premium billing systems, electronic imaging systems, Internet web systems and storage and processing systems for maintaining information to enable the preparation and analysis of daily, weekly and monthly reports;

6. Personnel and Professional Services — the appointment, direction, removal and suspension, in the name of DGI and the Insurance Subsidiaries, of employees and agents, including the determination of the appropriate levels thereof, and the ongoing review and analysis of professional services, including the retention of counsel, accountants, actuaries and other consultants;

7. Financial Reporting — the analysis and reporting of actual performance to budgeted performance, including analysis of financial results through the budgeted period and the preparation of all statements and reports necessary or appropriate for the respective businesses of DGI and the Insurance Subsidiaries, including reports to insurance regulatory authorities and the Securities and Exchange Commission;

8. Tax Administration — the ordinary and necessary tax administration services for income taxes, premium taxes, sales and use taxes, franchise and similar taxes and any other taxes incurred;

9. Accounting Services — the providing of routine accounting and bookkeeping services relating to cash, cash equivalents, receivables, supplies and other inventory items, fixed assets and other asset accounting, accounts payable, notes payable,

other trade payables, payroll and payroll taxes, other general ledger items, accounting services relating to investments and the reconciliation of all bank accounts;

10. Policyholder Services — the maintenance of policyholders' customer relation services and the maintenance of policyholder information, including names, addresses, policy anniversary dates and premiums due;

11. Internal Audit and Compliance Services — the providing of internal audit and compliance services to obtain an ongoing independent and objective evaluation of the internal control systems designed to provide reasonable assurance regarding the efficiency and effectiveness of operations, the reliability of financial reporting and compliance with applicable laws and regulations;

12. Actuarial Services — the providing of actuarial services including review and analysis of claims reserving assumptions, historical claims experience and 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; and

13. Marketing, Sales and Advertising Services — the creation and development of marketing, sales and advertising programs, media and agency co-op promotional materials to further increase brand awareness and promote the sales of insurance products and services.

E. Donegal Mutual shall use its best efforts to provide the services described above and such other or additional services as DGI or the Insurance Subsidiaries may from time to time request pursuant to this Agreement. Notwithstanding the foregoing, DGI and the Insurance Subsidiaries agree that Donegal Mutual shall have no obligation to provide services to DGI and the Insurance Subsidiaries of a quality greater than the quality of such services that Donegal Mutual maintains for its own operations.

F. Donegal Mutual shall, within 90 days after the expiration of each calendar year during the term of this Agreement, furnish the Boards of Directors of DGI and the Insurance Subsidiaries with a written report as to the allocations and reimbursements between Donegal Mutual, on the one hand, and DGI and the Insurance Subsidiaries, on the other hand, during such year as shall be sufficient, (i) in the discretion of the disinterested members of the Boards of Directors of DGI and the Insurance Subsidiaries, to provide a commercially reasonable basis to reach the conclusion that the transactions between Donegal Mutual, on the one hand, and DGI and the Insurance Subsidiaries, on the other hand, have been fair to DGI and its stockholders under prevailing circumstances and (ii) as shall be sufficient in the discretion of the disinterested members of Donegal Mutual's Board of Directors, to provide a commercially reasonable basis to reach the conclusion that the transactions between Donegal Mutual, on the one hand, and DGI and the Insurance

Subsidiaries, on the other hand, have been fair to Donegal Mutual and its policyholders under prevailing circumstances.

G. Nothing in this Agreement shall constitute or be construed to be or create a partnership or joint venture relationship between DGI and the Insurance Subsidiaries, on the one hand, and Donegal Mutual, on the other hand, and Donegal Mutual's status under this Agreement shall be that of an independent contractor. In connection with the performance of services under this Agreement, neither DGI, the Insurance Subsidiaries nor Donegal Mutual shall make any statement or take any action that is inconsistent with the provisions of this Section II.G. It is understood and agreed that the management, control and direction of the operations and policies of DGI and the Insurance Subsidiaries shall remain at all times under the exclusive control of the respective Boards of Directors of DGI and the Insurance Subsidiaries.

H. In the event that an issue or question arises in the future as to how this Agreement should be interpreted or whether the provisions of this Agreement should or should not apply in a particular set of circumstances as to a particular transaction between Donegal Mutual and DGI or one of the Insurance Subsidiaries, the issue or question shall be referred, upon the request of any of Donegal Mutual, DGI or the Insurance Subsidiary, for resolution to the Coordinating Committee maintained by the Boards of Directors of Donegal Mutual and DGI, and the decision of the Coordinating Committee with respect to such issue or question shall be final and binding on Donegal Mutual, DGI and the Insurance Subsidiaries.

III. Books and Records.

A. Donegal Mutual shall keep accurate records and accounts of all services provided pursuant to this Agreement. Such records and accounts shall be maintained in accordance with sound business practices and shall be subject to such systems of internal control as are required by law. All records and accounts shall be available for inspection by DGI, the Insurance Subsidiaries and their respective representatives, including DGI's independent registered public accounting firm, at any time upon request during commercially reasonable hours.

B. All such records and accounts maintained by Donegal Mutual for DGI and the Insurance Subsidiaries under Section III.A. of this Agreement shall be the sole property of DGI and the Insurance Subsidiaries, subject to the examination rights of insurance and other applicable regulatory authorities.

C. DGI and the Insurance Subsidiaries, as the case may be, shall be solely responsible, severally and not jointly, for, and shall hold harmless and indemnify Donegal Mutual, including its successors, officers, directors, employees, agents and affiliates, from and against all losses, claims, damages, liabilities and expenses, including any and all

reasonable expenses and attorneys' fees and disbursements incurred in investigating, preparing or defending against any litigation or proceeding, whether commenced or threatened, or any other claim whatsoever, whether or not resulting in any liability, suffered, incurred, made, brought or asserted by any person not a party to this Agreement in connection with Donegal Mutual's provision of services to DGI and the Insurance Subsidiaries, unless such loss, claim, damage, liability or expense results from the negligence, willful misconduct or fraud of Donegal Mutual or its officers, directors, employees, agents or affiliates or any other person engaged by Donegal Mutual to provide services to DGI and the Insurance Subsidiaries.

D. Donegal Mutual shall be solely responsible for, and shall hold harmless and indemnify DGI and the Insurance Subsidiaries, as the case may be, including their respective successors, officers, directors, employees, agents and affiliates, from and against all losses, claims, damages, liabilities and expenses, including any and all reasonable expenses and attorneys' fees and disbursements incurred in investigating, preparing or defending against any litigation or proceeding, whether commenced or threatened, or any other claim whatsoever, whether or not resulting in any liability, suffered, incurred, made, brought or asserted by any person not a party to this Agreement resulting from the negligence, willful misconduct or fraud of Donegal Mutual or its officers, directors, employees, agents or affiliates or any other person engaged by Donegal Mutual to provide services to DGI and the Insurance Subsidiaries.

IV. Termination. This Agreement shall have a term that initially expires on December 31, 2015, provided, however, that, on each December 31 after the Effective Date of this Agreement, the term of this Agreement shall be extended by one year so that upon each such automatic renewal this Agreement shall have a then current term of five years; provided, however, that this Agreement may be terminated at any time prior to its then termination date in any of the following events, subject, in all events, to the receipt of any necessary insurance regulatory filings or actions:

A. By Donegal Mutual, upon 180 days prior written notice to DGI and the Insurance Subsidiaries, if a Change of Control (as defined in this Agreement) of DGI shall have occurred. As used herein, "Change of Control" shall mean (i) the acquisition of shares of DGI by any "person" or "group," as such terms are used in Rule 13d-3 under the Securities Exchange Act of 1934 as now or hereafter amended, in a transaction or series of transactions that result in such person or group directly or indirectly becoming the beneficial owner of 25% or more of the voting power of DGI's common stock after the Effective Date of this Agreement, (ii) the consummation of a merger or other business combination after which the holders of voting common stock of DGI do not collectively own 60% or more of such voting common stock of the entity surviving such merger or other business combination, (iii) the sale, lease, exchange or other transfer in a transaction or series of transactions of all or substantially all of the assets of DGI, but excluding therefrom the sale and reinvestment of

the investment portfolio of DGI and the Insurance Subsidiaries or (iv) as the result of or in connection with any cash tender offer or exchange offer, merger or other business combination, sale of assets or contested election of directors or any combination of the foregoing transactions specified in clauses (i), (ii), (iii) and (iv), each, a "Transaction," the persons who constituted a majority of the members of the Board of Directors of DGI on the date of this Agreement and persons whose election as members of the Board of Directors of DGI was approved by such members then still in office or whose election was previously so approved after the Effective Date of this Agreement but before the event that constitutes a Change of Control, no longer constitute such a majority of the members of the Board of Directors of DGI then in office. A Transaction shall be deemed to constitute a Change in Control only upon the consummation of the Transaction.

B. By DGI and the Insurance Subsidiaries, upon 30 days prior written notice to Donegal Mutual, if Donegal Mutual shall have become insolvent or shall have become subject to any voluntary or involuntary conservatorship, receivership, reorganization, liquidation or bankruptcy case or proceeding.

C. By Donegal Mutual, DGI and the Insurance Subsidiaries at any time by mutual written agreement.

D. The aforesaid respective rights of termination of DGI, the Insurance Subsidiaries and Donegal Mutual may be exercised without prejudice to any other remedy to which DGI, the Insurance Subsidiaries or Donegal Mutual, as the case may be, is entitled in law or in equity.

V. Miscellaneous.

A. All notices, communications and deliveries under this Agreement shall (i) be made in writing, signed by the party making the same to the address as specified below, (ii) specify the section of this Agreement pursuant to which such notice is given and (iii) be deemed to be given if delivered in person, on the date delivered, or if sent by facsimile, on the date sent (if the party giving the notice, or its employee or agent, has no reason to believe that the facsimiled notice was not made or received), or if sent by Federal Express or some other overnight express courier with costs paid, on the date delivered to such express courier:

if to DGI, to:

Donegal Group Inc.
1195 River Road
Marietta, Pennsylvania 17547
Attention: President
Facsimile: 717-426-7009

if to Donegal Mutual, to:

Donegal Mutual Insurance Company
1195 River Road
Marietta, Pennsylvania 17547
Attention: President
Facsimile: 717-426-7009

if to Atlantic States, to:

Atlantic States Insurance Company
1195 River Road
Marietta, Pennsylvania 17547
Attention: Chief Executive Officer
Facsimile: 717-426-7009

if to Southern, to:

Southern Insurance Company of Virginia
1195 River Road
Marietta, Pennsylvania 17547
Attention: Chief Executive Officer
Facsimile: 717-426-7009

if to Le Mars, to:

Le Mars Insurance Company
1195 River Road
Marietta, Pennsylvania 17547
Attention: Chief Executive Officer
Facsimile: 717-426-7009

if to Peninsula and/or PIC, to:

The Peninsula Insurance Company
1195 River Road
Marietta, Pennsylvania 17547
Attention: Chief Executive Officer
Facsimile: 717-426-7009

if to SFIC, to:

Sheboygan Falls Insurance Company
511 Water Street
Sheboygan Falls, Wisconsin 53085
Attention: Chief Executive Officer
Facsimile: 920-467-3364

if to MICO, to:

Michigan Insurance Company
1700 East Beltline N.E., Suite 100
Grand Rapids, MI 49525
Attention: President
Facsimile: 616-447-9603

Such notice shall be given at such other address or to such other representative as a party to this Agreement may furnish pursuant to this Section V.A. to the other party to this Agreement.

B. No assignment, transfer or delegation, whether by merger or other operation of law or otherwise, of any rights or obligations under this Agreement shall be made by a party to this Agreement without the prior written consent of the other party to this Agreement and, if required by applicable law, the Pennsylvania Commissioner of Insurance and any other insurance regulatory authority having jurisdiction over this Agreement. This Agreement shall be binding upon the parties hereto and their respective permitted successors and assigns.

C. This Agreement constitutes the entire agreement of the parties to this Agreement with respect to its subject matter, supersedes all prior agreements, including the Prior Agreement, and may not be amended except in writing signed by the party to this Agreement against whom the change is asserted. The failure of any party to this Agreement at any time or times to require the performance of any provision of this Agreement shall in

no manner affect the right to enforce the same and no waiver by any party to this Agreement of any provision or breach of any provision of this Agreement in any one or more instances shall be deemed or construed either as a further or continuing waiver of any such provision or breach or as a waiver of any other provision or breach of any other provision of this Agreement.

D. In case any one or more of the provisions contained herein shall, for any reason, be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement, but this Agreement shall be construed as if such invalid, illegal or unenforceable provision or provisions had never been contained herein unless the deletion of such provision or provisions would result in such a material change as to cause continued performance of this Agreement as contemplated herein to be unreasonable or materially and adversely frustrate the objectives of the parties in originally entering into this Agreement as expressed in the Recitals to this Agreement.

E. This Agreement shall be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement the day and year first above written.

DONEGAL MUTUAL INSURANCE COMPANY

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

DONEGAL GROUP INC.

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus, President
and Chief Executive Officer

ATLANTIC STATES INSURANCE COMPANY

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus, President
and Chief Executive Officer

SOUTHERN INSURANCE COMPANY OF VIRGINIA

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus, President
and Chief Executive Officer

LE MARS INSURANCE COMPANY

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus, President
and Chief Executive Officer

THE PENINSULA INSURANCE COMPANY

By: /s/ G. Eric Crouchley, III
G. Eric Crouchley III, President

PENINSULA INDEMNITY COMPANY

By: /s/ G. Eric Crouchley, III
G. Eric Crouchley III, President

SHEBOYGAN FALLS INSURANCE COMPANY

By: /s/ Lee F. Wilcox
Lee F. Wilcox, Chief Executive Officer

MICHIGAN INSURANCE COMPANY

By: /s/ Ermil L. Adamson
Ermil L. Adamson, President

EXHIBIT A

Amended and Restated
Services Allocation Agreement
Allocation and Reimbursement Guidelines

The following information sets forth allocation and reimbursement guidelines to be followed for the calculation and settlement of amounts pursuant to the Agreement.

1. Personnel Costs.

Personnel Costs as used in this Exhibit A shall be defined to include salaries and payroll tax expense. Calculation and settlement of allocations and reimbursements of personnel costs shall be performed as follows:

(a) For DGI and the Insurance Subsidiaries other than Atlantic States receiving services from Donegal Mutual employees, DGI and the Insurance Subsidiaries shall reimburse Donegal Mutual for the direct costs of the employees performing such services. Donegal Mutual may also recover an administration fee to cover its costs of services rendered to maintain records and process payroll for DGI and the Insurance Subsidiaries.

(b) Atlantic States shall reimburse Donegal Mutual for its proportionate share of Donegal Mutual's personnel costs, after subtracting direct reimbursements from DGI and the Insurance Subsidiaries other than Atlantic States as described in Paragraph 1(a), in accordance with the following allocation methods:

(i) Underwriting and general personnel costs shall be allocated in proportion to Donegal Mutual's and Atlantic States' respective participation under the Proportional Reinsurance Agreement.

(ii) Claim personnel costs shall be allocated in proportion to Donegal Mutual's and Atlantic States' respective average claim reserves and loss payments

(iii) Investment personnel costs shall be allocated in proportion to Donegal Mutual's and Atlantic States' respective average invested assets, excluding 50% of the average value of Donegal Mutual's investment in subsidiaries and affiliates. Such costs shall include the proportionate amount of personnel costs for individuals who perform duties related to Donegal Mutual's and Atlantic States' investment portfolios.

(iv) Information technology and operational services personnel costs shall be allocated proportionately to the allocations calculated in (i) through (iii) above to reflect the provision of information technology and operational services to each of the respective functions.

(c) Donegal Mutual shall provide to DGI and the Insurance Subsidiaries periodic calculations of amounts pursuant to Paragraphs 1(a) and (b), and DGI and the Insurance Subsidiaries shall reimburse Donegal Mutual in the normal course of business, generally within 30 days of receipt of such calculations.

2. Information Services.

To the extent that Donegal Mutual purchases and maintains the computer hardware and software systems required to service the business underwritten by Donegal Mutual and one or more of the Insurance Subsidiaries, calculation and settlement of allocations and reimbursements for such services shall be performed as follows:

(a) The estimated purchase price and development costs of computer hardware and software systems required to provide such services shall be divided by the number of years those systems are reasonably expected to serve the respective information services requirements of Donegal Mutual, DGI and one or more of the Insurance Subsidiaries. Such estimated annual cost shall then be allocated to the respective companies based upon their proportionate net written premiums in the year prior to the establishment of the allocation amounts.

(b) The Insurance Subsidiaries shall reimburse Donegal Mutual for the amounts so allocated on a monthly basis.

3. Miscellaneous Expenses.

(a) DGI and the Insurance Subsidiaries other than Atlantic States shall reimburse Donegal Mutual for miscellaneous direct and allocated expenses including, but not limited to, postage, in-house printing services and insurance purchased by Donegal Mutual on their behalf. DGI and the Insurance Subsidiaries shall reimburse Donegal Mutual such allocation amounts in the normal course of business, generally within 30 days of receipt of such allocations.

(b) Atlantic States shall reimburse Donegal Mutual on a monthly basis for its proportionate share of Donegal Mutual’s expenses other than information systems depreciation expense, real estate depreciation and any other expenses for services solely benefiting Donegal Mutual and after subtracting direct reimbursements from DGI and the Insurance Subsidiaries other than Atlantic States as described in Paragraph 3(a) in accordance with the following allocation methods:

(i) Underwriting and general expenses allocated to the underwriting function shall be allocated in proportion to the respective participation of Donegal Mutual and Atlantic States under the Proportional Reinsurance Agreement.

(ii) Claim adjusting expenses and general expenses allocated to the claim function shall be allocated in proportion to the respective average claim reserves and loss payments of Donegal Mutual and Atlantic States.

(iii) General expenses allocated to the investment function shall be allocated in proportion to the respective average invested assets of Donegal Mutual and Atlantic States, excluding 50% of the average value of Donegal Mutual's investment in subsidiaries and affiliates.

4. Timing of Payments.

The parties to the Agreement agree that all funds collected by Donegal Mutual on behalf of DGI and the Insurance Subsidiaries shall be held in a fiduciary capacity and all intercompany balances arising under the Agreement shall be paid within 30 days of the end of the calendar month in which such transactions occur, unless a different time of payment is expressly specified in the Agreement.

QUOTA SHARE REINSURANCE AGREEMENT

THIS QUOTA SHARE REINSURANCE AGREEMENT (this "Agreement") is dated as of this 6th day of December, 2010, but effective as of December 1, 2010 (the "Effective Date") between MICHIGAN INSURANCE COMPANY, a Michigan corporation with its principal office in Grand Rapids, Michigan ("MICO"), and DONEGAL MUTUAL INSURANCE COMPANY, a Pennsylvania mutual fire insurance company with its principal office in Marietta, Pennsylvania ("Donegal Mutual").

WITNESSETH:

WHEREAS, Donegal Mutual has offered to provide reinsurance to MICO to the extent and on the terms and conditions and subject to the exceptions, exclusions and limitations set forth in this Agreement and nothing stated in this Agreement shall in any manner create any obligations or establish any rights against Donegal Mutual in favor of any person not a party to this Agreement;

WHEREAS, MICO has agreed to place such reinsurance with Donegal Mutual to the extent and on the terms and conditions and subject to the exceptions, exclusions and limitations set forth in this Agreement; and

WHEREAS, this Agreement shall constitute the entire contract between Donegal Mutual and MICO related to such reinsurance and provides no guarantee of profit, directly or indirectly, to either Donegal Mutual or MICO;

NOW, THEREFORE, in consideration of the mutual covenants set forth in this Agreement, and intending to be legally bound hereby, Donegal Mutual and MICO agree as follows:

ARTICLE 1

DEFINITIONS

1.1 Definitions.

As used in this Agreement:

"Allocated Loss Adjustment Expenses" shall mean all court costs, interest upon judgments and mitigation, investigation, adjustment and legal expenses chargeable to or incurred in (i) the mitigation, investigation, negotiation, settlement of or defense against a Loss under a Covered Policy, (ii) loss prevention mitigation or investigation in respect of any Covered Policy as to which MICO has posted a loss reserve, (iii) the investigation, prevention and workout of a potential Loss under a Covered Policy, (iv) the protection, perfection and exercise of any subrogation or salvage or rights of reimbursement with respect to any

Covered Policy or (v) any deficiency resulting from the loss settlement or the workout of a potential Loss under a Covered Policy. Allocated Loss Adjustment Expenses shall exclude all office expenses and salaries of officers and employees of MICO. All loss adjustment expenses that are not Allocated Loss Adjustment Expenses shall constitute Unallocated Loss Adjustment Expenses.

"Ceding Commission" shall have the meaning set forth in Section 8.1.

"Covered Policies" shall mean an insurance policy first issued by MICO on or after 12:01 a.m. on December 1, 2010. Donegal Mutual is not assuming any liability from any insurance policy MICO first issued on or before 12:01 a.m. on December 1, 2010.

"Donegal Mutual" shall have the meaning set forth in the introductory paragraph of this Agreement.

"Effective Date" shall have the meaning set forth in the Preamble.

"Exclusions" shall have the meaning set forth in Section 3.2.

"Extra Contractual Obligations" shall mean all liabilities (i) for compensatory, consequential, exemplary, punitive or similar damages which directly relate to any alleged or actual act, error, omission, fraud or misrepresentation by any Person, any of its affiliates or any of its or its affiliates' officers or employees, whether intentional or otherwise, in connection with the Covered Policies or (ii) from any alleged or actual reckless conduct or bad faith by any Person, any of its affiliates or any of its or its affiliates' officers or employees in connection with such Person's handling of any claim under any of the Covered Policies, including the settlement, defense of or appeal of any claim or in connection with the issuance, offer, sale, delivery, cancellation or administration by any Person or any of its affiliates or any of its or its affiliates' officers or employees under any of the Covered Policies.

"Insolvency Fund" shall mean any guaranty fund, insolvency fund, plan, pool, association or other arrangement, however denominated, established or governed, which provides for any assessment of or payment or assumption by MICO of part or all of any claim, debt, charge, fee or other obligation of an insurer or its successors or assigns which any competent authority has declared to be insolvent or which is otherwise deemed unable to meet any claim, debt, fee, charge or other obligation in whole or in part.

"Loss" shall mean (i) amounts incurred by MICO in settlement or satisfaction of claims under or in respect of the Covered Policies, (ii) any and all Allocated Loss Adjustment Expenses MICO incurs under or in respect of the Covered Policies, (iii) amounts payable to reinsurers other than Donegal Mutual under or with respect to the Covered Policies and (iv) Extra Contractual Obligations arising after the Effective Date from the acts of Donegal Mutual, in each case net of amounts actually collected by Donegal Mutual or MICO under Third Party Reinsurance Agreements.

“Occurrence” shall be the definition of said term as set forth in MICO’s Covered Policies, provided, however, in the event “Occurrence” is not defined in any Covered Policy that is reinsured pursuant to this Agreement, then, as to such policy, the term “each Occurrence” shall mean each accident or Occurrence or series of accidents or Occurrences arising out of one event, and shall include aggregate limits of liability for a period not exceeding 12 months when a Covered Policy applies in excess of aggregate limits. If MICO and Donegal Mutual cannot specifically determine the date of any Loss, accident, casualty or loss Occurrence, the date of such Loss, accident, casualty or loss Occurrence shall be the inception date of the original Covered Policy reinsured pursuant to this Agreement, provided that such policy period shall be deemed not to exceed 12 calendar months.

“Person” shall mean any individual, corporation, limited liability company, association, joint-stock company, business trust or other similar organization, partnership, joint venture, trust, unincorporated association or government or any agency, instrumentality or political subdivision of a government.

“Quota Share” shall mean 25%.

“Recovery shall mean any amount actually received by MICO in respect of any Loss covered by Donegal Mutual under this Agreement, whether by subrogation, salvage, reimbursement or other recovery.

“Recovery Expenses” shall mean any expense, including court costs and legal expenses MICO incurs for purposes of obtaining a Recovery with respect to Losses, but excluding the expenses and salaries of the officers and employees of MICO or its affiliates or normal overhead expenses of MICO and its affiliates and excluding any expense that would constitute an Allocated Loss Adjustment Expense.

“MICO” shall have the meaning set forth in the introductory paragraph of this Agreement.

“Termination Date” shall have the meaning assigned to it in Section 16.1.

“Third-Party Reinsurance Agreements” shall mean, to the extent such treaties or agreements relate to Covered Policies, (i) all reinsurance treaties and agreements under which MICO is a ceding party that were in force on the date of this Agreement, and (ii) any such treaty or agreement that is terminated or expired but under which MICO may continue to receive reinsurance coverage.

“Unallocated Loss Adjustment Expenses” shall have the meaning set forth in the definition of Allocated Loss Adjustment Expenses.

“Ultimate Net Loss” as used in this Agreement means the actual loss MICO pays or that MICO becomes liable to pay under the Covered Policies reinsured pursuant to this Agreement, including all loss adjustment expense, 100% of any Extra Contractual Obligation and 100% of any Loss in Excess of Policy Limits as defined in Sections 11.1 and 11.2 of this

Agreement. “Ultimate Net Loss” shall include any expenses of litigation, accrued interest where such accrued interest is a part of any judgment, and all other loss expenses of MICO including legal expenses and costs incurred in connection with coverage and validity issues and any legal proceedings with respect thereto that are allocable to a Covered Policy.

ARTICLE 2

APPLICATION OF AGREEMENT

2.1 Business Covered. This Agreement applies to all insurance policies MICO issues after the Effective Date and which MICO issues during the term of this Agreement until 11:59 p.m. on the Termination Date.

ARTICLE 3

COVER

3.1 Quota Share Reinsurance. Subject to the terms and conditions of this Agreement:

(a) MICO hereby cedes to Donegal Mutual, and Donegal Mutual hereby accepts and reinsures from MICO, the Quota Share of any Losses under the Covered Policies net of any losses covered by the Third-Party Reinsurance Agreements of MICO. Such Losses are sometimes referred to in this Agreement as the “Reinsured Liabilities.” All liabilities of MICO other than the Reinsured Liabilities under the Covered Policies shall remain the liabilities of MICO (the “Retained Liabilities”), and Donegal Mutual shall have no responsibility for the Retained Liabilities by reason of entering into this Agreement or otherwise. MICO hereby agrees to indemnify Donegal Mutual and hold Donegal Mutual harmless from and against the Retained Liabilities.

(b) For the avoidance of doubt, Donegal Mutual hereby assumes the risk that any third-party reinsurance maintained by MICO is not collected, and Donegal Mutual has no obligation to pay or to reimburse MICO for losses MICO paid or liabilities MICO first incurred prior to the Effective Date or after the Termination Date.

3.2 Exclusions. This Agreement shall not apply to, and the Reinsured Liabilities shall specifically exclude, loss, damage, cost or expense of any nature directly or indirectly caused by, resulting from or in connection with any of the following liabilities of MICO, regardless of any other cause or event contributing currently or in any other sequence to the loss, damage, cost or expense (the “Exclusions”), all of which shall remain the exclusive responsibility of MICO:

(a) all liability of MICO arising by agreement, assessment, operation of law or otherwise from MICO’s participation or membership, whether voluntary or involuntary, in any Insolvency Fund, coastal or wind storm authority or similar association; and

(b) all liability of MICO arising after the Effective Date arising from the acts, errors or omissions of MICO.

ARTICLE 4

REINSURANCE FOLLOWS ORIGINAL POLICIES

4.1 Follow the Fortunes. Except to the extent specifically otherwise provided in this Agreement or as MICO and Donegal Mutual may agree in writing, all reinsurance under this Agreement shall be subject in all respects to the same rates, terms, conditions, waivers and interpretations, and to the same modifications, cancellations and alterations as the Covered Policies, the true intent of this Agreement being that Donegal Mutual shall, in every case to which this Agreement applies, follow the fortunes of MICO; provided, however, that the Agreement shall not be construed to expand the liability of Donegal Mutual beyond the liabilities Donegal Mutual has specifically assumed pursuant to this Agreement.

4.2 Third-Party Rights. Except as set forth in Sections 6.1 or 12.1, nothing in this Agreement shall in any manner create any obligations or establish any rights against Donegal Mutual in favor of any Person not a party to this Agreement.

ARTICLE 5

CHANGE IN POLICY FORMS

5.1 Policy Forms. MICO and Donegal Mutual have agreed on the forms of Covered Policies that MICO will issue and that Donegal Mutual will reinsure pursuant to this Agreement. MICO shall advise Donegal Mutual of any change in any form of any Covered Policy no less than 90 days prior to the implementation of any such change, and such change shall not be implemented unless Donegal Mutual shall have approved such change in writing within 30 days after receipt of such notice from MICO, such approval not to be unreasonably withheld by Donegal Mutual.

ARTICLE 6

LOSSES AND LOSS ADJUSTMENT EXPENSES

6.1 Payment to MICO for Ultimate Net Losses. Donegal Mutual shall pay to MICO the Quota Share of sums actually paid by MICO in settlement of the Ultimate Net Losses under the Covered Policies, on and after the Effective Date; provided, however, that in the event of the insolvency of MICO, Donegal Mutual shall pay such amount to the liquidator, receiver or statutory successor of MICO in accordance with the provisions of Article 12 of this Agreement.

6.2 Expenses to be Borne by Donegal Mutual. Donegal Mutual shall bear its Quota Share of all external loss adjustment expenses MICO incurs in the investigation, adjustment and litigation of all claims under the Covered Policies.

6.3 Salvage. Donegal Mutual shall receive its Quota Share of all salvage, recoveries and payments received subsequent to a Loss settlement under this Agreement whether received before or after the final adjudication of any claim under the Covered Policies.

6.4 Loss Development. MICO shall advise Donegal Mutual promptly of all claims and any subsequent developments pertaining to those claims that may develop into Losses under the Covered Policies reinsured pursuant to this Agreement.

6.5 Defense of Claims. MICO shall investigate and, to the extent that may be required by the Covered Policies reinsured under this Agreement, defend any claim affecting the reinsurance provided by this Agreement and pursue such claim to final determination.

6.6 Donegal Mutual Participation. MICO agrees, upon the request of Donegal Mutual, that when so requested, MICO will afford Donegal Mutual an opportunity to participate with MICO, at the expense of Donegal Mutual, in the defense or control of any claim, suit or proceeding involving the reinsurance provided pursuant to this Agreement; and MICO and Donegal Mutual shall cooperate in all material respects in the defense of such suit, claim or proceeding.

ARTICLE 7

PREMIUM

7.1 Payment of Direct Written Premium. During the term of this Agreement, Donegal Mutual shall assume from MICO 25% of MICO's net written premiums applicable to its liability under the Covered Policies for the reinsurance provided pursuant to this Agreement. MICO shall pay such premiums, net of any premiums for third-party reinsurance.

7.2 Summary Statements. As soon as possible after the end of each month, MICO shall submit to Donegal Mutual a statement that summarizes the net premiums ceded, return premiums and conversions on MICO's net written business, the actual premiums due, net of commission, and MICO shall pay to Donegal Mutual any amount due within 15 days of MICO's delivery of such statement to Donegal Mutual. MICO shall furnish quarterly to Donegal Mutual, MICO's unearned premium reserve on the Covered Policies. MICO shall compute its unearned premium reserve on the daily pro rata basis.

7.3 Payment of Losses. Donegal Mutual shall pay its proportion of Loss and loss expenses paid by MICO to MICO within 15 days after MICO renders a monthly account summarizing the Losses and loss expenses. Donegal Mutual shall have the right, at its option, to offset the amount of such Loss or loss expense as provided in Article 13.

ARTICLE 8

CEDING COMMISSION

8.1 Payment of Ceding Commission. Donegal Mutual shall pay a ceding commission of 33% to MICO on the net written premiums MICO cedes to Donegal Mutual under this Agreement. On all return premiums, MICO shall promptly return to Donegal Mutual the Ceding Commission applicable to such returned premium.

8.2 Statement of Ceding Commission. As soon as possible after the end of each month, Donegal Mutual shall submit to MICO a statement that sets forth the Ceding Commission fees, and Donegal Mutual shall pay any amount due within fifteen (15) days of Donegal Mutual's receipt of the monthly statements required by Section 7.2.

8.3 Taxes. The Ceding Commission allowance that Donegal Mutual pays to MICO on the Covered Policies reinsured pursuant to this Agreement includes provision for all premium taxes, licenses and fees with the exception of service charges, assessments and any other expenses whatsoever, except external loss adjustment expenses.

ARTICLE 9

INSPECTION

9.1 Right of Inspection. MICO shall place at the disposal of Donegal Mutual and Donegal Mutual shall have the right to inspect, through its authorized representatives, at all reasonable times during the term of this Agreement and thereafter, the books, records and papers of MICO pertaining to the reinsurance provided pursuant to this Agreement and all claims made in connection therewith.

ARTICLE 10

RESERVES AND TAXES

10.1 Maintenance of Reserves. Donegal Mutual shall maintain legal reserves with respect to the unearned premiums and claims it assumed pursuant to this Agreement.

10.2 Premium Taxes. MICO shall be liable for all taxes on premiums reported to Donegal Mutual under this Agreement and MICO shall reimburse Donegal Mutual for such taxes where Donegal Mutual is required to pay the same.

ARTICLE 11

EXTRA CONTRACTUAL OBLIGATIONS/EXCESS OF POLICY LIMITS

11.1 Extra Contractual Obligations. The obligations reinsured pursuant to this Agreement shall include Extra Contractual Obligations under the Covered Policies.

11.2 Losses In Excess of Policy Limits. The obligations reinsured pursuant to this Agreement shall include Loss in Excess of Policy Limits with respect to any Covered Policy. "Loss in Excess of Policy Limits" shall mean losses in excess of the policy limit, having been incurred because of, but not limited to, failure by MICO to settle within the Covered Policy limit or by reason of alleged or actual negligence, fraud or bad faith in rejecting an offer of settlement or in preparation of the defense or in the trial of any action against its insured or reinsured or in the preparation or prosecution of an appeal consequent upon such action.

11.3 Date of Occurrence. An Extra Contractual Obligation and Loss in Excess of Policy Limits shall be deemed to have occurred on the same date as the Loss covered under a Covered Policy, and shall constitute part of the original Loss.

11.4 Meaning of Loss. For the purposes of the Loss in Excess of Policy Limits coverage under this Agreement, the word "Loss" shall mean any amount for which MICO would have been contractually liable to pay had it not been for the limit of the Covered Policy.

11.5 Loss Adjustment Expense. Loss adjustment expense in respect of Extra Contractual Obligations and Loss in Excess of Policy Limits shall be covered under this Agreement in the same manner as other loss adjustment expense.

11.6 Fraud. However, this Article 11 shall not apply where the Loss has been incurred due to final legal adjudication of fraud of a member of the board of directors or an officer of MICO acting individually or collectively or in collusion with any individual or corporation or any other organization or party involved in the presentation, defense or settlement of any claim covered under this Agreement.

11.7 Michigan Law. In no event shall Donegal Mutual provide reinsurance to MICO to the extent not permitted under the laws of Michigan.

ARTICLE 12

INSOLVENCY CLAUSE

12.1 Insolvency. In the event of the insolvency and the appointment of a conservator, rehabilitator, liquidator or statutory successor of MICO,

(a) the reinsurance provided by this Agreement and each and every reinsurance agreement heretofore or hereafter entered into between Donegal Mutual and MICO shall be payable, subject to Section 12.1(b), by Donegal Mutual directly to MICO or to its conservator, rehabilitator, liquidator, receiver or statutory successor on the basis of the liability of MICO under the Covered Policies without diminution because of the insolvency of MICO or because the conservator, rehabilitator, liquidator, receiver, or statutory successor has failed to pay all or any portion of any claims.

(b) Donegal Mutual shall make the payments as set forth above directly to MICO or to its conservator, rehabilitator, liquidator, receiver or statutory successor. If an insured under a Covered Policy submits a claim to MICO's conservator, rehabilitator, liquidator, receiver or statutory successor, Donegal Mutual shall have the right, in lieu of making a payment to such conservator, rehabilitator, liquidator, receiver or statutory successor, to make a payment on the claim directly to the insured. Any such payment by Donegal Mutual shall discharge Donegal Mutual from its related payment obligation under such Covered Policy.

(c) In the event of the insolvency of MICO, the rehabilitator, liquidator, receiver, conservator or statutory successor of MICO shall give written notice to Donegal Mutual of the pendency of each claim against MICO on each Covered Policy within a reasonable time after such claim is filed in the insolvency proceeding; and, during the pendency of such claim, Donegal Mutual may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated, any defense which Donegal Mutual may deem available to MICO, its rehabilitator, liquidator, receiver, conservator or statutory successor. The expense Donegal Mutual thus incurs shall be chargeable, subject to court approval, against MICO as part of the expense of liquidation or rehabilitation to the extent of the share of the benefit that may accrue to MICO solely as a result of the defense undertaken by Donegal Mutual.

ARTICLE 13

OFFSET CLAUSE

13.1 Offset. Except for payments to be made pursuant to Section 6.1, which may only be offset against each other, Donegal Mutual and MICO shall each have, and may exercise at any time and from time to time, the right to offset any balance or amount, whether on account of premiums, premium adjustments, commissions, claims, Losses, Recoveries or otherwise, due from such party to the other party hereto under this Agreement. The party asserting the right of offset shall have and may exercise such right at any time whether the balance or balances due or to become due to such party from the other are on account of premiums or on account of Losses or otherwise. If Donegal Mutual is required to make a payment directly to an insured under a Covered Policy, no offset shall be allowed between Donegal Mutual and the insured under a Covered Policy, provided, however, that Donegal Mutual shall continue to maintain its offset rights against MICO pursuant to this Agreement.

ARTICLE 14

ARBITRATION

14.1 Arbitration. Should an irreconcilable difference of opinion arise between MICO and Donegal Mutual as to the interpretation of this Agreement or the transactions this Agreement contemplates, as a condition precedent to any right of action under this Agreement, such difference shall be submitted to arbitration to the decision of a board of

arbitration composed of two arbitrators and an umpire, meeting in Lansing, Michigan under the rules of the American Arbitration Association.

14.2 Identity of Arbitrators. The members of the board of arbitration shall be active or retired disinterested executive officers of insurance or reinsurance companies. Each party shall appoint one arbitrator and the two arbitrators shall choose an umpire before they enter into arbitration. If either party fails to appoint its arbitrator within four weeks after being requested to do so, the other party shall also appoint the second arbitrator. If the two arbitrators fail to agree upon the appointment of an umpire within four weeks after their nominations, each of them shall name three nominees for umpire, of whom each arbitrator shall decline two nominees and the decision among the two remaining nominees shall be made by the claimant party drawing lots.

14.3 Default Selection. In the event that either party shall fail to choose an arbitrator within four weeks following a request by Donegal Mutual or MICO for arbitration, the requesting party shall choose two arbitrators who shall choose the umpire.

14.4 Submission of Initial Brief. The claimant shall submit its initial brief within 20 days from appointment of the umpire. The respondent shall submit its brief within 20 days after receipt of the claimant’s brief and the claimant may submit a reply brief within 10 days after receipt of the respondent’s brief.

14.5 Arbitrator Decision. The board of arbitration shall make its decision with regard to the custom and usage of the insurance and reinsurance business. The board of arbitration shall issue its decision in writing based upon a hearing in which evidence may be introduced without following strict rules of evidence but in which cross examination and rebuttal shall be allowed. The board of arbitration shall make its decision within 60 days following the conclusion of the hearings unless the parties consent to an extension. The majority decision of the board of arbitration shall be final and binding upon all parties to the proceeding. Judgment may be entered upon the award of the board of arbitration in any court having jurisdiction thereof.

14.6 Multiple Reinsurers. If more than one reinsurer is involved in the same dispute, all such reinsurers shall constitute and act as one party for purposes of this clause and communications shall be made by MICO to each of the reinsurers constituting the one party, provided, however, that nothing therein shall impair the rights of such reinsurers to assert several, rather than joint defenses or claims, nor be construed as changing the liability of the reinsurers under the terms of this Agreement from several to joint.

14.7 Arbitration Expenses. Each party shall bear the expense of its own arbitrator and shall jointly and equally bear with the other party the expense of the umpire. The remaining costs of the arbitration proceedings shall be allocated by the board of arbitration.

14.8 No Judicial Foundation. The arbitrators shall be relieved of all judicial formalities and may abstain from strict rules of law, interpreting this Agreement as an honorable obligation rather than as merely a legal obligation.

ARTICLE 15

GOVERNING LAW AND REGULATORY APPROVAL

15.1 Governing Law. This Agreement shall be interpreted under and pursuant to the laws of the State of Michigan in all respects.

15.2 Regulatory Approval. Any changes or amendments to this Agreement shall be subject to the receipt of prior written approval from the Michigan Office of Financial and Insurance Regulation and the Pennsylvania Insurance Department.

ARTICLE 16

COMMENCEMENT AND TERMINATION

16.1 Effective Time. This Agreement shall take effect as of 12:01 A.M. on the Effective Date and is entered into for an unlimited term, but either party may terminate the term of this Agreement at any time by giving not less than 90 days notice in writing to the other party of a date of termination of this Agreement (the "Termination Date").

16.2 Participation Until Termination. Donegal Mutual shall participate in business coming within the terms of this Agreement until the date of termination of this Agreement.

16.3 Run-Off. In the event either party terminates this Agreement the reinsurance assumed pursuant to this Agreement shall be provided on a "run-off" basis for all policies written after the Effective Date of this Agreement and prior to the Termination Date until all liabilities under the Covered Policies have been satisfied in full.

ARTICLE 17

CURRENCY OF PAYMENT

17.1 Currency of Payment. All payments under this Agreement shall be made in the currency of the United States of America.

ARTICLE 18

ACCESS TO RECORDS

18.1 Access to Records. Donegal Mutual, by its duly appointed representatives, shall have the right at any reasonable time, to examine all papers in the possession of MICO that relate to the Covered Policies that Donegal Mutual has reinsured pursuant to this Agreement.

ARTICLE 19

STATISTICS

19.1 Statistics. MICO shall furnish Donegal Mutual such statistics as may be necessary to comply with statutory requirements and in such form as Donegal Mutual may reasonably request from MICO.

ARTICLE 20

ERRORS AND OMISSIONS

20.1 Errors and Omissions. Any inadvertent delay, omission or error by either party shall not relieve the other party from any liability that would have attached under this Agreement, provided that such delay, omission or error shall not impose any greater liability on Donegal Mutual than would have attached under this Agreement if such act, delay, omission or error had not occurred, and such act, delay, omission or error is promptly and reasonably rectified upon discovery by the responsible party.

ARTICLE 21

MISCELLANEOUS

21.1 Notices. All reports, remittances, notices, letters, financial statements or any other communications between the parties to this Agreement shall be addressed as follows:

To Donegal Mutual:

Donegal Mutual Insurance Company
1195 River Road
Marietta, Pennsylvania 17547
Attention: President
Facsimile: (717) 426-7009

To MICO:

Michigan Insurance Company
1700 East Beltline N.E., Suite 100
Grand Rapids, Michigan 49525
Attention: President
Facsimile: (616) 447-9603

21.2 Assignment. Neither this Agreement nor any rights or obligations under this Agreement may be assigned or otherwise transferred by any party to this Agreement, including by operation of law, without the consent of the other party to this Agreement and the prior approval of the Commissioner of Insurance of the State of Michigan; provided,

however, that Donegal Mutual may assign its rights or obligations under this Agreement to any entity that has a current A.M. Best rating equal to or greater than A.

21.3 Severability. If any provision of this Agreement shall be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement and this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been part of this Agreement unless the deletion of such provision would result in such a material change as to cause completion or continuation of the transactions contemplated by this Agreement to be unreasonable or materially frustrate the objectives of MICO and Donegal Mutual as expressed in this Agreement.

21.4 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be an original, but such counterparts together shall constitute one and the same agreement.

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be executed in duplicate and delivered as of the day and year first above written.

DONEGAL MUTUAL INSURANCE COMPANY

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus, President

MICHIGAN INSURANCE COMPANY

By: /s/ Ermil L. Adamson
Ermil L. Adamson, President

Exhibit (10)(QQ)

DONEGAL GROUP INC.

2011 EMPLOYEE STOCK PURCHASE PLAN

Section 1. Purpose.

Donegal Group Inc. (the “Company”) has established this 2011 Employee Stock Purchase Plan (this “Plan”) for the benefit of the eligible employees of the Company, its parent, Donegal Mutual Insurance Company (“Donegal Mutual”), participating subsidiaries of the Company and of Donegal Mutual and any company from which the Company or Donegal Mutual assumes 100% quota share reinsurance.

The purpose of this Plan is to provide each eligible employee with an opportunity to acquire or increase his or her proprietary interest in the Company through the purchase of shares of the Company’s Class A common stock (the “Class A common stock”) at a discount from the market prices prevailing at the time of purchase. The Company intends that this Plan meet the requirements of Section 423 of the Internal Revenue Code of 1986, as amended (the “Code”).

Section 2. Eligible Employees.

(a) Employees eligible to participate in this Plan (“Eligible Employees”) will consist of all individuals: (i) who are full-time employees, as defined in Section 2(b) of this Plan, of the Company, Donegal Mutual, any subsidiary, as defined in Section 424 of the Code, of the Company or Donegal Mutual or any company from which the Company or Donegal Mutual assumes 100% quota share reinsurance (a “Participating Company”), and (ii) who have completed one month of employment on or prior to the date on which an Enrollment Period, as defined in Section 4 of this Plan, begins.

(b) A “full-time employee” is an employee of the Company, Donegal Mutual or any Participating Company who works or is scheduled to work at least 1,000 hours during any calendar year. The Company will consider an employee who is not scheduled to work at least 1,000 hours during a calendar year, but who in fact works at least 1,000 hours during a calendar year, a “full-time employee” once the employee is credited with at least 1,000 hours during such year.

(c) A person who is otherwise an Eligible Employee may not purchase any shares of Class A common stock under this Plan to the extent that:
(i) immediately after such person purchases Class A common stock, the person would own shares of Class A common stock, including shares that would be owned if all outstanding options to purchase Common Stock such person holds were exercised, that possess 5% or more of the total combined voting power or value of all classes of stock of the Company or any subsidiary of the Company or

(ii) such right would cause such person to have purchase rights under this Plan and all other stock purchase plans of the Company or any subsidiary of the Company or Donegal Mutual that meet the requirements of Section 423 of the Code, that accrue at a rate that exceeds $25,000 of fair market value of the stock of the Company, or any subsidiary of the Company, determined at the time the right to purchase Class A common stock under this Plan is exercisable, for each calendar year in which a purchase right under this Plan is outstanding. For this purpose, a right to purchase Class A common stock accrues when such right first becomes exercisable during the calendar year, but the rate of accrual for any calendar year may in no event exceed $25,000 of the fair market value of Class A common stock subject to the right, and the number of shares of Class A common stock under one right may not be carried over to any other right.

(d) Notwithstanding other provisions in this Plan to the contrary, any officer of the Company, Donegal Mutual or any Participating Company who is subject to Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act") with respect to his or her ownership of shares of Class A common stock (a "Section 16 officer") will be subject to the restrictions and conditions set forth in Sections 7(b) and 9 of this Plan.

Section 3. Duration of Plan and Subscription Periods.

This Plan is effective as of July 1, 2011 through and including June 30, 2022. During the term of this Plan, this Plan will have 20 semi-annual "Subscription Periods." Each Subscription Period will extend from July 1 through December 31 or from January 1 through June 30, respectively, with the first Subscription Period beginning on July 1, 2011 and the last Subscription Period ending on June 30, 2022.

Section 4. Enrollment and Enrollment Period.

Enrollment for participation in this Plan will take place during the "Enrollment Period" that precedes each Subscription Period. Enrollment Periods are in effect from June 1 through June 30 and from December 1 through December 31 of each year. In addition, the Company will deem each individual who participates in the Company's 2001 Employee Stock Purchase Plan and who is an Eligible Employee as of May 31, 2011 as automatically enrolled in this Plan effective as of the first Subscription Period. Except as provided regarding automatic enrollment in this Plan as of the first Subscription Period, any person who is an Eligible Employee and who would like to participate in this Plan should file a subscription agreement during an Enrollment Period, and that eligible employee's participation in this Plan will then commence as of the commencement of the next Subscription Period. Once enrolled, an Eligible Employee will continue to participate in this Plan for each succeeding Subscription Period until such Eligible Employee terminates his or her participation, the Eligible Employee ceases to be an Eligible Employee or elects to withdraw from this Plan, this Plan expires or the Company terminates this Plan. An Eligible Employee who desires to change his or her rate of contribution may do so effective as of the beginning of the next Subscription Period by submitting a properly completed and executed enrollment form to the Company

during the Enrollment Period for the next Subscription Period. An Eligible Employee who is not a Section 16 officer may also change his or her rate of contribution during a Subscription Period only pursuant to Section 7(b) of this Plan.

Section 5. Total Number of Shares Available.

The total number of shares available under this Plan is 300,000 shares of Class A common stock. Such Class A common stock may be authorized and unissued shares or previously issued shares that the Company reacquired. In the event the total number of shares available for purchase under this Plan have been purchased prior to the expiration of this Plan, the Company may terminate this Plan in accordance with Section 13 of this Plan.

Section 6. Subscription Price.

The "Subscription Price" for each share of Class A common stock subscribed for purchase under this Plan during each Subscription Period will be the lesser of (i) 85% of the fair market value of such share as determined as of the last trading day before the first day of the Enrollment Period with respect to such Subscription Period or (ii) 85% of the fair market value of such share as determined on the last trading day of such Subscription Period. The fair market value of a share will be the closing price the NASDAQ Stock Market reports for the applicable date.

Section 7. Amount of Contribution and Method of Payment.

(a) An Eligible Employee must pay the Subscription Price through a payroll deduction. The maximum payroll deduction may not be more than 10% of an Eligible Employee's Base Pay, as defined in Section 7(c) of this Plan. An Eligible Employee must authorize a minimum payroll deduction, based on such employee's Base Pay at the time of such authorization, that will enable such employee to accumulate by the end of the Subscription Period an amount sufficient to purchase at least ten shares of Class A common stock. An Eligible Employee may not make separate cash deposits toward the payment of the Subscription Price.

(b) An Eligible Employee who is not a Section 16 officer may at any time during a Subscription Period reduce the amount the Eligible Employee previously authorized the Company to deduct from his or her Base Pay, provided the reduction conforms with the minimum payroll deduction set forth in Section 7(a) of this Plan. To do so, an Eligible Employee should forward to the Company a properly completed and executed written notice setting forth the requested reduction in his or her payroll deduction. The change in payroll deduction will become effective on a prospective basis as soon as practicable after the Company receives the change notice. An Eligible Employee may change his or her payroll deduction under this Section 7(b), by forwarding to the Company a properly completed and executed written notice setting forth such reduction in his or her payroll deduction only once during any Subscription Period. Any such reduction will remain in effect for subsequent

Subscription Periods, subject to compliance with Section 7(a) of this Plan, until such Eligible Employee terminates his or her participation in this Plan, the Eligible Employee ceases to be an Eligible Employee, this Plan expires or the Company terminates this Plan. A Section 16 officer may not change his or her rate of contribution during a Subscription Period.

(c) "Base Pay" means the straight-time earnings or regular salary paid to an Eligible Employee. Base Pay will not include overtime, bonuses or other items that the committee administering this Plan pursuant to Section 14 of this Plan does not consider to be regular compensation. Payroll deductions will commence with the first paycheck issued during the Subscription Period and, except as set forth in Sections 9 and 10, will continue with each paycheck throughout the entire Subscription Period, except for pay periods for which the Eligible Employee receives no compensation (*i.e.*, uncompensated personal leave, leave of absence, etc.).

Section 8. Purchase of Shares.

The Company will maintain a "Plan Account" on its books for recordkeeping purposes only in the name of each Eligible Employee who authorized a payroll deduction (a "participant"). At the close of each pay period, the Company will credit the amount deducted from the participant's Base Pay to the participant's Plan Account. The Company will pay no interest on any Plan Account balance in any circumstance. As of the last day of each Subscription Period, the Company will divide the amount then in the participant's Plan Account by the Subscription Price for such Subscription Period as determined pursuant to Section 6 , and credit the participant's Plan Account with the number of whole shares that results. The Company will not credit fractional shares under this Plan. The Company will issue and deliver share certificates to each participant within a reasonable time thereafter. The Company will carry forward any amount remaining in a participant's Plan Account to the next Subscription Period. However, any amount the Company carries forward pursuant to this Section 8 will not reduce the amount a participant may contribute pursuant to Section 7 of this Plan during the next Subscription Period. If a participant does not accumulate sufficient funds in his or her Plan Account to purchase at least ten shares of Class A common stock during a Subscription Period, the Company will deem such participant to have withdrawn from this Plan pursuant to Section 9 of this Plan.

If the number of shares subscribed for purchase during any Subscription Period exceeds the number of shares available for purchase under this Plan, the Company will allocate the remaining shares available for purchase among all participants in proportion to their Plan Account balances, exclusive of any amounts carried forward pursuant to the preceding paragraph. If the number of shares that would be credited to any participant's Plan Account in either or both of the Subscription Periods occurring during any calendar year exceeds the limit specified in Section 2(c) of this Plan, the Company will credit the participant's Plan Account with the maximum number of shares permissible, and refund the remaining amounts to the participant in cash without interest thereon.

Section 9. Withdrawal from This Plan.

A participant, other than a Section 16 officer, may withdraw from this Plan at any time by giving a properly completed and executed written notice of withdrawal to the Company. As soon as practicable following the Company's receipt of a notice of withdrawal, the Company will refund the amount credited to the participant's Plan Account in cash without interest thereon. The Company will make no further payroll deductions with respect to such participant except in accordance with an authorization for a new payroll deduction filed during a subsequent Enrollment Period in accordance with Section 4 of this Plan. A participant's withdrawal will not affect the participant's eligibility to participate during any succeeding Subscription Period. A withdrawal by a Section 16 officer, other than a withdrawal under Section 10 of this Plan, will not become effective until the Subscription Period that commences after the date the Company receives written notice of such withdrawal.

Section 10. Separation from Employment.

The Company will treat separation from employment for any reason, including death, disability or retirement, as defined in this Section 10, as an automatic withdrawal pursuant to Section 9 of this Plan. However, at the election of a participant who retires, or in the event of a participant's death at the election of the participant's beneficiary, any cash balance in such participant's Plan Account may be used to purchase the appropriate number of whole shares of Class A common stock at a Subscription Price determined in accordance with Section 6 of this Plan using the date of the participant's retirement or death as though it was the last day of the Subscription Period. The Company will refund in cash any cash balance in the Plan Account after such purchase to the participant, or in the event of the participant's death to the participant's beneficiary without interest thereon. As used in this Section 10, "retirement" means a termination of employment by reason of a participant's retirement at or after the participant's earliest permissible retirement date pursuant to and in accordance with his or her employer's regular retirement plan or practice.

Section 11. Assignment and Transfer Prohibited.

No participant may assign, pledge, hypothecate or otherwise dispose of his or her subscription or rights to subscribe under this Plan to any other person, and any attempted assignment, pledge, hypothecation or disposition will be void. However, a participant may acquire shares of Class A common stock subscribed to under this Plan in the names of the participant and another person jointly with the right of survivorship upon appropriate written notice to the Company. No subscription or right to subscribe granted to a participant under this Plan will be transferable by the participant otherwise than by will or by the laws of descent and distribution, and such subscription rights will be exercisable only by the participant during the participant's lifetime.

Section 12. Adjustment of and Changes in Class A Common Stock.

In the event that the outstanding shares of Class A common stock of the Company are hereafter increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company, or of another corporation, by reason of reorganization, merger, consolidation, recapitalization, reclassification, stock split-up, stock dividend, either in shares of Class A common stock or of another class of the Company's stock, spin-off or combination of shares, the committee appointed pursuant to Section 14 of this Plan will make appropriate adjustments in the aggregate number and kind of shares that are reserved for sale under this Plan.

Section 13. Amendment or Termination of This Plan.

The Board of Directors of the Company (the "Board") will have the right to amend, modify or terminate this Plan at any time without notice, provided that the amendment, modification or termination of this Plan does not adversely affect any participant's existing rights and provided further that, without the approval of the stockholders of the Company in accordance with applicable law and regulations, no such amendment will increase the benefits accruing to participants under this Plan, increase the total number of shares subject to this Plan, change the formula by which the price at which the shares will be sold is determined, or change the class of employees eligible to participate in this Plan.

Section 14. Administration.

A committee of three employees of the Company the Board appoints from time to time will administer this Plan. The committee may from time to time adopt rules and regulations for carrying out this Plan. Any interpretation or construction of any provision of this Plan by the committee will be final and conclusive on all persons absent contrary action by the Board. Any interpretation or construction of any provision of this Plan by the Board will be final and conclusive on all persons.

Section 15. Designation of Beneficiary.

A participant may file a written designation of a beneficiary who is to receive any cash credited to the participant under this Plan in the event of such participant's death prior to the delivery to the participant of such cash. A participant may change such designation of a beneficiary at any time upon written notice to the Company. Upon the death of a participant and upon the committee's receipt of proof of the participant's death and of the identity and existence of a beneficiary validly designated by the participant under this Plan, the Company will deliver such cash to such beneficiary. In the event of the death of a participant and in the absence of a beneficiary validly designated under this Plan who is living at the time of such participant's death, the Company will deliver such cash to the executor or administrator of the estate of the participant, or if, to the knowledge of the Company, the participant has not appointed such executor or administrator, the Company, in its sole discretion, may deliver

such cash to the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent, or relative is known to the Company, then to such other person as the Company may designate. No designated beneficiary will, prior to the death of the participant by whom the beneficiary has been designated, acquire any interest in the shares or cash credited to the participant under this Plan.

Section 16. Employees' Rights.

Nothing contained in this Plan will prevent the Company, Donegal Mutual or any Participating Company from terminating any employee's employment. No employee will have any rights as a stockholder of the Company by reason of participation in this Plan unless and until the Company has issued and delivered certificates to the participant representing shares of Class A common stock for which the participant has subscribed.

Section 17. Use of Funds.

The Company may use all payroll deductions it receives or holds under this Plan for any corporate purpose, and the Company will not be obligated to segregate such payroll deductions. Any account established for a participant will be for recordkeeping purposes only.

Section 18. Government Regulations.

The Company's obligation to sell and deliver Class A common stock under this Plan is subject to any prior approval or compliance that may be required to be obtained or made from or with any governmental or regulatory authority in connection with the authorization, issuance or sale of such Class A common stock.

Section 19. Titles.

Titles are provided in this Plan for convenience only and are not to serve as a basis for interpretation or construction of this Plan.

Section 20. Applicable Law.

This Plan will be construed, administered and governed in all respects under the laws of the Commonwealth of Pennsylvania and the United States of America.

Section 21. Compliance with Rule 16b-3.

To the extent that Rule 16b-3 under the Exchange Act applies to purchases made under this Plan, it is the Company's intent that this Plan comply in all respects with the requirements of Rule 16b-3, that the Company interpret any ambiguities or inconsistencies in the construction of this Plan to give effect to such intention and that if this Plan will not so comply, whether on the date of adoption or by reason of any later amendment to or

interpretation of Rule 16b-3, the provisions of this Plan will be deemed to be automatically amended so as to bring them into full compliance with such rule.

Section 22. Approval of Stockholders.

Prior to June 30, 2011, the Company will submit this Plan to its stockholders for approval in accordance with applicable law and regulations. Subscriptions for the purchase of shares under this Plan will be subject to the condition that the stockholders of the Company approve this Plan prior to such date in the manner contemplated by Section 423(b)(2) of the Code. If the Company's stockholders do not approve this Plan prior to such date, this Plan will terminate, all subscriptions under this Plan will be terminated and be of no further force or effect and the Company shall promptly refund in cash, without interest, of all sums previously deducted from their compensation pursuant to this Plan.

DONEGAL GROUP INC.

2011 EQUITY INCENTIVE PLAN FOR EMPLOYEES

1. Purpose. The purpose of this 2011 equity incentive plan for employees (this “Plan”) is to encourage the employees of Donegal Group Inc. (the “Company”) and its subsidiaries to acquire a proprietary interest in the growth and performance of the Company, and to continue to align the interests of those employees with the interests of the Company’s stockholders to generate an increased incentive for such person to contribute to the growth, development and financial success of the Company and the member companies of the Donegal Insurance Group, including companies from which the Company or Donegal Mutual assumes 100% quota share reinsurance (the “Group”). To accomplish these purposes, this Plan provides a means whereby employees may receive stock options, stock awards and other stock-based awards that are based on, or measured by, or payable in shares of the Company’s Class A common stock.

2. Administration.

(a) Administrators. The Board of Directors of the Company (the “Board”) shall administer this Plan. The Board shall appoint a committee, which initially shall be the compensation committee to assist in the administration of this Plan. The committee, with the advice of the Company’s chief executive officer, shall recommend to the Board the employees to whom the Company should grant awards and the type, size and terms of each grant. The Board has the authority to make all other determinations necessary or advisable for the administration of this Plan. All decisions, determinations and interpretations of the Board shall be final and binding on all grantees and all other holders of awards granted under this Plan.

(b) The Committee. The committee shall be comprised of two or more members of the Board, each of whom shall be a “non-employee director” within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934 (the “Exchange Act”). In addition, each member of the committee shall be an “outside director” within the meaning of Section 162(m) of the Internal Revenue Code of 1986, as amended (the “Code”). Subject to the foregoing, from time to time, the Board may increase or decrease the size of the committee, appoint additional members, remove members, with or without cause, appoint new members, fill vacancies or remove all members of the committee and thereafter directly administer this Plan. The committee shall have those duties and responsibilities assigned to it under this Plan, and the Board may assign to the committee the authority to make certain other determinations and interpretations under this Plan. All decisions, determinations and interpretations of the committee in such cases shall be final and binding on all grantees and all other holders of awards granted under this Plan.

3. Shares Subject to this Plan.

(a) Shares Authorized. The total aggregate number of shares of Class A common stock that the Company may issue under this Plan is 3,500,000 shares, subject to adjustment as described below. The Company may issue each of the shares authorized under this Plan pursuant to incentive stock options awards within the meaning of Section 422 of the Code. The shares may be authorized but unissued shares or reacquired shares for purposes of this Plan.

(b) Share Counting. For administrative purposes, when the Board approves an award payable in shares of Class A common stock, the Board shall reserve, and count against the share limit, shares equal to the maximum number of shares that the Company may issue under the award. If and to the extent options granted under this Plan terminate, expire or are canceled, forfeited, exchanged or surrendered without having been exercised, and if and to the extent that any restricted stock awards are forfeited or terminated, or otherwise are not paid in full, the Company shall make the shares reserved for such awards available again for purposes of this Plan.

(c) Individual Limits. All awards under this Plan shall be expressed in shares of Class A common stock. The maximum number of shares of Class A common stock with respect to all awards that the Company may issue to any individual under this Plan during any calendar year shall be 250,000 shares, subject to adjustment as described below.

(d) Adjustments. If any change in the number or kind of shares of Class A common stock outstanding occurs by reason of:

- a stock dividend, spinoff, recapitalization, stock split or combination or exchange of shares;
- a merger, reorganization or consolidation;
- a reclassification or change in par value; or
- any other extraordinary or unusual event affecting the outstanding Class A common stock as a class without the Company’s receipt of consideration, or if the value of outstanding shares of Class A common stock is substantially reduced as a result of a spinoff or the Company’s payment of any extraordinary dividend or distribution,

the maximum number of shares of Class A common stock available for issuance under this Plan, the maximum number of shares of Class A common stock for which any individual may receive grants in any year, the kind and number of shares covered by outstanding awards, the kind and number of shares to be issued or issuable under this Plan and the price per share or applicable market value of such grants shall be automatically equitably adjusted

to reflect any increase or decrease in the number of, or change in the kind or value of, issued shares of Class A common stock to preclude, to the extent practicable, the enlargement or dilution of rights and benefits under this Plan and such outstanding grants. The Company shall eliminate any fractional shares resulting from such adjustment. Any adjustments to outstanding awards shall be consistent with Section 409A of the Code, to the extent applicable.

4. Eligibility for Participation. All employees of the Company and its subsidiaries and the member companies of the Group, including employees who are officers or members of the Board of any of the foregoing companies, shall be eligible to participate in this Plan. The committee shall recommend to the Board the employees to receive awards and the number of shares of Class A common stock subject to each award.

5. Awards. Awards under this Plan may consist of stock options as described in Section 7, stock awards as described in Section 8 and other stock-based awards as described in Section 9. The committee shall specify the terms and conditions of the award granted to the grantee in an agreement. The award shall be conditioned upon the grantee's signed agreement to accept the award and to acknowledge that all decisions and determinations of the committee and the Board shall be final and binding on the grantee, his or her beneficiaries and any other person having or claiming an interest under the award. Awards under this Plan need not be uniform as among the grantees. The Board may grant awards that are contingent on, and subject to, stockholder approval of this Plan or an amendment to this Plan.

6. Definition of Fair Market Value. For purposes of this Plan, "fair market value" shall mean the last sales price of a share of Class A common stock on the NASDAQ Global Select Stock Market, or NASDAQ, on the day on which the Board is determining the fair market value, as reported by NASDAQ. In the event that there are no transactions in shares of Class A common stock on NASDAQ on such day, the Board will determine the fair market value as of the immediately preceding day on which there were transactions in shares of Class A common stock on that exchange. If shares of common stock are not listed by NASDAQ, the Board shall determine the fair market value pursuant to Section 422 of the Code.

7. Stock Options. The committee may recommend to the Board the grant of stock options to an employee upon such terms and conditions as the committee deems appropriate under this Section 7.

(a) Number of Shares. The committee shall recommend the number of shares of Class A common stock that will be subject to each grant of stock options.

(b) Type of Stock Option, Price and Term. The committee may recommend to the Board the grant of stock options to purchase Class A common stock that the Company

intends to qualify as incentive stock options within the meaning of Section 422 of the Code, or incentive stock options, or stock options that the Company does not intend to so qualify, or non-qualified stock options. The committee shall recommend the exercise price of shares of Class A common stock subject to a stock option, which shall be equal to or greater than the fair market value of a share of Class A common stock on the date of grant.

(c) Exercisability of Stock Options. Each stock option agreement shall specify the period or periods of time within which a grantee may exercise a stock option, in whole or in part, as the Board determines. No grantee may exercise a stock option after ten years from the grant date of the stock option. The Board may accelerate the exercisability of any or all outstanding stock options at any time for any reason.

(d) Termination of Employment. Except as provided in the stock option agreement, a grantee may exercise a stock option only while the Company, Donegal Mutual or any of their respective subsidiaries employs the grantee. The Board shall specify in the option agreement under what circumstances and during what time periods a grantee may exercise a stock option after employment terminates. If the term of an incentive stock option continues for more than three months after employment terminates due to retirement or more than one year after termination of employment due to death or disability, the stock option shall lose its status as an incentive stock option and the Company shall treat such stock option as a non-qualified stock option.

(e) Exercise of Stock Options. A grantee may exercise a stock option that has become exercisable, in whole or in part, by delivering a notice of exercise to the Company. The grantee shall pay the exercise price for the stock option:

- in cash;
- by delivery of shares of Class A common stock at fair market value, shares of Class B common stock at fair market value, or a combination of those shares, as the committee or the Board may determine from time to time and subject to the terms and conditions as the committee or the Board may prescribe;
- by payment through a brokerage firm of national standing whereby the grantee will simultaneously exercise the stock option and sell the shares acquired upon exercise through the brokerage firm and the brokerage firm shall remit to the Company from the proceeds of the sale of the shares the exercise price as to which the option has been exercised in accordance with the procedures permitted by Regulation T of the Federal Reserve Board; or
- by any other method the committee or the Board authorizes.

The Company must receive payment for the shares acquired upon exercise of the stock option, and any required withholding taxes and related amounts, by the time the committee

specifies depending on the type of payment being made, but in all cases prior to the issuance of the shares.

(f) Incentive Stock Options. The committee shall recommend other terms and conditions of an incentive stock option as the committee deems necessary or desirable in order to qualify such stock option as an incentive stock option under Section 422 of the Code, including the following provisions, which the committee may omit or modify if no longer required under that section:

- As determined as of the grant date, the aggregate fair market value of shares subject to incentive stock options that first become exercisable by a grantee during any calendar year, under all plans of the Company, shall not exceed $100,000;
- The exercise price of any incentive stock option granted to an individual who owns stock having more than 10% of the total combined voting power of all classes of stock of the Company must be at least 110% of the fair market value of the shares subject to the incentive stock option on the grant date, and the individual may not exercise the incentive stock option after the expiration of five years from the date of grant; and
- The grantee may not exercise the incentive stock option more than three months, or one year in the case of death or disability within the meaning of the applicable Code provisions, after termination of employment.

8. Stock Awards. The committee may recommend to the Board the issuance of shares of Class A common stock to an employee upon such terms and conditions as the committee deems appropriate under this Section 8. The committee may recommend to the Board the issuance of shares of Class A common stock for cash consideration or for no cash consideration, and subject to restrictions or no restrictions. The committee may recommend conditions under which restrictions on stock awards shall lapse over a period of time or according to other criteria as the committee deems appropriate, including restrictions based upon the achievement of specific performance goals.

(a) Number of Shares. The committee shall recommend the number of shares of Class A common stock to be issued pursuant to a stock award and any restrictions applicable to the stock award.

(b) Requirement of Employment. The Board shall specify in the stock award agreement under what circumstances a grantee may retain stock awards after termination of the grantee’s employment and under what circumstances the grantee may forfeit the stock awards.

(c) Restrictions on Transfer. During the period that the stock award is subject to restrictions, a grantee may not sell, assign, transfer, pledge or otherwise dispose of the shares of the stock award except upon death as described in Section 13. Each certificate representing a share of Class A common stock issued under the stock award shall contain a legend giving appropriate notice of the restrictions on the stock award. The grantee shall be entitled to have the legend removed when all restrictions on the shares subject to the stock award have lapsed. The Company may maintain possession of any certificates representing shares subject to the stock award until all restrictions on the shares subject to the stock award have lapsed.

(d) Right To Vote and To Receive Dividends. The committee shall recommend to what extent, and under what conditions, the grantee shall have the right to vote the shares subject to the stock award and to receive any dividends or other distributions paid on the shares during the restriction period.

9. Other Stock-Based Awards. The committee may recommend to the Board the grant of other awards that are based on, measured by or payable in Class A common stock to an employee on such terms and conditions as the committee deems appropriate under this Section 9. The committee may recommend to the Board the grant of other stock-based awards subject to achievement of performance goals or other conditions and may be payable in shares of Class A common stock or cash, or a combination of cash and shares, as recommended by the committee in the stock-based award agreement.

10. Grant Date. The grant date of an award under this Plan shall be the date of the Board of Director's approval or such later date as may be determined by the Board at the time it authorizes the award. The Board may not make retroactive grants of awards under this Plan. The Company shall provide notice of the award to the grantee within a reasonable time after the grant date.

11. Withholding. All grants under this Plan shall be subject to applicable federal, including FICA, state and local tax withholding requirements. The Company may require that the grantee or other person receiving or exercising a grant pay to the Company the amount of any federal, state or local taxes that the Company is required to withhold with respect to the grant, or the Company may deduct from other wages paid to the grantee the amount of any withholding taxes due with respect to the grants. The Board or the committee may permit a grantee to elect to satisfy the Company's tax withholding obligations with respect to grants paid in shares of Class A common stock by having shares of Class A common stock withheld, at the time such grants become taxable, up to an amount that does not exceed the minimum applicable withholding tax rate for federal, including FICA, state and local tax liabilities. The Board or committee will value any shares so withheld as of the date the grants become taxable.

12. Transferability of Grants. Only the grantee of an award may exercise rights under the award grant during the grantee's lifetime, and a grantee may not transfer those rights except by will or by the laws of descent and distribution. When a grantee dies, the personal representative or other person entitled to succeed to the rights of the grantee may exercise those rights. Any successor to a grantee must furnish proof satisfactory to the Company of his or her right to receive the award under the grantee's will or under the applicable laws of descent and distribution.

13. Requirements for Issuance of Shares. The Company will not issue shares of Class A common stock in connection with any award under this Plan until the issuance of the shares complies with all applicable legal requirements to the satisfaction of the Board. The Board shall have the right to condition any award made to any employee under this Plan on the employee's undertaking in writing to comply with the restrictions on his or her subsequent disposition of shares subject to the award as the Board shall deem necessary or advisable, and the Company may legend certificates representing those shares to reflect any such restrictions. Certificates representing shares of Class A common stock issued under this Plan will be subject to such stop-transfer orders and other restrictions as applicable laws, regulations and interpretations may require, including any requirement that a legend be placed thereon. No grantee shall have any right as a stockholder with respect to shares of Class A common stock covered by an award until shares have been issued to the grantee.

14. Amendment and Termination of this Plan.

(a) Amendments. The Board may amend or terminate this Plan at any time, except that the Board shall not amend this Plan without approval of the stockholders of the Company if such approval is required in order to comply with the Code or applicable laws, or to comply with applicable stock exchange requirements. The Board may not, without the consent of the grantee, negatively affect the rights of a grantee under any award previously granted under this Plan.

(b) No Repricing Without Stockholder Approval. The Board may not reprice stock options nor may the Board amend this Plan to permit repricing of options unless the stockholders of the Company provide prior approval for the repricing.

(c) Termination. This Plan shall terminate on April 20, 2021, unless the Board terminates this Plan earlier or the term is extended with the approval of the stockholders of the Company. The termination of this Plan shall not impair the power and authority of the Board or the committee with respect to an outstanding award.

15. Grants in Connection with Corporate Transactions and Otherwise. Nothing contained in this Plan shall be construed to:

- limit the right of the Board to grant awards under this Plan in connection with the acquisition, by purchase, lease, merger, consolidation or otherwise, of the business or assets of any corporation, firm or association, including awards to employees of those entities who become employees, or for other proper corporate purposes; or
- limit the right of the Company to grant stock options or make other stock-based awards outside of this Plan.

Without limiting the foregoing, the Board may grant an award to an employee of another corporation or other entity who becomes an employee by reason of a corporate merger, consolidation, acquisition of stock or property, reorganization or liquidation involving the Company in substitution for a grant made by that corporation or other entity. The terms and conditions of the awards may vary from the terms and conditions this Plan requires and from those of the substituted stock awards, as the Board determines.

16. Right to Terminate Employment. Nothing contained in this Plan or in any award agreement entered into pursuant to this Plan shall confer upon any grantee the right to continue in the employment of the Company or any of its subsidiaries or the Group or affect any right that the Company or any of its subsidiaries or the Group may have to terminate the employment of the grantee.

17. Reservation of Shares. The Company, during the term of this Plan, shall at all times reserve and keep available the number of shares of Class A common stock needed to satisfy the requirements of this Plan. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which the Company's counsel has deemed such authority to be necessary to the lawful issuance and sale of any shares under this Plan, shall relieve the Company of any liability for the failure to issue or sell any shares as to which the Company has not obtained such requisite authority.

18. Effect on Other Plans. Participation in this Plan shall not affect an employee's eligibility to participate in any other benefit or incentive plan of the Company or any of its subsidiaries or the Group. The Company shall not use any awards granted pursuant to this Plan in determining the benefits provided under any other plan unless specifically provided.

19. Forfeiture for Dishonesty. Notwithstanding anything to the contrary in this Plan, if the Board finds, by a majority vote, after full consideration of the facts presented on behalf of both the Company and any grantee, that the grantee has engaged in fraud, embezzlement, theft, commission of a felony or dishonest conduct in the course of his employment that damaged the Company or any of its subsidiaries or the Group or that the grantee has disclosed confidential information of the Company or any of its subsidiaries or the Group, the grantee shall forfeit all unexercised or unvested awards and all exercised or vested awards under which the Company has not yet delivered the certificates or cash

payments therefor. The decision of the Board in interpreting and applying the provisions of this Section 19 shall be final. No decision of the Board, however, shall affect the finality of the discharge or termination of the grantee.

20. No Prohibition on Corporate Action. No provision of this Plan shall be construed to prevent the Company or any officer or director of the Company from taking any action the Company or such officer or director of the Company deems to be appropriate or in the Company's best interest, whether or not such action could have an adverse effect on this Plan or any awards granted under this Plan, and no grantee or grantee's estate, personal representative or beneficiary shall have any claim against the Company or any officer or director of the Company as a result of the taking of the action.

21. Indemnification. With respect to the administration of this Plan, the Company shall indemnify each present and future member of the committee and the Board against, and each member of the committee and the Board shall be entitled without further action on such member's part to indemnity from the Company for, all expenses, including the amount of judgments and the amount of approved settlements made with a view to the curtailment of costs of litigation, other than amounts paid to the Company itself, such member reasonably incurs in connection with or arising out of, any action, suit or proceeding in which he or she may be involved by reason of being or having been a member of the committee or the Board, whether or not he or she continues to be such member at the time of incurring such expenses; provided, however, that this indemnity shall not include any expenses such member incurs (i) in respect of matters as to which he or she shall be finally adjudged in any such action, suit or proceeding to have been guilty of gross negligence or willful misconduct in the performance of his or her duty as such member of the committee or the Board; or (ii) in respect of any matter in which any settlement is effected for an amount in excess of the amount approved by the Company on the advice of its legal counsel; and provided further that no right of indemnification under the provisions set forth in this Section 21 shall be available to or enforceable by any such member of the committee or the Board unless, within 60 days after institution of any such action, suit or proceeding, he or she shall have offered the Company in writing the opportunity to handle and defend the same at its own expense. The foregoing right of indemnification shall inure to the benefit of the heirs, executors or administrators of each such member of the committee or the Board and shall be in addition to all other rights to which such member may be entitled as a matter of law, contract or otherwise.

22. Miscellaneous Provisions.

(a) Compliance with Plan Provisions. No grantee or other person shall have any right with respect to this Plan, the Class A common stock reserved for issuance under this Plan or in any award until the Company and the grantee executed a written agreement and all the terms, conditions and provisions of this Plan and the award applicable to the grantee have been met.

(b) Approval of Counsel. In the discretion of the Board, no shares of Class A common stock, other securities or property of the Company or other forms of payment shall be issued under this Plan with respect to any award unless counsel for the Company is satisfied that such issuance will be in compliance with applicable federal, state, local and foreign legal, securities exchange and other applicable requirements.

(c) Compliance with Rule 16b-3. To the extent that Rule 16b-3 under the Exchange Act applies to this Plan or to awards granted under this Plan, it is the intention of the Company that this Plan comply in all respects with the requirements of Rule 16b-3, that any ambiguities or inconsistencies in construction of this Plan be interpreted to give effect to such intention and that, if this Plan shall not so comply, whether on the date of adoption or by reason of any later amendment to or interpretation of Rule 16b-3, the provisions of this Plan shall be deemed to be automatically amended so as to bring them into full compliance with such rule.

(d) Section 409A Compliance. This Plan is intended to comply with the requirements of Section 409A of the Code and the regulations issued thereunder. To the extent of any inconsistencies with the requirements of Section 409A, this Plan shall be interpreted and amended in order to meet the requirements of Section 409A. Notwithstanding anything contained in this Plan to the contrary, it is the intent of the Company to have this Plan interpreted and construed to comply with any and all provisions Section 409A including any subsequent amendments, rulings or interpretations from appropriate governmental agencies.

(e) Effects of Acceptance of the Award. By accepting any award or other benefit under this Plan, each grantee and each person claiming under or through the grantee shall be conclusively deemed to have indicated his acceptance and ratification of, and consent to, any action taken under this Plan by the Company, the Board or the committee or its delegates.

Date of Adoption by Board: March 7, 2011.

DONEGAL GROUP INC.

2011 AGENCY STOCK PURCHASE PLAN

1. Purpose.

Donegal Group Inc. (the "Company") established this 2011 Agency Stock Purchase Plan (this "Plan") for the benefit of eligible independent insurance agencies of the Company and Donegal Mutual Insurance Company ("Donegal Mutual") and their respective subsidiaries, any insurance company that the Company or Donegal Mutual owns 50% or more of such company's stock or any company from which the Company or Donegal Mutual assumes 100% quota share reinsurance (collectively, the "Companies"). This Plan provides an Eligible Agency, as defined in Section 2, an opportunity to acquire a long-term proprietary interest in the Company through the purchase of the Company's Class A common stock (the "Class A common stock") at a discount from current market prices. In offering this Plan, the Company seeks to foster the common interests of the Company and Eligible Agencies in achieving long-term profitable growth for the Company. Accordingly, the Company has created this Plan to facilitate the purchase and long-term investment in shares of the Class A common stock by Eligible Agencies.

2. Eligible Agencies.

An Eligible Agency is an agency that, the Company determines, in its discretion, brings value to the Companies and with which the Companies seek a long-term relationship. The Company will consider the following criteria to determine eligibility:

(i) the agency's premium volume;

(ii) the potential growth of such premium volume;

(iii) the profitability of the agency's business; and

(iv) whether the Company has placed the agency on rehabilitation or revoked the agency's binding authority.

The Company, in its discretion, may base eligibility on agency segmentation class or any other factors that indicate value, directly or indirectly, to the Companies. The Company will conduct periodic reviews to determine the continued eligibility of each Eligible Agency. A pattern of immediate resale of the Class A common stock acquired under this Plan by an Eligible Agency will be a factor in the Company's determination whether an agency should remain eligible for continued participation in this Plan

because immediate resales would tend to indicate that an Eligible Agency is not seeking to share in the long-term profitable growth of the Companies. The Company will treat its decision, in its discretion, to discontinue the eligibility of an agency under this Plan, as an automatic withdrawal from this Plan. See Section 9 below.

3. Methods of Payment and Amount of Contribution.

An Eligible Agency will have three methods of payment, pursuant to subsections (a), (b) and (c) of this Section 3, through which it may purchase shares of the Class A common stock under this Plan. Subject to the provisions of Section 11(b), an Eligible Agency may elect any of the payment methods individually or in combination. In each Subscription Period, as defined in Section 4, an Eligible Agency may contribute an aggregate maximum of $12,000 toward the purchase of Class A common stock under all payment methods combined (the "Maximum Amount"), subject to the limitations set forth below:

(a) An Eligible Agency may elect to purchase Class A common stock through deductions from its monthly direct bill commission payments. Under this method, an Eligible Agency will direct the Company to withhold no less than 1% and no more than 10% of the Eligible Agency's direct bill commission payments from the Eligible Agency's direct bill commission payments; provided, however, that the Company will withhold no more than $12,000 from direct bill commission payments during each Subscription Period. Direct bill commission payments will mean the commissions earned and that are actually available for payment in a monthly period to an Eligible Agency for personal and commercial direct bill policies after all offsetting debits and credits are applied, as determined solely from the Company's records.

(b) An Eligible Agency may elect to purchase Class A common stock during each July 1 through December 31 Subscription Period through a deduction from the contingent commission, if any, payable to the Eligible Agency under the applicable agency contingent plan or its equivalent. Under this method, an Eligible Agency will direct the Company to withhold a percentage of the contingent commission subject to the Maximum Amount.

(c) An Eligible Agency may elect to purchase Class A common stock through lump-sum payments to the Company. Under this method, the Eligible Agency will pay to the Company a dollar amount in a lump sum by the last day of the applicable

Subscription Period. The amount of the lump sum payment may not be less than $1,000 nor more than the Maximum Amount.

At the end of each Subscription Period, the Company will total each Eligible Agency's direct bill commission payments, if any, and add such total to all lump-sum and contingent commission payments, if any, made by such agency. If at any time during a Subscription Period an Eligible Agency's total payments exceed the Maximum Amount for that Subscription Period then, upon the Eligible Agency's request, the Company will return such excess amount to the Eligible Agency without interest within a reasonable period. The Company will apply any such amount not returned to the Eligible Agency to the purchase of Class A common stock during the next Subscription Period without reducing the Maximum Amount applicable to such Subscription Period.

4. Duration of This Plan and Subscription Periods.

This Plan is effective as of July 1, 2011 through and including June 30, 2016. During its term, this Plan will have ten semi-annual "Subscription Periods." Each Subscription Period will extend from July 1 through December 31 or from January 1 through June 30 of each year, with the first Subscription Period beginning on July 1, 2011.

5. Enrollment and Enrollment Periods.

"Enrollment Periods" are in effect from June 15 through June 30 and from December 15 through December 31 of each year commencing with June 15, 2011. The Company will send an Eligible Agency a Subscription Agreement prior to the beginning of the first Enrollment Period following such agency's designation as an Eligible Agency.

(a) An Eligible Agency that desires to subscribe for the purchase of Class A common stock through withholding from direct bill commissions must return a duly executed and completed Subscription Agreement during the first applicable Enrollment Period.

(b) An Eligible Agency that wishes to make lump-sum purchases during a Subscription Period will remit each lump-sum payment to the Company with a supplemental Subscription Agreement by the last day of the applicable Subscription Period.

(c) An Eligible Agency that wishes to make a purchase during a Subscription Period through designation of a portion of its contingent commission under the agency contingent plan will file a Subscription Agreement during the Enrollment Period applicable to that Subscription Period.

Once enrolled, an Eligible Agency will continue to participate in this Plan for each succeeding Subscription Period until it ceases to be an Eligible Agency or chooses to withdraw from this Plan pursuant to Section 9. If an Eligible Agency desires to change its rate of contribution, it may do so effective for the next Subscription Period by filing a new Subscription Agreement during the Enrollment Period for the next Subscription Period.

6. Number of Shares To Be Offered.

The total number of shares available under this Plan is 300,000 shares of the Class A common stock. In the event all 300,000 shares of the Class A common stock are purchased prior to the expiration of this Plan, the Company may terminate this Plan in accordance with Section 13.

7. Subscription Price.

The “Subscription Price” for each share of Class A common stock will be equal to 90% of the average of the closing prices of the Class A common stock on the Nasdaq Global Select Market for the last ten trading days of the applicable Subscription Period.

8. Purchase of Shares.

The Company will maintain a “Plan Account” on behalf of each enrolled Eligible Agency. As of the last day of each Subscription Period, the Company will credit the aggregate of (i) the amount deducted from the Eligible Agency’s direct bill commission payments, (ii) the Eligible Agency’s contingent commission withholdings and (iii) all of the Elgible Agency’s lump-sum payments, not to exceed the Maximum Amount

permitted pursuant to Section 3 of this Plan from all three payment methods, to the Eligible Agency's Plan Account. At such time, the Company will divide the amount then contained in the Eligible Agency's Plan Account by the Subscription Price for such Subscription Period and credit each Plan Account with the number of whole shares that results. The Company will carry forward any amount remaining in the Plan Account to the next Subscription Period or, at the option of the Eligible Agency, return it to the Eligible Agency. Any amount so carried forward will not reduce the Maximum Amount applicable to such succeeding Subscription Period. If the number of shares subscribed for during any Subscription Period exceeds the number of shares available for sale under this Plan, the Company will allocate the remaining shares among all Eligible Agencies in proportion to their aggregate Plan Account balances, exclusive of any amounts carried forward as provided in Section 3 and this Section 8 of this Plan. The Company will issue and deliver stock certificates to each Eligible Agency with respect to the shares it has purchased under this Plan within a reasonable time thereafter.

9. Withdrawal from This Plan.

An enrolled Eligible Agency may withdraw from this Plan at any time by giving written notice of withdrawal signed by an authorized representative of the Eligible Agency to the Company. Promptly after the time of withdrawal or the discontinuance of an Eligible Agency's eligibility, the Company will issue certificates representing any shares held under this Plan in the name of the Eligible Agency and refund the amount of any cash credited to the Eligible Agency's Plan Account for the current Subscription Period without interest. If an Eligible Agency withdraws, such Eligible Agency may not resubscribe until after the next full Subscription Period has elapsed, and then only if the Company has redesignated such agency as an Eligible Agency.

10. Termination of Agency Status.

The Company will treat termination of agency status for any reason as an automatic withdrawal from this Plan pursuant to Section 9.

11. Assignment and Issuance of Shares.

Except as expressly permitted by this Section 11, no Eligible Agency may assign its subscription payments under this Plan or rights to subscribe under this Plan to any other person (including its shareholders, partners or other principals), and any

attempted assignment will be void. Neither an Eligible Agency's rights under this Plan nor shares held in an Eligible Agency's Plan Account may be transferred, pledged, hypothecated or assigned. All shares issued under this Plan will be titled in the name of the Eligible Agency; provided, however, that an Eligible Agency may, upon written request to the Company: (a) designate that the Company issue such shares to a shareholder, partner, other principal or other licensed employee of such Eligible Agency, or (b) designate that any retirement plan maintained by or for the benefit of such Eligible Agency or a shareholder, partner, other principal or other licensed employee of such Eligible Agency may purchase shares in lieu of such Eligible Agency through lump-sum payments made by the designee, subject to the $12,000 Maximum Amount limitation set forth in Section 3, compliance with applicable laws, including the Employee Retirement Income Security Act of 1974, as amended, and, if applicable, payment by the Eligible Agency or its designee of any applicable transfer taxes and satisfaction of the Company's usual requirements for recognition of a transfer of Class A common stock.

12. Adjustment of and Changes in the Class A Common Stock.

In the event that the outstanding shares of the Class A common stock are hereafter increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company, or of another corporation, by reason of reorganization, merger, consolidation, recapitalization, reclassification, stock split-up, stock dividend either in shares of the Class A common stock or of another class of the Company's stock, spin-off or combination of shares, the Committee appointed pursuant to Section 14 of this Plan will make appropriate adjustments in the aggregate number and kind of shares that are reserved for sale under this Plan.

13. Amendment or Discontinuance of This Plan.

The board of directors of the Company will have the right to amend, modify or terminate this Plan at any time without notice provided that the amendment, modification or termination of this Plan does not adversely affect any participant's existing rights.

14. Administration.

A committee (the "Committee") consisting of three persons the board of directors of the Company has appointed from time to time will administer this Plan. The

Committee may from time to time adopt rules and regulations for carrying out this Plan. Any Committee interpretation or construction of any provision of this Plan will be final and conclusive on all participants absent contrary action by the board of directors. Any board of directors interpretation or construction of any provision of this Plan will be final and conclusive on all participants.

15. Titles.

Titles are provided in this Plan for convenience only and are not to serve as a basis for interpretation or construction of this Plan.

16. Applicable Law.

This Plan will be construed, administered and governed in all respects under the laws of the Commonwealth of Pennsylvania and the United States of America.

DONEGAL GROUP INC.

2011 EQUITY INCENTIVE PLAN FOR DIRECTORS

1. Purpose. The purpose of this 2011 equity incentive plan for directors (this “Plan”) is to enhance the ability of Donegal Group Inc. (the “Company”) and its subsidiaries and the member companies of the Donegal Insurance Group, including companies from which the Company or Donegal Mutual assumes 100% quota share reinsurance (the “Group”), to attract and retain highly qualified directors, to establish a basis for providing a portion of director compensation in the form of equity and, in doing so, to strengthen the alignment of the interest of directors of the Company and the members of the Group with the interests of the Company’s stockholders.

2. Administration.

(a) Administration by the Board. The Board of Directors of the Company (the “Board”) shall administer this Plan.

(b) Duty and Powers of the Board. The Board shall have the power to interpret this Plan and the awards granted under this Plan and to adopt rules for the administration, interpretation and application of this Plan. The Board shall have the discretion to determine to whom the Company will grant stock options and to determine the number of stock options the Company will grant to any director, the timing of the grant and the terms of exercise. The Board shall not have any discretion to determine to whom the Company will grant restricted stock awards under this Plan.

(c) Compensation; Professional Assistance; Good Faith Actions. Members of the Board shall not receive any compensation for their services in administering this Plan. The Company shall pay all expenses and liabilities incurred in connection with the administration of this Plan. The Company may employ attorneys, consultants, accountants or other experts. The Board, the Company and the officers and directors of the Company shall be entitled to rely upon the advice, opinions or valuations of any such experts. All actions taken and all interpretations and determinations the Board makes in good faith shall be final and binding upon all grantees, the Company and all other interested persons. No member of the Board shall be personally liable for any action, determination or interpretation the Board makes in good faith with respect to this Plan, and the Company shall fully protect and indemnify all members of the Board in respect to any such action, determination or interpretation.

3. Shares Subject to this Plan.

(a) Shares Authorized. The shares of stock issuable pursuant to awards shall be shares of Class A common stock. The total aggregate number of shares of Class A common

stock that the Company may issue under this Plan is 400,000 shares, subject to adjustment as described below. The shares may be authorized but unissued shares or reacquired shares for purposes of this Plan.

(b) Share Counting. For administrative purposes, when the Board approves an award payable in shares of Class A common stock, the Board shall reserve, and count against the share limit, shares equal to the maximum number of shares that the Company may issue under the award. If and to the extent options granted under this Plan terminate, expire or are canceled, forfeited, exchanged or surrendered without having been exercised, and if and to the extent that any restricted stock awards are forfeited or terminated, or otherwise are not paid in full, the Company shall make the shares reserved for such awards available again for purposes of this Plan.

(c) Adjustments. If any change in the number or kind of shares of Class A common stock outstanding occurs by reason of:

- a stock dividend, spinoff, recapitalization, stock split or combination or exchange of shares;
- a merger, reorganization or consolidation;
- a reclassification or change in par value; or
- any other extraordinary or unusual event affecting the outstanding Class A common stock as a class without the Company's receipt of consideration, or if the value of outstanding shares of Class A common stock is substantially reduced as a result of a spinoff or the Company's payment of any extraordinary dividend or distribution,

the maximum number of shares of Class A common stock available for issuance under this Plan, the maximum number of shares of Class A common stock for which any individual may receive grants in any year, the kind and number of shares covered by outstanding awards, the kind and number of shares to be issued or issuable under this Plan and the price per share or applicable market value of such grants shall automatically be equitably adjusted to reflect any increase or decrease in the number of, or change in the kind or value of, issued shares of Class A common stock to preclude, to the extent practicable, the enlargement or dilution of rights and benefits under this Plan and such outstanding grants. Any fractional shares resulting from such adjustment shall be eliminated. Any adjustments to outstanding awards shall be consistent with Section 409A of the Internal Revenue Code of 1986, as amended, or the Code, to the extent applicable.

4. Eligibility for Participation. Each director of the Company and its subsidiaries and each director of a member of the Group who is not eligible to receive stock options under the Company's Equity Incentive Plan for Employees shall be eligible to receive stock options

under this Plan. Each director of the Company and each director of the member companies of the Group shall be eligible to receive restricted stock awards under this Plan.

5. Awards. Awards under this Plan may consist of stock options as described in Section 7 and restricted stock awards as described in Section 8. Each award shall be evidenced by a written agreement.

6. Definition of Fair Market Value. For purposes of this Plan, "fair market value" shall mean the last sales price of a share of Class A common stock on the NASDAQ Stock Market, or NASDAQ, on the day on which the board is determining the fair market value, as reported by NASDAQ. In the event that there are no transactions in shares of Class A common stock on NASDAQ on such day, the Board will determine the fair market value as of the immediately preceding day on which there were transactions in shares of Class A common stock on that exchange. If shares of Class A common stock are not listed by NASDAQ, the Board shall determine the fair market value pursuant to Section 422 of the Code.

7. Stock Options.

(a) Granting of Stock Options. The Board may grant stock options to an outside director upon such terms as the Board deems appropriate under this Section 7.

(b) Type of Stock Option and Price. The Board may grant stock options to purchase Class A common stock that the Board does not intend to qualify as incentive stock options within the meaning of Section 422 of the Code. The Board shall determine the exercise price of shares of Class A common stock subject to a stock option, which shall be equal to or greater than the fair market value of a share of Class A common stock on the date of grant.

(c) Exercisability of Stock Options. Each stock option agreement shall specify the period or periods of time within which a grantee may exercise a stock option, in whole or in part, as the Board determines. No grantee may exercise a stock option after ten years from the grant date of the stock option. The Board may accelerate the exercisability of any or all outstanding stock options at any time for any reason.

(d) Rights upon Termination of Service. Upon a grantee's termination of service as an outside director, as a result of resignation, failure to be re-elected, removal for cause or any reason other than death, the grantee shall have the right to exercise the stock option during its term within a period of three years after such termination to the extent that the stock option was exercisable at the time of termination, or within such other period, and subject to such terms and conditions, as the Board may specify. In the event that a grantee dies prior to the expiration of his or her stock option and without having fully exercised his or her stock option, the grantee's representative or successor shall have the right to exercise

the stock option during its term within a period of one year after the grantee's death to the extent that the stock option was exercisable at the time of death, or within such other period, and subject to such terms and conditions, as the Board may specify.

(e) Exercise of Stock Options. A grantee may exercise a stock option that has become exercisable, in whole or in part, by delivering a notice of exercise to the Company. The grantee shall pay the exercise price for the stock option:

- in cash;
- by delivery of shares of Class A common stock at fair market value, shares of Class B common stock at fair market value, or a combination of those shares, as the Board may determine from time to time and subject to the terms and conditions as the Board may prescribe;
- by payment through a brokerage firm of national standing whereby the grantee will simultaneously exercise the stock option and sell the shares acquired upon exercise through the brokerage firm and the brokerage firm shall remit to the Company from the proceeds of the sale of the shares the exercise price as to which the option has been exercised in accordance with the procedures permitted by Regulation T of the Federal Reserve Board; or
- by any other method the Board authorizes.

The Company must receive payment for the shares acquired upon exercise of the stock option, and any required withholding taxes and related amounts, by the time the Board specifies depending on the type of payment being made, but in all cases prior to the issuance of the shares.

8. Restricted Stock Awards.

(a) Granting of Awards. The Company shall grant each director of the Company and each director of Donegal Mutual an annual restricted stock award consisting of 400 shares of Class A common stock, except that a person who serves as a director on both boards shall receive only one annual grant. The Company shall grant the restricted stock awards on the first business day of January in each year, commencing January 2, 2012, provided that the director served as a member of the Board or of the board of directors of a member of the Group during any portion of the preceding calendar year.

(b) Terms of Restricted Stock Awards. Each restricted stock award agreement shall contain such restrictions, terms and conditions as this Plan requires:

- The grantee may not sell or otherwise transfer the shares of Class A common stock comprising the restricted stock awards until one year after the date of

grant. Although the Company shall register the shares of Class A common stock comprising each restricted stock award in the name of the grantee, the Company reserves the right to place a restrictive legend on the stock certificate. None of such shares of Class A common stock shall be subject to forfeiture.

- Subject to the restrictions on transfer set forth in this Section 8(b), a grantee shall have all the rights of a stockholder with respect to the shares of Class A common stock the Company issues pursuant to restricted stock awards made under this Plan, including the right to vote the shares and receive all dividends and other distributions paid or made with respect to the shares.
- In the event of changes in the capital stock of the Company by reason of stock dividends, split-ups or combinations of shares, reclassifications, mergers, consolidations, reorganizations or liquidations while the shares comprising a restricted stock award shall be subject to restrictions on transfer, any and all new, substituted or additional securities to which the grantee shall be entitled by reason of the ownership of a restricted stock award shall be subject immediately to the terms, conditions and restrictions of this Plan.
- If a grantee receives rights or warrants with respect to any shares comprising a restricted stock award, the grantee may hold, exercise, sell or otherwise dispose of such rights or warrants or any shares or other securities acquired by the exercise of such rights or warrants free and clear of the restrictions and obligations set forth in this Plan.

9. Date of Grant. The grant date of a stock option under this Plan shall be the date of the Board’s approval or such later date as the Board determines at the time it authorizes the grant. The Board may not make retroactive grants of stock options under this Plan. The Company shall provide notice of the grant to the grantee within a reasonable time after the grant date.

10. Requirements for Issuance of Shares. The Company will not issue shares of Class A common stock in connection with any award under this Plan until the issuance of the shares complies with all of the applicable legal requirements to the satisfaction of the Board. The Board shall have the right to condition any award made to any director on the director’s undertaking in writing to comply with the restrictions on his or her subsequent disposition of shares subject to the award as the Board shall deem necessary or advisable, and certificates representing those shares may be legended to reflect any such restrictions. Certificates representing shares of Class A common stock issued under this Plan will be subject to such stop-transfer orders and other restrictions as applicable laws, regulations and interpretations may require, including any requirement that a legend be placed on the certificate.

11. Withholding. The Company shall have the right to require the grantee to remit to the Company an amount sufficient to satisfy any federal, state or local withholding tax requirements prior to the delivery of any certificate for shares of Class A common stock. If and to the extent the Board authorizes, in its sole discretion, a grantee may make an election, by means of a form of election the Board prescribes, to have shares of Class A common stock that are acquired upon exercise of a stock option withheld by the Company or to tender other shares of Class A common stock or other securities of the Company owned by the grantee to the Company at the time of exercise of a stock option to pay the amount of tax that would otherwise be required by law to be withheld by the Company. Any such election shall be irrevocable and shall be subject to termination by the Board, in its sole discretion, at any time. Any securities so withheld or tendered will be valued by the Board as of the date of exercise.

12. Transferability of Awards. Only the grantee of an award may exercise rights under the award grant during the grantee’s lifetime, and a grantee may not transfer those rights except by will or by the laws of descent and distribution. When a grantee dies, the personal representative or other person entitled to succeed to the rights of the grantee may exercise those rights. Any successor to a grantee must furnish proof satisfactory to the Company of his or her right to receive the award under the grantee’s will or under the applicable laws of descent and distribution. Except as stated in this Section 12, no stock option or interest therein and, for a period of one year after the date of grant, no restricted stock award or any interest therein, shall be subject to the debts, contracts or engagements of the grantee or his or her successors in interest, nor shall they be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means, whether such disposition is voluntary or involuntary or by operation of law by judgment, levy, attachment, garnishment or any other legal or equitable proceedings, including bankruptcy, and any attempted disposition thereof shall be null and void and of no effect.

13. Amendment and Termination of this Plan.

(a) Amendments. The Board may amend or terminate this Plan at any time, except that the Board shall not amend this Plan without approval of the stockholders of the Company if such approval is required in order to comply with the Code or applicable laws, or to comply with applicable stock exchange requirements. The Board may not, without the consent of the grantee, negatively affect the rights of a grantee under any award previously granted under this Plan.

(b) No Repricings Without Stockholder Approval. The Board may not reprice stock options, nor may the Board amend this Plan to permit repricing of stock options unless the stockholders of the Company provide prior approval for the repricing.

(c) Termination. This Plan shall terminate on April 21, 2021, unless the Board earlier terminates this Plan or the term is extended with the approval of the stockholders of

the Company. The termination of this Plan shall not impair the power and authority of the Board with respect to an outstanding award.

14. Reservation of Shares. The Company, during the term of this Plan, shall at all times reserve and keep available the number of shares of Class A common stock needed to satisfy the requirements of this Plan. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority the Company's counsel deems necessary to the lawful issuance and sale of any shares under this Plan, shall relieve the Company of any liability for the failure to issue or sell any shares as to which the requisite authority the Company has not obtained.

15. No Prohibition on Corporate Action. No provision of this Plan shall be construed to prevent the Company or any officer or director of the Company from taking any action the Company or such officer or director deems appropriate or in the Company's best interest, whether or not such action could have an adverse effect on this Plan or any awards granted under this Plan, and no grantee or grantee's estate, personal representative or beneficiary shall have any claim against the Company or any officer or director of the Company as a result of the taking of the action.

16. Indemnification. With respect to the administration of this Plan, the Company shall indemnify each present and future member of the Board against, and each member of the Board shall be entitled without further action on such member's part to indemnity from the Company for, all expenses, including the amount of judgments and the amount of approved settlements made with a view to the curtailment of costs of litigation, other than amounts paid to the Company itself, reasonably incurred by him or her in connection with or arising out of, any action, suit or proceeding in which he or she may be involved by reason of being or having been a member of the Board, whether or not he or she continues to be such member at the time of incurring such expenses; provided, however, that this indemnity shall not include any expenses incurred by any such member of the Board (i) in respect of matters as to which he or she shall be finally adjudged in any such action, suit or proceeding to have been guilty of gross negligence or willful misconduct in the performance of his or her duty as such member of the Board or (ii) in respect of any matter in which any settlement is effected for an amount in excess of the amount approved by the Company on the advice of its legal counsel; and provided further that no right of indemnification under the provisions set forth in this Section 16 shall be available to or enforceable by any such member of the Board unless, within 60 days after institution of any such action, suit or proceeding, he or she shall have offered the Company in writing the opportunity to handle and defend same at its own expense. The foregoing right of indemnification shall inure to the benefit of the heirs, executors or administrators of each such member of the Board and shall be in addition to all other rights to which such member may be entitled as a matter of law, contract or otherwise.

17. Miscellaneous Plan Provisions.

(a) Compliance with Plan Provisions. No grantee or other person shall have any right with respect to this Plan, the Class A common stock reserved for issuance under this Plan or in any award until the Company and the grantee execute a written agreement and the Company and grantee satisfy all the applicable terms, conditions and provisions of this Plan and award.

(b) Approval of Counsel. In the discretion of the Board, no shares of Class A common stock, other securities or property of the Company or other forms of payment shall be issued hereunder with respect to any award unless counsel for the Company shall be satisfied that such issuance will be in compliance with applicable federal, state, local and foreign legal, securities exchange and other applicable requirements.

(c) Compliance with Rule 16b-3. To the extent that Rule 16b-3 under the Securities Exchange Act of 1934, as amended, applies to awards granted under this Plan, it is the intention of the Company that this Plan comply in all respects with the requirements of Rule 16b-3, that any ambiguities or inconsistencies in construction of this Plan be interpreted to give effect to such intention and that if this Plan shall not so comply, whether on the date of adoption or by reason of any later amendment to or interpretation of Rule 16b-3, the provisions of this Plan shall be deemed to be automatically amended so as to bring them into full compliance with that rule.

(d) Section 409A Compliance. This Plan is intended to comply with the requirements of Section 409A of the Code and the regulations issued thereunder. To the extent of any inconsistencies with the requirements of Section 409A, this Plan shall be interpreted and amended in order to meet the requirements of Section 409A. Notwithstanding anything contained in this Plan to the contrary, it is the intent of the Company to have this Plan interpreted and construed to comply with any and all provisions Section 409A including any subsequent amendments, rulings or interpretations from appropriate governmental agencies.

(e) Effects of Acceptance of the Award. By accepting any award or other benefit under this Plan, the Company shall conclusively deem each grantee and each person claiming under or through the grantee to have indicated his acceptance and ratification of, and consent to, any action taken under this Plan by the Company, the Board or its delegates.

Adopted by the Board on March 7, 2011.

Selected Consolidated Financial Data

Year Ended December 31,	2010	2009	2008	2007	2006
Income Statement Data					
Premiums earned	$ 378,030,129	$355,025,477	$346,575,266	$310,071,534	$301,478,162
Investment income, net	19,949,714	20,630,583	22,755,784	22,785,252	21,320,081
Realized investment gains (losses)	4,395,720	4,479,558	(2,970,716)	2,051,050	1,829,539
Total revenues	408,817,787	386,262,310	372,424,227	340,618,294	329,967,034
Income before income tax (benefit)	9,844,149	20,676,689	32,092,044	52,848,938	56,622,263
Income tax (benefit)	(1,623,030)	1,846,611	6,550,066	14,569,033	16,407,541
Net income	11,467,179	18,830,078	25,541,978	38,279,905	40,214,722
Basic earnings per share — Class A	.46	.76	1.03	1.55	1.65
Diluted earnings per share — Class A	.46	.76	1.02	1.53	1.60
Cash dividends per share — Class A	.46	.45	.42	.36	.33
Basic earnings per share — Class B	.41	.68	.92	1.39	1.48
Diluted earnings per share — Class B	.41	.68	.92	1.39	1.48
Cash dividends per share — Class B	.41	.40	.37	.31	.28
Balance Sheet Data at Year End					
Total investments	$ 728,541,814	$666,835,186	$632,135,526	$605,869,587	$591,337,674
Total assets	1,174,619,523	935,601,927	880,109,036	834,095,576	831,697,811
Debt obligations	56,082,371	15,465,000	15,465,000	30,929,000	30,929,000
Stockholders' equity	380,102,810	385,505,699	363,583,865	352,690,191	320,802,262
Book value per share	14.86	15.12	14.29	13.92	12.70

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Management's Discussion and Analysis of Results of Operations and Financial Condition

General

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"), Le Mars Insurance Company ("Le Mars"), the Peninsula Insurance Group ("Peninsula"), which consists of Peninsula Indemnity Company and The Peninsula Insurance Company, Sheboygan Falls Insurance Company ("Sheboygan") and Michigan Insurance Company ("Michigan"), write personal and commercial lines of property and casualty coverages exclusively through a network of independent insurance agents in certain Mid-Atlantic, Midwest, New England and Southern states. We acquired Michigan on December 1, 2010, and we have included Michigan's results of operations in our consolidated results from that date. We acquired Sheboygan on December 1, 2008, and we have included Sheboygan's results of operations in our consolidated results from that date. The personal lines products of our insurance subsidiaries consist primarily of homeowners and private passenger automobile policies. The commercial lines products of our insurance subsidiaries consist primarily of commercial automobile, commercial multi-peril and workers' compensation policies. We also own 48.2% of the outstanding stock of Donegal Financial Services Corporation ("DFSC"), a thrift holding company. Donegal Mutual owns the remaining 51.8% of the outstanding stock of DFSC.

At December 31, 2010, Donegal Mutual held approximately 42% of our outstanding Class A common stock and approximately 75% of our outstanding Class B common stock, which provide Donegal Mutual with 66% of the total voting power of our common stock. Our insurance subsidiaries and Donegal Mutual have interrelated operations. While maintaining the separate corporate existence of each company, 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.

In December 2006, Donegal Mutual consummated an affiliation with Sheboygan. As part of the affiliation, Donegal Mutual made a $3.5 million contribution note investment in Sheboygan. During 2008, Sheboygan's board of directors adopted a plan of conversion to convert to a stock insurance company. Following policyholder and regulatory approval of the plan of conversion, we acquired Sheboygan as of December 1, 2008 for approximately $12.0 million in cash, including payment of the contribution note and accrued interest to Donegal Mutual.

In February 2009, our board of directors authorized a share repurchase program, pursuant to which we may purchase up to 300,000 shares of our Class A common stock at market prices prevailing from time to time in the open market subject to the provisions of Securities and Exchange Commission Rule 10b-18 and in privately negotiated transactions. We purchased 9,702 and 7,669 shares of our Class A common stock under this program during 2010 and 2009, respectively. As of December 31, 2010, we had the authority to purchase 282,629 shares under this program.

In October 2009, Donegal Mutual consummated an affiliation with Southern Mutual Insurance Company ("Southern Mutual"), pursuant to which Donegal Mutual purchased a surplus note of Southern Mutual in the principal amount of $2.5 million, Donegal Mutual designees became a majority of the members of Southern Mutual's board of directors and Donegal Mutual agreed to provide quota-share reinsurance to Southern Mutual for 100% of its business. Effective October 31, 2009, Donegal Mutual began to include business assumed from Southern Mutual in its pooling agreement with Atlantic States. Southern Mutual writes primarily personal lines of insurance in Georgia and South Carolina and had direct written premiums of approximately $12.8 million and $13.3 million in 2010 and 2009, respectively.

In April 2010, DFSC and certain of its affiliates, including Donegal Mutual and us, and Union National Financial Corporation ("UNNF") executed an agreement pursuant to which DFSC and UNNF would merge, with DFSC as the surviving company in the merger. The merger is subject to a number of conditions, including the approval of various federal bank regulatory agencies. Under the agreement, Province Bank FSB and Union National Community Bank, which UNNF owns, would also merge. The combined bank would have total assets of approximately $600 million and would have 13 branch locations in Lancaster County, Pennsylvania. The companies expect to complete the mergers in the first quarter of 2011. Following the mergers, we expect to continue using the equity method of accounting for our investment in DFSC. Under the equity method, we record our investment at cost, with adjustments for our share of DFSC's earnings and losses as well as changes in DFSC's equity due to unrealized gains and losses.

In December 2010, we acquired Michigan, which had been a majority-owned subsidiary of West Bend Mutual Insurance Company ("West Bend"). Michigan writes various lines of property and casualty insurance and had direct written premiums of $105.4 million and net written premiums of $27.1 million for the year ended December 31, 2010. Effective on December 1, 2010, Michigan entered into a 50% quota-share agreement with third-party reinsurers and a 25% quota-share reinsurance agreement with Donegal Mutual to replace the 75% quota-share reinsurance agreement Michigan maintained with West Bend through November 30, 2010. The final purchase price for the acquisition was approximately $42.3 million in cash.

Pooling Agreement and Other Transactions with Affiliates

In the mid-1980's, Donegal Mutual recognized the need to develop additional sources of capital and surplus to remain competitive and to have the capacity to expand its business and assure its long-term viability. Donegal Mutual determined to implement a downstream holding company structure as a strategic response. Thus, in 1986, Donegal Mutual formed us as a downstream holding company, then wholly owned by Donegal Mutual. We in turn formed Atlantic States as our wholly owned subsidiary. Donegal Mutual and Atlantic States then entered into a proportional reinsurance agreement, or pooling agreement, in 1986. Under this pooling agreement, Donegal Mutual and Atlantic States pool substantially all of their respective premiums, losses and expenses. Donegal Mutual then cedes 80% of the pooled premiums, losses and expenses to Atlantic States.

Since 1986, we have completed three public offerings. A major purpose of those offerings was to provide capital for Atlantic States and our other insurance subsidiaries and to fund acquisitions. As the capital of Atlantic States increased, its underwriting capacity increased proportionately. Thus, as we originally planned in the mid-1980's, Atlantic States has had access to the capital necessary to support the growth of its direct business and increases in the amount and percentage of business it assumes from the underwriting pool. As a result, the participation of Atlantic States in the inter-

company pool has increased over the years from its initial 35% participation in 1986 to its 80% participation from and after February 29, 2008, and the size of the pool has increased substantially. From July 1, 2000 through February 29, 2008, Atlantic States had a 70% share of the results of the pool, and Donegal Mutual had a 30% share of the results of the pool.

The risk profiles of the business Atlantic States and Donegal Mutual write have historically been, and continue to be, substantially similar. 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 offer 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 and Donegal Mutual do not allocate all of the standard risk gradients to one company. Therefore, the underwriting profitability of the business written directly by the individual companies will vary. However, since the underwriting pool homogenizes the risk characteristics of all business written directly by Donegal Mutual and Atlantic States, Donegal Mutual and Atlantic States share the underwriting results in proportion to their respective participation in the pool. We realize 80% of the underwriting results of the pool because of the 80% participation of Atlantic States in the underwriting pool. The business Atlantic States derives from the pool represents the predominant percentage of our total revenues. See Note 3 — Transactions with Affiliates for more information regarding the pooling agreement.

In addition to the pooling agreement and third-party reinsurance, our insurance subsidiaries have various reinsurance arrangements with Donegal Mutual. These agreements include:

- catastrophe reinsurance agreements with Atlantic States, Le Mars and Southern;
- an excess of loss reinsurance agreement with Southern;
- a quota-share reinsurance agreement with Le Mars;
- a quota-share reinsurance agreement with Peninsula;
- a quota-share reinsurance agreement with Southern; and
- a quota-share reinsurance agreement with Michigan.

The intent of the excess of loss and catastrophe reinsurance agreements is to lessen the effects of a single large loss, or an accumulation of smaller losses arising from one event, to levels that are appropriate given each subsidiary's size, underwriting profile and surplus position.

The intent of the quota-share reinsurance agreement with Le Mars is to transfer to Le Mars 100% of the premiums and losses related to certain products Donegal Mutual offers in certain Midwest states, which provide the availability of complementary products to Le Mars' commercial accounts.

Donegal Mutual and Peninsula have a quota-share reinsurance agreement that transfers to Donegal Mutual 100% of the premiums and losses related to the workers' compensation product line of Peninsula in certain states, which provides the availability of an additional workers' compensation tier to Donegal Mutual's commercial accounts.

The intent of the quota-share reinsurance agreement with Southern is to transfer to Southern 100% of the premiums and losses related to certain personal lines products Donegal Mutual offers in Virginia through the use of its automated policy quoting and issuance system.

Donegal Mutual and Michigan have a quota-share reinsurance agreement that transfers to Donegal Mutual 25% of the premiums and losses related to Michigan's business.

Donegal Mutual provides facilities, management and other services to us and our insurance subsidiaries. Donegal Mutual allocates certain related expenses to Atlantic States in relation to the relative participation of Atlantic States and Donegal Mutual in the pooling agreement. Our insurance subsidiaries other than Atlantic States reimburse Donegal Mutual for their personnel costs and bear their proportionate share of information services costs based on their percentage of the total written premiums of the Donegal Insurance Group.

All new agreements and all changes to existing agreements between our insurance subsidiaries and Donegal Mutual must first be approved by a coordinating committee that is comprised of two of our board members who do not serve on Donegal Mutual's board and two members of Donegal Mutual's board who do not serve on our board. In order to approve an agreement or a change in an agreement, our members on the coordinating committee must conclude that the agreement or change is fair and equitable to us and in the best interests of our stockholders, and Donegal Mutual's members on the coordinating committee must conclude that the agreement or change is fair and equitable to Donegal Mutual and in the best interests of its policyholders.

We made no significant changes to the pooling agreement or other reinsurance agreements with Donegal Mutual during 2010 and 2009 except as noted above.

Critical Accounting Policies and Estimates

We combine our financial statements with those of our insurance subsidiaries and present them on a consolidated basis in accordance with United States generally accepted accounting principles ("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 reserves of our insurance subsidiaries for property and casualty insurance unpaid losses and loss expenses, valuation of investments and determination of other-than-temporary impairment and the policy acquisition costs of our insurance subsidiaries. While we believe our estimates and the estimates of our insurance subsidiaries are appropriate, the ultimate amounts may differ from the estimates provided. We regularly review our methods for making these estimates, and we reflect any adjustment we consider necessary in our current results of operations.

Liability 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 policyholder claims based on facts and circumstances then known. 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 and 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 of liability. We reflect any adjustments to our insurance subsidiaries' liabilities for losses and loss expenses in our operating results in the period in which our insurance subsidiaries make the changes in 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 their 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 closely monitor their liabilities 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.

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 as to our insurance subsidiaries' internal operations. For example, our insurance subsidiaries have experienced a decrease in claims frequency on workers' compensation claims during the past several years while claims severity has gradually increased. These trend changes give rise to greater uncertainty as to the pattern of future loss settlements on workers' compensation claims. Related uncertainties regarding future trends include the cost of medical technologies and procedures and changes in the utilization of medical 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 collectibility of reinsured losses, among other items. To the extent our insurance subsidiaries determine that underlying factors impacting their assumptions have changed, our insurance subsidiaries attempt to make appropriate adjustments for such changes in their reserves. Accordingly, our insurance subsidiaries' ultimate liability for unpaid losses and loss expenses will likely differ from the amount recorded at December 31, 2010. For every 1% change in our insurance subsidiaries' estimate for loss and loss expense reserves, net of reinsurance recoverable, the effect on our pre-tax results of operations would be approximately $2.2 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, since 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 estimates have exceeded their actual liabilities. Changes in our insurance subsidiaries' estimate of their liability for losses and loss expenses generally reflect actual payments and their evaluation of information received since the prior reporting date. Our insurance subsidiaries recognized a (decrease) increase in their liability for losses and loss expenses of prior years of ($2.9) million, $9.8 million and $2.7 million in 2010, 2009 and 2008, respectively. Our insurance subsidiaries made no significant changes in their reserving philosophy, key reserving assumptions or claims management personnel, and there have been no significant offsetting changes in estimates that increased or decreased their loss and loss expense reserves in those years. The majority of the 2010 development related to decreases in the liability for losses and loss expenses of prior years for Atlantic States and Peninsula. The 2010 development represented 1.6% of the December 31, 2009 carried reserves and was driven primarily by lower-than-expected severity in the private passenger automobile liability and homeowners lines of business in accident years prior to 2009.

Excluding the impact of isolated catastrophic weather events, our insurance subsidiaries have noted stable amounts in the number of claims incurred and a slight downward trend in 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 as the property and casualty insurance industry has experienced increased litigation trends and economic conditions that have extended the estimated length of disabilities and contributed to increased medical loss costs and a general slowing of settlement rates in litigated 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 it to adverse loss development on the business of Donegal Mutual that is included in the pool. However, pooled business represents the predominant percentage of the net underwriting activity of both companies, and Donegal Mutual and Atlantic States would proportionately share any adverse risk development of the pooled business. The business in the pool is homogenous and each company has a pro-rata share of the entire pool. Since substantially all 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 they would experience individually and to spread the risk of loss between the companies.

Our insurance subsidiaries' liability for losses and loss expenses by major line of business as of December 31, 2010 and 2009 consisted of the following:

(in thousands)	2010	2009
Commercial lines:		
Automobile	$ 22,790	$ 21,465
Workers' compensation	54,902	38,092
Commercial multi-peril	32,961	30,640
Other	3,875	1,886
Total commercial lines	114,528	92,083
Personal lines:		
Automobile	83,042	70,019
Homeowners	18,695	16,312
Other	1,632	1,848
Total personal lines	103,369	88,179
Total commercial and personal lines	217,897	180,262
Plus reinsurance recoverable	165,422	83,337
Total liability for losses and loss expenses	$383,319	$263,599

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 considered in establishing loss and loss expense reserves. We established the range of reasonably likely changes based on a review of changes in accident year development by line of business and applied it to our insurance subsidiaries' loss reserves as a whole. The selected range does not necessarily indicate what could be the potential best or worst case or likely scenario. The following table sets forth 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 considered in establishing loss and loss expense reserves:

Change in Loss and Loss Expense Reserves Net of Reinsurance	Adjusted Loss and Loss Expense Reserves Net of Reinsurance as of December 31, 2010	Percentage Change in Equity as of December 31, 2010(1)	Adjusted Loss and Loss Expense Reserves Net of Reinsurance as of December 31, 2009	Percentage Change in Equity as of December 31, 2009(1)
		(dollars in thousands)		
-10.0%	$ 196,107	3.7%	$ 162,236	3.0%
-7.5	201,555	2.8	166,742	2.3
-5.0	207,002	1.9	171,249	1.5
-2.5	212,450	0.9	175,755	0.8
Base	217,897	—	180,262	—
2.5	223,344	-0.9	184,769	-0.8
5.0	228,792	-1.9	189,275	-1.5
7.5	234,239	-2.8	193,782	-2.3
10.0	239,687	-3.7	198,288	-3.0

(1) Net of income tax effect.

Our insurance subsidiaries base their reserves for unpaid losses and loss expenses on current trends in loss and loss expense development and reflect their best estimates for future amounts needed to pay losses and loss expenses with respect to incurred events currently known to them plus incurred but not reported ("IBNR") claims. Our insurance subsidiaries develop their reserve estimates based on an assessment of known facts and circumstances, review of historical loss settlement patterns, estimates of trends in claims severity, frequency, legal and regulatory changes and other assumptions. Our insurance subsidiaries consistently apply actuarial loss reserving techniques and assumptions, which rely on historical information as adjusted to reflect current conditions, including consideration of recent case reserve activity. For the year ended December 31, 2010, our insurance subsidiaries used the most-likely number determined by our actuaries. Based upon information provided by our actuaries during the development of our insurance subsidiaries' net reserves for losses and loss expenses for the year ended December 31, 2010, we developed a range from a low of $200.4 million to a high of $236.8 million and with a most-likely number of $217.9 million. The range of estimates for commercial lines in 2010 was $105.4 million to $124.4 million, and we selected the actuaries' most-likely number of $114.5 million. The range of estimates for personal lines in 2010 was $95.0 million to $112.4 million, and we selected the actuaries' most-likely number of $103.4 million. Based upon information provided by our actuaries during the development of our insurance subsidiaries' net reserves for losses and loss expenses for the year ended December 31, 2009, we developed a range from a low of $165.6 million to a high of $196.2 million and with a most-likely number of $180.3 million. The range of estimates for commercial lines in 2009 was $84.6 million to $100.2 million, and we selected the actuaries' most-likely number of $92.1 million. The range of estimates for personal lines in 2009 was $81.0 million to $96.0 million, and we selected the actuaries' most-likely number of $88.2 million.

Our insurance subsidiaries seek to enhance their underwriting results by carefully selecting the product lines they underwrite. For personal lines products, our insurance subsidiaries insure standard and preferred risks in private passenger automobile and homeowners lines. For commercial lines products, the commercial risks that our insurance subsidiaries primarily insure are mercantile risks, business offices, wholesalers, service providers, contractors and artisan risks, limiting industrial and manufacturing exposures. Our insurance subsidiaries have limited exposure to asbestos and other environmental liabilities. Our insurance subsidiaries write no medical malpractice or professional liability risks. Through the consistent application of this disciplined underwriting philosophy, our insurance subsidiaries have avoided many of the "long-tail" issues other insurance companies have faced. We consider workers' compensation to be a "long-tail" line of business, in that workers' compensation claims tend to be settled over a longer timeframe than those in our other lines of business. The following table presents 2010 and 2009 claim count and payment amount information for workers' compensation. The table does not include amounts related to Michigan, which we acquired December 1, 2010. Workers' compensation losses primarily consist of indemnity and medical costs for injured workers.

For the Year Ended

	December 31,	
	2010	2009
	(dollars in thousands)	
Number of claims pending, beginning of period	1,296	1,401
Number of claims reported	2,936	2,449
Number of claims settled or dismissed	2,909	2,554
Number of claims pending, end of period	1,323	1,296
Losses paid	$18,193	$17,131
Loss expenses paid	3,918	3,944

Investments

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 write down the investment to its fair value, and we reflect the amount of the write-down as a realized loss in our results of operations when we consider the decline in value of an individual investment to be other than temporary. We individually monitor all investments for other-than-temporary declines in value. Generally, we assume there has been an other-than-temporary decline in value if an individual equity security has depreciated in value by more than 20% of original cost, and has been in such an unrealized loss position for more than six months. We held five equity securities that were in an unrealized loss position at December 31, 2010. Based upon our analysis of general market conditions and underlying factors impacting these equity securities, we considered these declines in value to be temporary. 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 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 an 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. 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, company or geographic events that have negatively impacted the value of a security and rating agency downgrades. We held 302 debt securities that were in an unrealized loss position at December 31, 2010. 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 did not recognize any impairment losses in 2010 or 2009. We included losses of $1.2 million in net realized investment gains (losses) in 2008 for certain equity investments trading below cost on an other-than-temporary basis.

We held fixed maturities and equity securities with unrealized losses representing declines that we considered temporary at December 31, 2010 as follows:

	Less than 12 months		12 months or longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 23,901,400	$ 452,352	$ —	$ —
Obligations of states and political subdivisions	171,609,617	5,208,910	1,406,325	91,184
Corporate securities	44,101,089	1,061,972	490,970	11,514
Residential mortgage-backed securities	35,930,054	453,967	750	18
Equity securities	313,888	35,182	—	—
Totals	$275,856,048	$7,212,383	$1,898,045	$102,716

We held fixed maturities and equity securities with unrealized losses representing declines that we considered temporary at December 31, 2009 as follows:

	Less than 12 months		12 months or longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$26,703,601	$ 585,364	$ —	$ —
Obligations of states and political subdivisions	17,971,018	256,527	29,582,488	786,970
Corporate securities	1,284,405	23,525	666,941	61,366
Residential mortgage-backed securities	23,514,855	328,969	477,421	543
Equity securities	2,139,457	227,798	—	—
Totals	$71,613,336	$1,422,183	$30,726,850	$848,879

We present our investments in available-for-sale fixed maturity and equity securities at estimated fair value and classify them in one of the three categories we describe in Note 6 — Fair Value Measurements. 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 for our fixed maturity and equity investments. We generally obtain one price per security. The 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 using proprietary pricing applications, which include available relevant market information, benchmark yields, sector curves and matrix pricing. The pricing services do not use broker quotes in determining the fair values of our investments. We review the estimates of fair value the pricing services provide to determine if the estimates obtained are representative of fair values based upon our general knowledge of the market, our research findings related to unusual fluctuations in value and our comparison of such values to execution prices for similar securities. As of December 31, 2010 and 2009, we received one estimate per security from one of the pricing services, and we priced all but an insignificant amount of our Level 1 and Level 2 investments using those prices. In our review of the estimates provided by the pricing services as of December 31, 2010 and 2009, we did not identify any discrepancies, and we did not make any adjustments to the estimates the pricing services provided. We reclassified one equity security to Level 3 during 2009. We utilized a fair value model that incorporated significant other unobservable inputs, such as estimated volatility, to estimate the equity security's fair value.

We had no sales or transfers from the held to maturity portfolio in 2010, 2009 or 2008.

Policy Acquisition Costs

We defer our insurance subsidiaries' policy acquisition costs, consisting primarily of commissions, premium taxes and certain other underwriting costs that vary with and relate directly to the production of business, and amortize these costs over the period in which our insurance subsidiaries earn the premiums. The method our insurance subsidiaries follow in computing

deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and loss expenses and certain other costs we expect to incur as our insurance subsidiaries earn the premium.

Management Evaluation of Operating Results

We believe that the principal factors contributing to our earnings over the past several years have been our insurance subsidiaries' overall premium growth, earnings from acquisitions and our insurance subsidiaries' disciplined underwriting practices.

The property and casualty insurance industry is highly cyclical, and individual lines of business experience their own cycles within the overall property and casualty insurance industry cycle. Premium rate levels relate to the availability of insurance coverage, which varies according to the level of surplus in the insurance industry and other factors. The level of surplus in the industry varies with returns on capital and regulatory barriers to the withdrawal of surplus. Increases in surplus have generally been accompanied by increased price competition among property and casualty insurers. If our insurance subsidiaries were to find it necessary to reduce premiums or limit premium increases due to competitive pressures on pricing, our insurance subsidiaries could experience a reduction in profit margins and revenues, an increase in ratios of losses and expenses to premiums and, therefore, lower profitability. The cyclicality of the insurance market and its potential impact on our results is difficult to predict with any significant reliability. We evaluate the performance of our commercial lines and personal lines segments primarily based upon the underwriting results of our insurance subsidiaries as determined under statutory accounting practices ("SAP"), which our management uses to measure performance for the total business of our insurance subsidiaries. We use the following financial data to monitor and evaluate our operating results:

	Year Ended December 31,		
(in thousands)	2010	2009	2008
Net premiums written:			
Personal lines:			
Automobile	$171,497	$161,932	$154,091
Homeowners	83,415	77,420	72,195
Other	13,135	13,135	13,254
Total personal lines	268,047	252,487	239,540
Commercial lines:			
Automobile	37,094	34,054	35,959
Workers' compensation	34,920	28,921	36,459
Commercial multi-peril	47,411	44,000	49,004
Other	4,050	3,767	3,979
Total commercial lines	123,475	110,742	125,401
Total net premiums written	$391,522	$363,229	$364,941
Components of GAAP combined ratio:			
Loss ratio	72.6%	70.7%	64.7%
Expense ratio	32.0	31.3	32.1
Dividend ratio	0.1	0.2	0.4
GAAP combined ratio	104.7%	102.2%	97.2%
Revenues:			
Premiums earned:			
Personal lines	$260,900	$242,313	$225,143
Commercial lines	117,755	113,233	121,567
SAP premiums earned	378,655	355,546	346,710
GAAP adjustments	(625)	(521)	(135)
GAAP premiums earned	378,030	355,025	346,575
Net investment income	19,950	20,631	22,756
Realized investment gains (losses)	4,396	4,480	(2,971)
Other	6,442	6,597	5,952
Total revenues	$408,818	$386,733	$372,312

	Year Ended December 31,		
(in thousands)	2010	2009	2008
Components of net income:			
Underwriting (loss) income:			
Personal lines	$(22,526)	$(17,235)	$ (7,609)
Commercial lines	2,252	5,805	13,819
SAP underwriting (loss) income	(20,274)	(11,430)	6,210
GAAP adjustments	2,458	3,636	3,530
GAAP underwriting (loss) income	(17,816)	(7,794)	9,740
Net investment income	19,950	20,631	22,756
Realized investment gains (losses)	4,396	4,480	(2,971)
Other	3,314	3,360	2,567
Income before income tax benefit (expense)	9,844	20,677	32,092
Income tax benefit (expense)	1,623	(1,847)	(6,550)
Net income	$ 11,467	$ 18,830	$25,542

Statutory Combined Ratios

We evaluate our insurance operations by monitoring certain key measures of growth and profitability. In addition to using GAAP-based performance measurements, we also utilize certain non-GAAP financial measures that we believe are valuable in managing our business and for comparison to our peers. These non-GAAP measures are underwriting (loss) income, statutory combined ratio and net premiums written. An insurance company's statutory combined ratio is a standard measure of underwriting profitability. This ratio is the sum of the ratio of calendar-year incurred losses and loss expenses to premiums earned; the ratio of expenses incurred for commissions, premium taxes and underwriting expenses to premiums written and the ratio of dividends to policyholders to premiums earned. The statutory combined ratio does not reflect investment income, federal income taxes or other non-operating income or expense. A ratio of less than 100 percent generally indicates underwriting profitability. The statutory combined ratio differs from the GAAP combined ratio. In calculating the GAAP combined ratio, installment payment fees are not deducted from incurred expenses, and the expense ratio is based on premiums earned instead of premiums written. The following table sets forth our insurance subsidiaries' statutory combined ratios by major line of business for the years ended December 31, 2010 and 2009:

	For Year Ended December 31,	
	2010	2009
Commercial lines:		
Automobile	90.0%	90.5%
Workers' compensation	99.3	97.4
Commercial multi-peril	96.7	95.6
Other	42.8	23.4
Total commercial lines	93.6	92.2
Personal lines:		
Automobile	103.8	103.8
Homeowners	115.4	111.4
Other	97.0	86.7
Total personal lines	107.0	105.2
Total commercial and personal lines	102.9	101.1

Results of Operations
Years Ended December 31, 2010 and 2009

Net Premiums Written

Our insurance subsidiaries' 2010 net premiums written increased 7.8% to $391.5 million, compared to $363.2 million for 2009. Commercial lines net premiums written increased $12.8 million, or 11.6%, for 2010 compared to 2009, due in part to expansion of commercial lines products in subsidiaries acquired in recent years. Personal lines net premiums written increased $15.5 million, or 6.1%, for 2010 compared to 2009, due largely to premium rate increases implemented throughout 2010. Net premiums written for 2009 included a $5.4 million transfer of unearned premium related to Donegal Mutual's affiliation with Southern Mutual.

Net Premiums Earned

Our insurance subsidiaries' net premiums earned increased to $378.0 million for 2010, an increase of $23.0 million, or 6.5%, over 2009. Our insurance subsidiaries' net earned premiums during 2010 have grown due to the increase in written premiums during 2009. Our insurance subsidiaries earn premiums and recognize them as income over the terms of the policies they issue. Such terms are generally one year or less in duration. Therefore, increases or decreases in net premiums earned will generally reflect increases or decreases in net premiums written in the preceding twelvemonth period compared to the same period one year earlier.

Investment Income

For 2010, our net investment income was $19.9 million, a slight decrease from 2009. An increase in our average invested assets from $649.5 million in 2009 to $697.7 million in 2010 was offset by a decrease in our annualized average rate of return to 2.9% in 2010, compared to 3.2% in 2009. The decrease in our annualized average rate of return on investments was primarily due to lower reinvestment rates for securities added to our fixed income portfolio during 2010.

Installment Payment Fees

Our insurance subsidiaries' installment fees increased primarily as a result of increases in policy counts during 2010.

Net Realized Investment Gains/Losses

Our net realized investment gains in 2010 and 2009 were $4.4 million and $4.5 million, respectively. Realized investment gains in 2010 resulted primarily from sales of equity securities as well as fixed maturity investments that had appreciated significantly during the year. We recognized no impairment charges in 2010 or 2009. The net realized investment gains in both periods resulted from turnover within our investment portfolio.

Losses and Loss Expenses

Our insurance subsidiaries' loss ratio, which is the ratio of incurred losses and loss expenses to premiums earned, was 72.6% in 2010, compared to 70.7% in 2009. Our insurance subsidiaries' commercial lines loss ratio increased to 66.6% in 2010, compared to 64.3% in 2009. This increase resulted primarily from the workers' compensation loss ratio increasing to 80.0% in 2010, compared to 75.1% in 2009, and the commercial multi-peril ratio increasing to 67.4% in 2010, compared to 66.3% in 2009, as a result of increased claim severity. The personal lines loss ratio increased to 75.3% in 2010, compared to 73.6% in 2009, primarily as a result of an increase in the homeowners loss ratio to 80.7% in 2010, compared to 78.3% in 2009, as a result of an increase in weather-related claims and increased property claims from fires.

Underwriting Expenses

Our insurance subsidiaries' expense ratio, which is the ratio of policy acquisition and other underwriting expenses to premiums earned, was 32.0% in 2010, compared to 31.3% in 2009.

Combined Ratio

Our insurance subsidiaries' combined ratio was 104.7% and 102.2% in 2010 and 2009, respectively. The combined ratio represents the sum of the loss ratio, expense ratio and dividend ratio, which is the ratio of workers' compensation policy dividends incurred to premiums earned.

Interest Expense

Our interest expense in 2010 was $799,578, compared to $1.7 million in 2009. We attribute the decrease in interest expense to the interest expense we paid in 2009 related to a premium tax litigation settlement.

Income Taxes

Our income tax (benefit) expense was ($1.6) million in 2010, compared to $1.8 million in 2009. For 2010, our tax-exempt interest income exceeded our taxable income. As a result, we carried back a net operating loss to the taxable income of prior years, and our income tax benefit reflects a current tax benefit for the carryback.

Net Income and Earnings Per Share

Our net income in 2010 was $11.5 million, or $.46 per share of Class A common stock and $.41 per share of Class B common stock, compared to our net income of $18.8 million, or $.76 per share of Class A common stock and $.68 per share of Class B common stock, in 2009. Our Class A shares outstanding increased slightly to 20.0 million at December 31, 2010, compared to 19.9 million at December 31, 2009. Our Class B shares outstanding did not change at 5.6 million.

Book Value Per Share and Return on Equity

Our stockholders' equity decreased by $5.4 million in 2010. We attribute the decrease to a decline in our net after-tax unrealized gains within our available-for-sale fixed maturity and equity investment portfolio from $15.0 million at December 31, 2009 to $8.6 million at December 31, 2010. This decline reflects the impact of increased market interest rates on the fair value of our fixed maturity investments during 2010. Book value per share decreased by 1.7% to $14.86 at December 31, 2010, compared to $15.12 a year earlier. Our return on average equity was 3.0% for 2010, compared to 5.0% for 2009.

Years Ended December 31, 2009 and 2008

Net Premiums Written

Our insurance subsidiaries' 2009 net premiums written decreased slightly to $363.2 million, compared to $364.9 million for 2008. Commercial lines net premiums written decreased $14.7 million, or 11.7%, for 2009 compared to 2008. Personal lines net premiums written increased $13.0 million, or 5.4%, for 2009 compared to 2008. Net premiums written for 2009 included a $5.4 million transfer of unearned premium related to Donegal Mutual's affiliation with Southern Mutual. Net premiums written for 2008 included a $13.6 million transfer of unearned premiums related to the change in the pooling agreement between Atlantic States and Donegal Mutual effective March 1, 2008.

Net Premiums Earned

Our insurance subsidiaries' net premiums earned increased to $355.0 million for 2009, an increase of $8.4 million, or 2.4%, over 2008. Our insurance subsidiaries' net earned premiums during 2009 grew due to the increase in written premiums during 2008. Our insurance subsidiaries earn premiums and recognize them as income over the terms of the policies they issue. Such terms are generally one year or less in duration. Therefore, increases or decreases in net premiums earned will generally reflect increases or decreases in net premiums written in the preceding twelve-month period compared to the same period one year earlier.

Investment Income

For 2009, our net investment income was $20.6 million, a 9.7% decrease from 2008. An increase in our average invested assets from $619.0 million in 2008 to $649.5 million in 2009 was offset by a decrease in our annualized average return to 3.2% in 2009, compared to 3.7% in 2008. The decrease

in our annualized average rate of return on investments was primarily due to lower reinvestment rates for securities added to our fixed income portfolio during 2009.

Installment Payment Fees

Our insurance subsidiaries' installment fees increased primarily as a result of increases in policy counts during 2009.

Net Realized Investment Gains/Losses

Our net realized investment gains (losses) in 2009 and 2008 were $4.5 million and ($3.0) million, respectively. Realized investment gains in 2009 resulted primarily from sales of equity securities as well as fixed maturity investments that had appreciated significantly during the year. Realized investment losses in 2008 included $2.4 million representing our pro rata share of investment losses in a limited partnership investment that was solely invested in equity securities. We recognized no impairment charges in 2009, compared to impairment charges of $1.2 million in 2008. Our impairment charges for 2008 were the result of declines in the fair value of equity securities that we determined to be other than temporary. The remaining net realized investment gains and losses in both periods resulted from turnover within our investment portfolio.

Losses and Loss Expenses

Our insurance subsidiaries' loss ratio, which is the ratio of incurred losses and loss expenses to premiums earned, was 70.7% in 2009, compared to 64.7% in 2008. Our insurance subsidiaries' commercial lines loss ratio increased to 64.3% in 2009, compared to 56.6% in 2008. This increase primarily resulted from the workers' compensation loss ratio increasing to 75.1% in 2009, compared to 58.9% in 2008, and the commercial automobile loss ratio increasing to 56.4% in 2009, compared to 53.5% in 2008, as a result of increased claim severity and less favorable prior-accident-year loss reserve development. The personal lines loss ratio increased to 73.6% in 2009, compared to 69.1% in 2008, primarily as a result of an increase in the homeowners loss ratio to 78.3% in 2009, compared to 63.0% in 2008, as a result of an increase in weather-related claims and increased property claims from fires.

Underwriting Expenses

Our insurance subsidiaries' expense ratio, which is the ratio of policy acquisition and other underwriting expenses to premiums earned, was 31.3% in 2009, compared to 32.1% in 2008. The decrease in the 2009 expense ratio reflects decreased underwriting-based incentive compensation costs in 2009 compared to 2008 and expense savings initiatives that commenced in the fourth quarter of 2008.

Combined Ratio

Our insurance subsidiaries' combined ratio was 102.2% and 97.2% in 2009 and 2008, respectively. The combined ratio represents the sum of the loss ratio, expense ratio and dividend ratio, which is the ratio of workers' compensation policy dividends incurred to premiums earned.

Interest Expense

Our interest expense in 2009 was $1.7 million, compared to $1.8 million in 2008. The decrease in interest expense reflected the redemption of $15.5 million of subordinated debentures in August 2008 and a decrease in average interest rates on our subordinated debentures in 2009 compared to 2008, offset by interest expense related to a premium tax litigation settlement.

Income Taxes

Our income tax expense was $1.8 million in 2009, compared to $6.6 million in 2008, representing an effective tax rate of 8.9%, compared to 20.4% in 2008. The change in effective tax rates was primarily due to tax-exempt interest income representing a larger proportion of income before income tax expense in 2009 compared to 2008. We benefited from a 9.9% increase in tax-exempt interest income in 2009 compared to 2008.

Net Income and Earnings Per Share

Our net income in 2009 was $18.8 million, or $.76 per share of Class A common stock and $.68 per share of Class B common stock on a diluted basis, compared to our net income of $25.5 million, or $1.02 per share of Class A common stock and $.92 per share of Class B common stock on a diluted basis, in 2008. Our fully diluted Class A shares outstanding decreased slightly to 19.9 million at December 31, 2009, compared to 20.0 million at December 31, 2008, as a result of our repurchase of treasury stock. Our Class B shares outstanding did not change at 5.6 million.

Book Value Per Share and Return on Equity

Our stockholders' equity increased by $21.9 million in 2009, primarily as a result of favorable operating results and unrealized gains within our investment portfolio. Book value per share increased by 5.8% to $15.12 at December 31, 2009, compared to $14.29 a year earlier. Our return on average equity was 5.0% for 2009, compared to 7.1% for 2008.

Financial Condition

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 they arise. Our major sources of funds from operations are the net cash flows generated from our insurance subsidiaries' underwriting results, investment income and maturing investments.

We have historically generated sufficient net positive cash flow from our operations to fund our commitments and build our investment portfolio, thereby increasing future investment returns. The impact of the pooling agreement with Donegal Mutual historically has been cash flow positive because of the historical profitability of the underwriting pool. We settle the pool monthly, thereby resulting in cash flows substantially similar to cash flows that would result from the underwriting of direct business. We maintain a high degree of liquidity in our investment portfolio in the form of 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. This laddering provides an additional measure of liquidity to meet our obligations and the obligations of our insurance subsidiaries should an unexpected variation occur in the future. Net cash flows provided by operating activities in 2010, 2009 and 2008, were $22.0 million, $34.1 million and $52.9 million, respectively.

In June 2010, we renewed our existing credit agreement with Manufacturers and Traders Trust Company ("M&T") relating to a $35.0 million unsecured, revolving line of credit that will expire in June 2013. We may request a one-year extension of the credit agreement as of each anniversary date of the

agreement. In October 2010, we requested and received approval of an increase in the credit amount to $60.0 million. In December 2010, we borrowed $35.0 million in connection with our acquisition of Michigan. As of December 31, 2010, we had $35.0 million in outstanding borrowings and had the ability to borrow $25.0 million at interest rates equal to M&T's current prime rate or the then current LIBOR rate plus between 1.75% and 2.25%, depending on our leverage ratio. We pay a fee of 0.2% per annum on the loan commitment amount regardless of usage. The credit agreement requires our compliance with certain covenants, which include minimum levels of our net worth, leverage ratio and statutory surplus and the A.M. Best ratings of our insurance subsidiaries. We complied with all requirements of the credit agreement during the year ended December 31, 2010.

Michigan has an agreement with the Federal Home Loan Bank ("FHLB") of Indianapolis. Through its membership, Michigan has issued debt to the FHLB of Indianapolis in exchange for cash advances in the amount of $617,371 as of December 31, 2010. The interest rate on the advances is variable and was .50% at December 31, 2010. The advances are due in 2011.

The following table shows expected payments for our significant contractual obligations as of December 31, 2010:

(in thousands)	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Net liability for unpaid losses and loss expenses of our insurance subsidiaries	$217,897	$101,217	$ 96,668	$8,787	$11,225
Subordinated debentures	20,465	—	—	—	20,465
Borrowings under line of credit	35,617	617	35,000	—	—
Payable for purchase of Michigan	7,207	7,207	—	—	—
Total contractual obligations	$281,186	$109,041	$131,668	$8,787	$31,690

We estimate the timing of the amounts for the net liability for unpaid losses and loss expenses of our insurance subsidiaries based on historical experience and expectations of future payment patterns. We have shown the liability net of reinsurance recoverable on unpaid losses and loss expenses to reflect expected future cash flows related to such liability. Assumed amounts from the underwriting pool with Donegal Mutual represent a substantial portion of our insurance subsidiaries' gross liability for unpaid losses and loss expenses, and ceded amounts to the underwriting pool represent a substantial portion of our insurance subsidiaries' reinsurance recoverable on unpaid losses and loss expenses. We will include future cash settlement of Atlantic States' assumed liability from the pool in our monthly settlements of pooled activity, wherein we net amounts ceded to and assumed from the pool. Although Donegal Mutual and Atlantic States do not anticipate any further 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 for Atlantic States' proportionate liability for pooled losses occurring in periods prior to the effective date of such change.

We estimate the timing of the amounts for the subordinated debentures based on their contractual maturities. We may redeem the debentures at our option, at par, dates as discussed in Note 10 — Borrowings. Our subordinated debentures carry interest rates that vary as discussed in Note 10—Borrowings. Based upon the interest rates in effect as of December 31, 2010, our annual interest cost associated with our subordinated debentures is approximately $871,000. For every 1% change in the three-month LIBOR rate, the effect on our annual interest cost would be approximately $200,000.

We estimate the timing of the amounts for the borrowings under our line of credit based on their contractual maturities as discussed in Note 10 — Borrowings. Our borrowings under our line of credit carry interest rates that vary as discussed in Note 10 — Borrowings. Based upon the interest rates in effect as of December 31, 2010, our annual interest cost associated with our borrowings under our line of credit is approximately $791,000. For every 1% change in the interest rate associated with our borrowings under our line of credit, the effect on our annual interest cost would be approximately $356,000.

Cash dividends declared to stockholders totaled $11.5 million, $11.2 million and $10.4 million in 2010, 2009 and 2008, respectively. There are no regulatory restrictions on our payment of dividends to our stockholders, although there are state law restrictions on the payment of dividends from our insurance subsidiaries to us. Our insurance subsidiaries are required by law to maintain certain minimum surplus on a statutory basis and are subject to regulations under which payment of dividends from statutory surplus is restricted and may require prior approval of their domiciliary insurance regulatory authorities. Our insurance subsidiaries are subject to risk-based capital ("RBC") requirements. At December 31, 2010, each of our insurance subsidiaries had capital substantially above the RBC requirements. In 2011, amounts available for distribution as dividends to us from our insurance subidiaries without prior approval of their domiciliary insurance regulatory authorities are $19.2 million from Atlantic States, $2.6 million from Le Mars, $3.7 million from Michigan, $4.2 million from Peninsula, $0 from Sheboygan and $0 from Southern.

Investments

At December 31, 2010 and 2009, our investment portfolio of primarily investment-grade bonds, common stock, short-term investments and cash totaled $744.9 million and $679.8 million, respectively, representing 63.4% and 72.7%, respectively, of our total assets.

At December 31, 2010 and 2009, the carrying value of our fixed maturity investments represented 91.8% and 88.7% of our total invested assets, respectively.

Our fixed maturity investments consisted of high-quality marketable bonds, of which 99.0% were rated at investment-grade levels at December 31, 2010 and 2009. As we invested excess cash from operations and proceeds from maturities of fixed maturity investments during 2010, we decreased our holdings of tax-exempt fixed maturities to reduce the percentage of our total portfolio that is invested in municipal securities.

At December 31, 2010, the net unrealized gain on available-for-sale fixed maturity investments, net of deferred taxes, amounted to $1.7 million, compared to $9.2 million at December 31, 2009.

At December 31, 2010, the net unrealized gain on our equity securities, net of deferred taxes, amounted to $6.9 million, compared to $5.8 million at December 31, 2009.

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to the impact of interest rate changes, changes in fair values of investments and to credit risk.

In the normal course of business, we employ established policies and procedures to manage our exposure to changes in interest rates, fluctuations in the fair market value of our debt and equity securities and credit risk. We seek to mitigate these risks by various actions described below.

Interest Rate Risk

Our exposure to market risk for a change in interest rates is concentrated in our investment portfolio. We monitor this exposure through periodic reviews of asset and liability positions. We regularly monitor estimates of cash flows and the impact of interest rate fluctuations relating to the investment portfolio. Generally, we do not hedge our exposure to interest rate risk because we have the capacity to, and do, hold fixed maturity investments to maturity.

Principal cash flows and related weighted-average interest rates by expected maturity dates for financial instruments sensitive to interest rates at December 31, 2010 are as follows:

(in thousands)	Principal Cash Flows	Weighted-Average Interest Rate
Fixed maturity and short-term investments:		
2011	$ 53,551	1.14%
2012	24,891	4.10
2013	27,004	4.02

2014	25,261	3.94
2015	42,080	4.08
Thereafter	523,954	4.42
Total	$696,741	
Fair value	$712,431	
Debt:		
2011	$ 617	0.50%
2013	35,000	2.25
Thereafter	20,465	4.35
Total	$ 56,082	
Fair value	$ 56,082	

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

Equity Price Risk

Our portfolio of equity securities, which we carry on our consolidated balance sheets at estimated fair value, has exposure to price risk, which is the risk of potential loss in estimated fair value resulting from an adverse change in prices. Our objective is to earn competitive relative returns by investing in a diverse portfolio of high-quality, liquid securities.

Credit Risk

Our objective is to earn competitive returns by investing in a diversified portfolio of securities. Our portfolio of fixed maturity securities and, to a lesser extent, short-term investments is subject to credit risk. We define this risk as the potential loss in fair value resulting from adverse changes in the borrower's ability to repay the debt. We manage this risk by performing an analysis of prospective investments and through regular reviews of our portfolio by our investment staff. We also limit the amount of our total investment portfolio that we invest in any one security.

Our insurance subsidiaries provide property and liability insurance coverages through independent insurance agencies located throughout their operating areas. Our insurance subsidiaries bill the majority of this business directly to the insured, although our insurance subsidiaries bill a portion of their commercial business through their agents, to whom they 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 business ceded to Donegal Mutual. Our insurance subsidiaries maintain reinsurance agreements with Donegal Mutual and with a number of other major unaffiliated authorized reinsurers.

Through November 30, 2010, Michigan and West Bend were parties to quota-share reinsurance agreements whereby Michigan ceded 75% (80% prior to 2008) of its business to West Bend. Michigan and West Bend agreed to terminate the reinsurance agreement in effect as of November 30, 2010 on a run-off basis. West Bend's obligations related to all past reinsurance agreements with Michigan remain in effect for all policies effective prior to December 1, 2010. West Bend and Michigan entered into a trust agreement on December 1, 2010. Under the terms of the trust agreement, West Bend placed into trust, for the sole benefit of Michigan, assets with a fair value equal to the amount of unearned premiums and unpaid losses and loss expenses, reduced by any net premium balances not yet paid by Michigan, that West Bend had assumed pursuant to such reinsurance agreements as of November 30, 2010. The amount of assets required to be held in trust is adjustable monthly based upon the remaining net obligations of West Bend. West Bend may terminate the trust agreement on the earlier of December 1, 2020 or the date when the obligations of West Bend are equal to or less than $5.0 million. As of December 31, 2010, West Bend's net obligations under the reinsurance agreements were approximately $58.0 million, and the fair value of assets held in trust was approximately $64.0 million.

Impact of Inflation

Our insurance subsidiaries establish their property and casualty insurance premium rates before they know the amount of losses and loss settlement expenses, or the extent to which inflation may impact such expenses. Consequently, our insurance subsidiaries attempt, in establishing rates, to anticipate the potential impact of inflation.

Impact of New Accounting Standards

In June 2009, the Financial Accounting Standards Board ("FASB") issued Financial Accounting Standard ("FAS") 166, "Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140," codified in FASB Accounting Standards Codification ("ASC") subtopic 860-20. ASC subtopic 860-20 amends the derecognition guidance in FAS 140 and eliminates the concept of qualifying special-purpose entities. ASC subtopic 860-20 is effective for fiscal years and interim periods beginning after November 15, 2009. We adopted ASC subtopic 860-20 on January 1, 2010. The adoption did not impact our financial position or results of operations.

In June 2009, the FASB issued FAS 167, "Amendments to FASB Interpretation No. 46(R)," which amends the consolidation guidance applicable to variable interest entities ("VIEs") and is codified in ASC subtopic 810-10. An entity would consolidate a VIE, as the primary beneficiary, when the entity has both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the entity's economic performance and (b) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. ASC subtopic 810-10 requires ongoing reassessment of whether an enterprise is the primary beneficiary of a VIE. ASC subtopic 810-10 amends interpretation 46(R) to eliminate the quantitative approach previously required for determining the primary beneficiary of a VIE. ASC subtopic 810-10 is effective for fiscal years and interim periods beginning after November 15, 2009. We adopted ASC subtopic 810-10 on January 1, 2010. The adoption did not impact our financial position or results of operations.

In January 2010, the FASB issued Accounting Standards Update ("ASU") 2010-06, "Improving Disclosures about Fair Value Measurements." ASU 2010-06 amends ASC subtopic 820-10 by requiring new, and clarifying existing, fair value disclosures. ASU 2010-06 is effective for the interim period ended March 31, 2010, except for certain new Level 3 roll forward disclosures, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. We have included herein the disclosures ASU 2010-06 requires for 2010, and we will include the Level 3 roll forward disclosures ASU 2010-06 requires for fiscal years and interim periods beginning after December 31, 2010.

In October 2010, the FASB issued updated guidance to address the diversity in practice for the accounting for costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost must be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. If application of this guidance would result in the capitalization of acquisition costs that a reporting entity had not previously capitalized, the entity may elect not to capitalize those costs. The updated guidance is effective for periods ending after December 15, 2011. We do not expect the adoption of this guidance to have a material impact on our financial position or results of operations.

Donegal Group Inc.

Consolidated Balance Sheets

December 31,	2010	2009
Assets		
Investments		
Fixed maturities		
Held to maturity, at amortized cost (fair value $67,808,721 and $77,005,740)	$ 64,766,429	$ 73,807,126
Available for sale, at fair value (amortized cost $601,302,986 and $503,745,585)	603,846,201	517,703,672
Equity securities, available for sale, at fair value (cost $2,503,565 and $3,804,064)	10,161,614	9,914,626
Investments in affiliates	8,991,577	9,309,347
Short-term investments, at cost, which approximates fair value	40,775,993	56,100,415
Total investments	728,541,814	666,835,186
Cash	16,342,212	12,923,898
Accrued investment income	7,365,171	6,202,710
Premiums receivable	96,467,949	61,187,021
Reinsurance receivable	173,836,746	84,670,009
Deferred policy acquisition costs	34,445,579	32,844,179
Deferred tax asset, net	11,988,169	5,086,949
Prepaid reinsurance premiums	89,365,771	56,040,728
Property and equipment, net	7,069,086	6,592,223
Accounts receivable — securities	428,983	588,292
Federal income taxes recoverable	948,325	663,047
Goodwill	5,493,316	922,040
Other intangible assets	958,010	—
Other	1,368,392	1,045,645
Total assets	$1,174,619,523	$935,601,927
Liabilities and Stockholders' Equity		
Liabilities		
Losses and loss expenses	$ 383,318,672	$263,598,844
Unearned premiums	297,272,161	241,821,419
Accrued expenses	21,287,406	10,578,695
Reinsurance balances payable	19,140,322	2,561,426
Borrowings under line of credit	35,617,371	—
Cash dividends declared to stockholders	2,870,955	2,798,378
Subordinated debentures	20,465,000	15,465,000
Accounts payable — securities	—	6,828,873
Payable for the purchase of Michigan	7,207,471	—
Due to affiliate	2,926,104	3,813,294
Drafts payable	1,304,779	884,993
Other	3,106,472	1,745,306
Total liabilities	794,516,713	550,096,228
Stockholders' Equity		
Preferred stock, $1.00 par value, authorized 2,000,000 shares; none issued	—	—
Class A common stock, $.01 par value, authorized 30,000,000 shares, issued 20,656,527 and 20,569,930 shares and outstanding 19,994,226 and 19,917,331 shares	206,566	205,700
Class B common stock, $.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	167,093,504	164,585,214
Accumulated other comprehensive income	8,561,086	15,007,044
Retained earnings	213,435,095	214,755,495
Treasury stock, at cost	(9,249,933)	(9,104,246)
Total stockholders' equity	380,102,810	385,505,699
Total liabilities and stockholders' equity	$1,174,619,523	$935,601,927

See accompanying notes to consolidated financial statements.

Donegal Group Inc.

Consolidated Statements of Income and Comprehensive Income

Year Ended December 31,	2010	2009	2008
Statements of Income			
Revenues			
Net premiums earned (includes affiliated reinsurance of $134,823,098, $128,747,699 and $130,067,404 — see footnote 3)	$378,030,129	$355,025,477	$346,575,266
Investment income, net of investment expenses	19,949,714	20,630,583	22,755,784
Installment payment fees	5,519,287	5,205,109	5,025,138
Lease income	922,937	921,583	926,690
Net realized investment gains (losses)	4,395,720	4,479,558	(2,970,716)
Total revenues	408,817,787	386,262,310	372,312,162
Expenses			
Net losses and loss expenses (includes affiliated reinsurance of $81,539,930, $68,712,989 and $85,598,098 — see footnote 3)	274,308,858	250,835,396	224,300,964
Amortization of deferred policy acquisition costs	66,354,000	60,292,000	58,250,000
Other underwriting expenses	54,564,500	50,843,464	53,108,436
Policyholder dividends	619,158	848,882	1,175,809
Interest	799,578	1,746,509	1,821,229
Other	2,327,544	1,019,370	1,563,680
Total expenses	398,973,638	365,585,621	340,220,118
Income before income tax (benefit) expense	9,844,149	20,676,689	32,092,044
Income tax (benefit) expense	(1,623,030)	1,846,611	6,550,066
Net income	$ 11,467,179	$ 18,830,078	$ 25,541,978
Basic earnings per common share:			
Class A common stock	$ .46	$ .76	$ 1.03
Class B common stock	$ .41	$ .68	$ .76
Diluted earnings per common share:			
Class A common stock	$ .46	$ .76	$ 1.02
Class B common stock	$ .41	$ .68	$ .92
Statements of Comprehensive Income			
Net income	$ 11,467,179	$ 18,830,078	$ 25,541,978
Other comprehensive (loss) income, net of tax			
Unrealized (losses) gains on securities:			
Unrealized holding (loss) gain arising during the period, net of income tax (benefit) of ($1,976,358), $8,680,941 and ($3,872,368)	(3,544,783)	16,249,716	(7,191,540)
Reclassification adjustment for (gains) losses included in net income, net of income tax (benefit) of $1,494,545, $1,523,050 and ($1,039,751)	(2,901,175)	(2,956,508)	1,930,965
Other comprehensive (loss) income	(6,445,958)	13,293,208	(5,260,575)
Comprehensive income	$ 5,021,221	$ 32,123,286	$ 20,281,403

See accompanying notes to consolidated financial statements.

Donegal Group Inc.

Consolidated Statements of Stockholders' Equity

	Common Stock				Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total Stockholders' Equity
	Class A Shares	Class B Shares	Class A Amount	Class B Amount					
Balance, January 1, 2008	20,167,999	5,649,240	$201,680	$56,492	$156,850,666	$ 6,974,411	$193,806,855	$(5,199,913)	$352,690,191
Issuance of common stock (stock compensation plans)	326,765		3,268		3,853,328				3,856,596
Net income							25,541,978		25,541,978
Cash dividends							(10,417,517)		(10,417,517)
Grant of stock options					1,749,063		(1,749,063)		—
Tax benefit on exercise of stock options					683,881				683,881
Purchase of treasury stock								(3,510,689)	(3,510,689)
Other comprehensive loss						(5,260,575)			(5,260,575)
Balance, December 31, 2008	20,494,764	5,649,240	$204,948	$56,492	$163,136,938	$ 1,713,836	$207,182,253	$(8,710,602)	$363,583,865
Issuance of common stock (stock compensation plans)	75,166		752		1,385,285				1,386,037
Net income							18,830,078		18,830,078
Cash dividends							(11,193,845)		(11,193,845)
Grant of stock options					62,991		(62,991)		—
Purchase of treasury stock								(393,644)	(393,644)
Other comprehensive income						13,293,208			13,293,208
Balance, December 31, 2009	20,569,930	5,649,240	$205,700	$56,492	$164,585,214	$15,007,044	$214,755,495	$(9,104,246)	$385,505,699
Issuance of common stock (stock compensation plans)	86,597		866		1,198,556				1,199,422
Net income							11,467,179		11,467,179
Cash dividends							(11,477,845)		(11,477,845)
Grant of stock options					1,309,734		(1,309,734)		—
Purchase of treasury stock								(145,687)	(145,687)
Other comprehensive loss						(6,445,958)			(6,445,958)
Balance, December 31, 2010	20,656,527	5,649,240	$206,566	$56,492	$167,093,504	$ 8,561,086	$213,435,095	$(9,249,933)	$380,102,810

See accompanying notes to consolidated financial statements.

Donegal Group Inc.
Consolidated Statements of Cash Flows

Year Ended December 31,	2010	2009	2008
Cash Flows from Operating Activities:			
Net income	$ 11,467,179	$ 18,830,078	$ 25,541,978
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	3,143,767	2,552,186	2,401,345
Net realized investment (gains) losses	(4,395,720)	(4,479,558)	2,970,716
Equity loss (income)	268,341	(471,097)	(112,065)
Changes in Assets and Liabilities:			
Losses and loss expenses	14,904,770	23,789,568	9,952,760
Unearned premiums	21,762,781	12,807,490	22,477,395
Accrued expenses	718,956	(3,571,059)	966,958
Premiums receivable	(7,478,337)	(5,849,751)	(3,173,057)
Deferred policy acquisition costs	(1,601,400)	(3,302,898)	(3,306,209)
Deferred income taxes	(2,380,430)	(1,250,187)	(832,628)
Reinsurance receivable	(5,348,447)	(4,717,038)	204,249
Accrued investment income	(489,244)	452,796	(668,682)
Amounts due to/from affiliate	(887,190)	665,237	2,906,139
Reinsurance balances payable	(320,278)	994,610	(636,074)
Prepaid reinsurance premiums	(8,270,621)	(4,604,241)	(4,111,609)
Current income taxes	(368,145)	1,927,881	(2,618,163)
Other, net	1,278,821	323,491	898,872
Net adjustments	10,537,624	15,267,430	27,319,947
Net cash provided by operating activities	22,004,803	34,097,508	52,861,925
Cash Flows from Investing Activities:			
Purchase of fixed maturities			
Available for sale	(195,198,227)	(158,409,231)	(204,882,809)
Purchase of equity securities	(59,191,998)	(39,163,607)	(45,091,418)
Sale of fixed maturities			
Available for sale	72,092,788	62,668,210	28,971,515
Maturity of fixed maturities			
Held to maturity	8,649,275	25,617,925	53,830,674
Available for sale	80,116,222	48,363,915	69,699,141
Sale of equity securities	70,029,195	39,638,895	71,177,458
Payments to Sheboygan policyholders	—	(6,526,527)	(3,352,938)
Purchase of Michigan	(35,088,228)	—	—
Net (increase) decrease in investment in affiliates	—	(100,000)	464,000
Net purchase of property and equipment	(651,160)	(941,020)	(1,222,246)
Net sales (purchases) of short-term investments	16,052,089	15,852,054	(453,790)
Net cash used in investing activities	(43,190,044)	(12,999,386)	(30,860,413)
Cash Flows from Financing Activities:			
Issuance of common stock	1,199,422	1,386,037	3,856,596
Redemption of subordinated debentures	—	—	(15,464,000)
Cash dividends paid	(11,405,268)	(10,997,571)	(10,025,711)
Purchase of treasury stock	(145,687)	(393,644)	(3,510,689)
Borrowings under line of credit, net	34,955,088	—	—
Tax benefit on exercise of stock options	—	—	683,881
Net cash provided by (used in) financing activities	24,603,555	(10,005,178)	(24,459,923)
Net increase (decrease) in cash	3,418,314	11,092,944	(2,458,411)
Cash at beginning of year	12,923,898	1,830,954	4,289,365
Cash at end of year	$ 16,342,212	$ 12,923,898	$ 1,830,954

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1 — Summary of Significant Accounting Policies

Organization and Business

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"), Le Mars Insurance Company ("Le Mars"), the Peninsula Insurance Group ("Peninsula"), which consists of Peninsula Indemnity Company and The Peninsula Insurance Company, Sheboygan Falls Insurance Company ("Sheboygan") and Michigan Insurance Company ("Michigan"), write personal and commercial lines of property and casualty coverages exclusively through a network of independent insurance agents in certain Mid-Atlantic, Midwest, New England and Southern states. We acquired Michigan on December 1, 2010, and we have included Michigan's results of operations in our consolidated results from that date. We acquired Sheboygan on December 1, 2008, and we have included Sheboygan's results of operations in our consolidated results from that date. We have three operating segments: our investment function, our personal lines of insurance and our commercial lines of insurance. The personal lines products of our insurance subsidiaries consist primarily of homeowners and private passenger automobile policies. The commercial lines products of our insurance subsidiaries consist primarily of commercial automobile, commercial multi-peril and workers' compensation policies. We also own 48.2% of the outstanding stock of Donegal Financial Services Corporation ("DFSC"), a thrift holding company that owns Province Bank FSB. Donegal Mutual owns the remaining 51.8% of the outstanding stock of DFSC.

At December 31, 2010, Donegal Mutual held approximately 42% of our outstanding Class A common stock and approximately 75% of our outstanding Class B common stock, which provide Donegal Mutual with 66% of the total voting power of our common stock. Our insurance subsidiaries and Donegal Mutual have interrelated operations. 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 pooling agreement with Donegal Mutual. Under the pooling agreement, the two companies pool their insurance business, and each company receives an allocated percentage of the pooled business. From July 1, 2000 through February 29, 2008, Atlantic States had a 70% share of the results of the pool, and Donegal Mutual had a 30% share of the results of the pool. Effective March 1, 2008, Donegal Mutual and Atlantic States amended the pooling agreement to increase Atlantic States' share of the pooled business to 80%.

The risk profiles of the business Atlantic States and Donegal Mutual write have historically been, and continue to be, substantially similar. 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, as the risk characteristics of all business Donegal Mutual and Atlantic States write directly are homogenized within the underwriting pool, Donegal Mutual and Atlantic States share the underwriting results in proportion to their respective participation in the pool. Pooled business represents the predominant percentage of the net underwriting activity of both Donegal Mutual and Atlantic States. See Note 3 — Transactions with Affiliates for more information regarding the pooling agreement.

In October 2009, Donegal Mutual consummated an affiliation with Southern Mutual Insurance Company ("Southern Mutual"), pursuant to which Donegal Mutual purchased a surplus note of Southern Mutual in the principal amount of $2.5 million, Donegal Mutual designees became a majority of the members of Southern Mutual's board of directors, and Donegal Mutual agreed to provide quota-share reinsurance to Southern Mutual for 100% of its business. Effective October 31, 2009, Donegal Mutual began to include business assumed from Southern Mutual in its pooling agreement with Atlantic States. Southern Mutual writes primarily personal lines of insurance in Georgia and South Carolina and had direct written premiums of approximately $12.8 million and $13.3 million in 2010 and 2009, respectively. Pursuant to applicable accounting standards, Southern Mutual is a variable interest entity, of which we are not the primary beneficiary.

In April 2010, DFSC and certain of its affiliates, including Donegal Mutual and us, and Union National Financial Corporation ("UNNF") executed an agreement pursuant to which DFSC and UNNF would merge, with DFSC as the surviving company in the merger. The merger is subject to a number of conditions, including the approval of various federal bank regulatory agencies. Under the agreement, Province Bank FSB and Union National Community Bank, which UNNF owns, would also merge. The combined bank would have total assets of approximately $600 million (unaudited) and would have 13 branch locations in Lancaster County, Pennsylvania. The companies expect to complete the mergers in the first quarter of 2011. Following the mergers, we expect to continue using the equity method of accounting for our investment in DFSC. Under the equity method, we record our investment at cost, with adjustments for our share of DFSC's earnings and losses as well as changes in DFSC's equity due to unrealized gains and losses.

In December 2010, we acquired Michigan, which had been a majority-owned subsidiary of West Bend Mutual Insurance Company ("West Bend"). Michigan writes various lines of property and casualty insurance and had direct written premiums of $105.4 million and net written premiums of $27.1 million for the year ended December 31, 2010. Effective on December 1, 2010, Michigan entered into a 50% quota-share agreement with third-party reinsurers and a 25% quota-share reinsurance agreement with Donegal Mutual to replace the 75% quota-share reinsurance agreement Michigan maintained with West Bend through November 30, 2010. The final purchase price for the acquisition was approximately $42.3 million in cash.

Basis of Consolidation

Our consolidated financial statements, which we have prepared in accordance with accounting principles generally accepted in the United States of America, include our accounts and those of our wholly owned subsidiaries. We have eliminated all significant inter-company accounts and transactions in consolidation. The terms "we," "us," "our" or the "Company" as used herein refer to the consolidated entity.

Use of Estimates

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

We make estimates and assumptions that can have a significant effect on amounts and disclosures we report in our consolidated financial statements. The most significant estimates relate to our insurance subsidiaries' reserves for property and casualty insurance unpaid losses and loss expenses, valuation of investments and determination of other-than-temporary impairment and our insurance subsidiaries' policy acquisition costs. While we believe our estimates and the estimates of our insurance subsidiaries are appropriate, the ultimate amounts may differ from the estimates provided. We regularly review our methods for making these estimates as well as the continuing appropriateness of the estimated amounts, and we reflect any adjustment we consider necessary in our current results of operations.

Reclassification

We have reclassified certain amounts in 2010 as reported in our Consolidated Statements of Income to conform to the current year presentation.

Investments

We classify our debt and equity securities into the following categories:

Held to Maturity—Debt securities that we have the positive intent and ability to hold to maturity; reported at amortized cost.

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

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

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 write down the investment to its fair value, and we reflect the amount of the write-down as a realized loss in our results of operations when we consider the decline in value of an individual investment to be other than temporary. We individually monitor all of our investments for other-than-temporary declines in value. Generally, we assume there has been an other-than-temporary decline in value if an individual equity security has depreciated in value by more than 20% of original cost and has been in such an unrealized loss position for more than six months. As of April 1, 2009, we adopted new accounting guidance related to the accounting for and presentation of impairment losses on debt securities. 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 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 an 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. 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, company or geographic events that have negatively impacted the value of a security and rating agency downgrades.

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 for mortgage-backed debt securities using anticipated prepayments.

We account for investments in affiliates using the equity method of accounting. Under the equity method, we record our investment at cost, with adjustments for our share of the affiliate's earnings and losses as well as changes in the affiliate's equity due to unrealized gains and losses.

Fair Values of Financial Instruments

We use the following methods and assumptions in estimating our fair value disclosures:

Investments—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 for our fixed maturity and equity investments. We generally obtain one price per security. The 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 using proprietary pricing applications, which include available relevant market information, benchmark yields, sector curves and matrix pricing. The pricing services do not use broker quotes in determining the fair values of our investments. We review the estimates of fair value the pricing services provide to determine if the estimates obtained are representative of fair values based upon our general knowledge of the market, our research findings related to unusual fluctuations in value and our comparison of such values to execution prices for similar securities. See Note 6 — Fair Value Measurements for more information regarding our methods and assumptions in estimating fair values.

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

Premiums and Reinsurance Receivables and Payables—The carrying amounts reported in the balance sheet for these instruments related to premiums and paid losses and loss expenses approximate their fair values.

Subordinated Debentures—The carrying amounts reported in the balance sheet for these instruments approximate their fair values.

Revenue Recognition

Our insurance subsidiaries recognize insurance premiums as income over the terms of the policies they issue. Our insurance subsidiaries calculate unearned premiums on a daily pro-rata basis. We recorded an unearned premium liability for the fair value of the net unexpired portion of the insurance contracts we acquired in connection with our acquisition of Michigan. We will recognize this unearned premium liability as income over the terms of Michigan's policies.

Policy Acquisition Costs

We defer our insurance subsidiaries' policy acquisition costs, consisting primarily of commissions, premium taxes and certain other underwriting costs, reduced by ceding commissions, that vary with and relate directly to the production of business. We amortize these deferred policy acquisition costs over the period in which our insurance subsidiaries earn the premiums. The method we follow in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and loss expenses and certain other costs we expect to incur as our insurance subsidiaries earn the premium. Estimates in the calculation of policy acquisition costs have not shown material variability because of uncertainties in applying accounting principles or as a result of sensitivities to changes in key assumptions.

Property and Equipment

We report property and equipment at depreciated cost that we compute using the straight-line method based upon estimated useful lives of the assets.

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 policyholder claims based on facts and circumstances then known. 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 and expected claims severity, judicial theories of liability and other factors. However, during the loss adjustment period, our insurance subsidiaries may learn additional facts regarding certain claims, and consequently, it often becomes necessary for our insurance subsidiaries to refine and adjust their estimates of liability. We reflect any adjustments to our insurance subsidiaries' liabilities for losses and loss expenses in our operating results in the period in which our insurance subsidiaries record the changes in 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 their 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 closely monitor their liabilities 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.

We recorded a liability for the fair value of the net loss and loss expense reserves we assumed in connection with our acquisition of Michigan. We incorporated various factors in determining the fair value of these reserve estimates, including the guarantee against any deficiency in excess of $1.0 million discussed in Note 4—Business Combinations.

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 as to our insurance subsidiaries' internal operations. For example, our insurance subsidiaries have experienced a decrease in claims frequency on workers' compensation claims during the past several years while claims severity has gradually increased. These trend changes give rise to greater uncertainty as to the pattern of future loss settlements on workers' compensation claims. Related uncertainties regarding future trends include the cost of medical technologies and procedures and changes in the utilization of medical 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 collectibility of reinsured losses, among other items. To the extent our insurance subsidiaries determine that underlying factors impacting their assumptions have changed, our insurance subsidiaries attempt to make appropriate adjustments for such changes in their reserves. Accordingly, our insurance subsidiaries' ultimate liability for unpaid losses and loss expenses will likely differ from the amount recorded.

Our insurance subsidiaries seek to enhance their underwriting results by carefully selecting the product lines they underwrite. Our insurance subsidiaries' personal lines products include standard and preferred risks in private passenger automobile and homeowners lines. Our insurance subsidiaries commercial lines products primarily include mercantile risks, business offices, wholesalers, service providers and artisan risks, avoiding industrial and manufacturing exposures. Our insurance subsidiaries have limited exposure to asbestos and other environmental liabilities. Our insurance subsidiaries write no medical malpractice or other professional liability risks.

Income Taxes

We currently file a consolidated federal income tax return.

We account for income taxes using the asset and liability method. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the tax basis of our assets and liabilities at enacted tax rates expected to be in effect when we realize or settle such amounts.

Credit Risk

Our objective is to earn competitive returns by investing in a diversified portfolio of securities. Our portfolio of fixed maturity securities and, to a lesser extent, short-term investments is subject to credit risk. We define this risk as the potential loss in fair value resulting from adverse changes in the borrower's ability to repay the debt. We manage this risk by performing an analysis of prospective investments and through regular reviews of our portfolio by our investment staff. We also limit the amount of our total investment portfolio that we invest in any one security.

Our insurance subsidiaries provide property and liability insurance coverages through independent insurance agencies located throughout their operating areas. Our insurance subsidiaries bill the majority of this business directly to the insured, although our insurance subsidiaries bill a portion of their commercial business through their agents, to whom they extend credit in the normal course of business.

Our insurance subsidiaries have reinsurance agreements with Donegal Mutual and with a number of other major unaffiliated authorized reinsurers.

Reinsurance Accounting and Reporting

Our insurance subsidiaries rely upon reinsurance agreements to limit their maximum net loss from large single risks or risks in concentrated areas and to increase their capacity to write insurance. Reinsurance does not relieve our insurance subsidiaries from liability to their respective policyholders. To the extent that a reinsurer cannot pay losses for which it is liable under the terms of a reinsurance agreement, our insurance subsidiaries retain continued liability for such losses. However, in an effort to reduce the risk of non-payment, our insurance subsidiaries require all of their reinsurers to have an A.M. Best rating of A- or better or, with respect to foreign reinsurers, to have a financial condition that, in the opinion of management, is equivalent to a company with an A.M. Best rating of A- or better. See Note 11 — Reinsurance for more information regarding our reinsurance agreements.

Stock-Based Compensation

We measure all share-based payments to employees, including grants of stock options, using a fair-value-based method and record such 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 other than Donegal Mutual, 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, expected term, dividend yield and expected volatility.

We did not realize any tax benefits upon the exercise of stock options in 2010 or 2009. We classified tax benefits realized upon the exercise of stock options of $683,881 for the year ended December 31, 2008 as financing activities in our consolidated statement of cash flows.

Earnings per Share

We calculate basic earnings per share by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

We have two classes of common stock, which we refer to as Class A common stock and Class B common stock. Our Class A common stock is entitled to cash dividends that are at least 10% higher than those declared and paid on our Class B common stock. Accordingly, we use the two-class method for the computation of 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 declared and an allocation of remaining undistributed earnings using a participation percentage that reflects the dividend rights of each class.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the underlying fair value of acquired entities. When completing acquisitions, we seek to also identify separately identifiable intangible assets that we have acquired. We assess goodwill and intangible assets with an indefinite useful life for impairment annually. We also assess goodwill and other intangible assets for impairment upon the occurrence of certain events. In making our assessment, we consider a number of factors including operating results, business plans, economic projections, anticipated future cash flows and current market data. Inherent uncertainties exist with respect to these factors and to our judgment in applying them when we make our assessment. Impairment of goodwill and other intangible assets could result from changes in economic and operating conditions in future periods.

2 — Impact of New Accounting Standards

In June 2009, the Financial Accounting Standards Board (“FASB”) issued Financial Accounting Standard (“FAS”) 166, “Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140,” codified in FASB Accounting Standards Codification (“ASC”) subtopic 860-20. ASC subtopic 860-20 amends the derecognition guidance in FAS 140 and eliminates the concept of qualifying special-purpose entities. ASC subtopic 860-20 is effective for fiscal years and interim periods beginning after November 15, 2009. We adopted ASC subtopic 860-20 on January 1, 2010. Our adoption did not impact our financial position or results of operations.

In June 2009, the FASB issued FAS 167, “Amendments to FASB Interpretation No. 46(R),” which amends the consolidation guidance applicable to variable interest entities (“VIEs”) and is codified in ASC subtopic 810-10. An entity would consolidate a VIE, as the primary beneficiary, when the entity has both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the entity’s economic performance and (b) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. ASC subtopic 810-10 requires ongoing reassessment of whether an enterprise is the primary beneficiary of a VIE. ASC subtopic 810-10 amends interpretation 46(R) to eliminate the quantitative approach previously required for determining the primary beneficiary of a VIE. ASC subtopic 810-10 is effective for fiscal years and interim periods beginning after November 15, 2009. We adopted ASC subtopic 810-10 on January 1, 2010. Our adoption did not impact our financial position or results of operations.

In January 2010, the FASB issued Accounting Standards Update (“ASU”) 2010-06, “Improving Disclosures about Fair Value Measurements.” ASU 2010-06 amends ASC subtopic 820-10 by requiring new, and clarifying existing, fair value disclosures. ASU 2010-06 is effective for the interim period ended March 31, 2010, except for certain new Level 3 roll forward disclosures, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. We have included herein the disclosures ASU 2010-06 requires for 2010, and we will include the Level 3 roll forward disclosures ASU 2010-06 requires for fiscal years and interim periods beginning after December 31, 2010.

In October 2010, the FASB issued updated guidance to address the diversity in practice for the accounting for costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost must be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. If application of this guidance would result in the capitalization of acquisition costs that a reporting entity had not previously capitalized, the entity may elect not to capitalize those costs. The updated guidance is effective for periods ending after December 15, 2011. We do not expect our adoption of this guidance to have a material impact on our financial position or results of operations.

3 — Transactions with Affiliates

Our insurance subsidiaries conduct business and have various agreements with Donegal Mutual that we describe below:

a. Reinsurance Pooling and Other Reinsurance Arrangements

Atlantic States, our largest subsidiary, and Donegal Mutual have a pooling agreement under which both companies contribute all of their direct written business to the pool and receive an allocated percentage of their combined underwriting results, excluding certain reinsurance Donegal Mutual assumes from our insurance subsidiaries. From July 1, 2000 through February 29, 2008, Atlantic States had a 70% share of the results of the pool, and Donegal Mutual had a 30% share of the results of the pool. Effective March 1, 2008, Donegal Mutual and Atlantic States amended the pooling agreement to increase Atlantic States’s share of the pooled business to 80%. The intent of the pooling agreement is to produce more uniform and stable underwriting results from year to year for each pool participant than they would experience individually and to spread the risk of loss between the participants based on each participant’s relative amount of surplus and relative access to capital. Each participant in the pool has at its disposal the capacity of the entire pool, rather than being limited to policy exposures of a size commensurate with its own capital and surplus.

The following amounts represent reinsurance Atlantic States ceded to the pool during 2010, 2009 and 2008:

	2010	2009	2008
Premiums earned	$105,376,068	$96,502,445	$93,336,444
Losses and loss expenses	$ 81,203,625	$68,248,082	$54,407,168

Prepaid reinsurance premiums	$ 57,783,435	$52,199,831	$48,448,624
Liability for losses and loss expenses	$ 65,028,781	$55,396,390	$45,777,168

The following amounts represent reinsurance Atlantic States assumed from the pool during 2010, 2009 and 2008:

	2010	2009	2008
Premiums earned	$238,308,846	$223,223,583	$220,641,805
Losses and loss expenses	$160,256,348	$138,058,878	$140,969,892
Unearned premiums	$125,322,884	$117,044,000	$110,064,380
Liability for losses and loss expenses	$134,580,026	$131,247,578	$121,366,321

Donegal Mutual and Southern have a quota-share reinsurance agreement whereby Southern assumes 100% of the premiums and losses related to personal lines products Donegal Mutual offers in Virginia through the use of its automated policy quoting and issuance system. Donegal Mutual and Le Mars have a quota-share reinsurance agreement whereby Le Mars assumes 100% of the premiums and losses related to certain products Donegal Mutual offers in certain Midwest states, which provide the availability of complementary products to Le Mars' commercial accounts. The following amounts represent reinsurance Southern and Le Mars assumed from Donegal Mutual pursuant to the quota-share reinsurance agreements during 2010, 2009 and 2008:

	2010	2009	2008
Premiums earned	$ 14,516,901	$12,856,983	$9,690,726
Losses and loss expenses	$ 12,600,094	$10,987,391	$7,612,090
Unearned premiums	$ 8,124,069	$ 6,998,285	$6,064,734
Liability for losses and loss expenses	$ 7,316,879	$ 4,868,486	$2,672,698

Donegal Mutual and Michigan have a quota-share reinsurance agreement whereby Donegal Mutual assumes 25% of the premiums and losses related to the business of Michigan. Donegal Mutual and Peninsula have a quota-share reinsurance agreement whereby Donegal Mutual assumes 100% of the premiums and losses related to the workers' compensation product line of Peninsula in certain states. The business Donegal Mutual assumes becomes part of the pooling agreement between Donegal Mutual and Atlantic States. The following amounts represent reinsurance ceded to Donegal Mutual pursuant to these quota-share reinsurance agreements during 2010, 2009 and 2008:

	2010	2009	2008
Premiums earned	$4,516,313	$2,515,075	$880,017
Losses and loss expenses	$3,463,112	$2,342,895	$697,929
Prepaid reinsurance premiums	$4,590,424	$1,855,076	$889,993
Liability for losses and loss expenses	$4,006,231	$1,980,626	$679,718

Atlantic States, Southern and Le Mars each have a catastrophe reinsurance agreement with Donegal Mutual that limits the maximum liability under any one catastrophic occurrence to $1,000,000, $750,000 and $500,000, respectively, with a combined limit of $1,800,000 for a catastrophe involving a combination of these subsidiaries. Donegal Mutual and Southern have an excess of loss reinsurance agreement in which Donegal Mutual assumes up to $350,000 ($300,000 in 2008) of losses in excess of $400,000 ($300,000 in 2008). In 2009, Donegal Mutual and Sheboygan had an excess of loss reinsurance agreement in which Donegal Mutual assumed up to $50,000 of losses in excess of $150,000. The following amounts represent reinsurance ceded to Donegal Mutual pursuant to these reinsurance agreements during 2010, 2009 and 2008:

	2010	2009	2008
Premiums earned	$8,110,268	$8,315,347	$5,508,666
Losses and loss expenses	$6,649,775	$9,742,303	$7,878,787
Liability for losses and loss expenses	$3,441,447	$3,268,129	$5,456,611

The following amounts represent the effect of affiliated reinsurance transactions on net premiums our insurance subsidiaries earned during 2010, 2009 and 2008:

	2010	2009	2008
Assumed	$ 252,825,747	$ 236,080,566	$230,332,531
Ceded	(118,002,649)	(107,332,867)	(99,725,127)
Net	$ 134,823,098	$ 128,747,699	$130,607,404

The following amounts represent the effect of affiliated reinsurance transactions on net losses and loss expenses our insurance subsidiaries incurred during 2010, 2009 and 2008:

	2010	2009	2008
Assumed	$172,856,442	$149,046,269	$148,581,982
Ceded	(91,316,512)	(80,333,280)	(62,983,884)
Net	$ 81,539,930	$ 68,712,989	$ 85,598,098

b. Expense Sharing

Donegal Mutual provides facilities, management and other services to us and our insurance subsidiaries. Donegal Mutual allocates certain related expenses to Atlantic States in relation to the relative participation of Atlantic States and Donegal Mutual in the pooling agreement. Our insurance subsidiaries other than Atlantic States reimburse Donegal Mutual for their personnel costs and bear their proportionate share of information services costs based on their percentage of the total written premiums of the Donegal Insurance Group. Charges for these services totalled $63,982,793, $60,175,789 and $56,819,869 for 2010, 2009 and 2008, respectively.

c. Lease Agreement

We lease office equipment and automobiles with terms ranging from 3 to 10 years to Donegal Mutual under a 10-year lease agreement dated January 1, 2010.

d. Legal Services

Donald H. Nikolaus, our President and one of our directors, is a partner in the law firm of Nikolaus & Hohenadel. Such firm has served as our general counsel since 1986, principally in connection with the defense of claims litigation arising in Lancaster, Dauphin and York counties of Pennsylvania. We pay such firm its customary fees for such services.

e. Province Bank

As of December 31, 2010 and 2009, we had $11,851,757 and $10,163,195, respectively, in checking accounts with Province Bank FSB, a wholly owned subsidiary of DFSC. We earned $1,575, $3,260 and $133,251 in interest on these accounts during 2010, 2009 and 2008, respectively

4 — Business Combinations

On December 1, 2010, we acquired all of the outstanding stock of Michigan. We accounted for this acquisition as a business combination.

We acquired Michigan from West Bend and its other stockholders for a price equal to 122% of Michigan's stockholders' equity as of November 30, 2010, or approximately $42.3 million in cash. We paid $35.1 million to Michigan's stockholders in December 2010 and recorded an additional amount payable as of December 31, 2010 of $7.2 million, which we paid pursuant to the terms of our acquisition agreement in the first quarter of 2011. The acquisition of Michigan enabled us to extend our insurance business to the state of Michigan. Michigan writes various lines of property and casualty insurance and had direct written premiums of $105.4 million and $106.6 million and net premiums earned of $26.9 million and $27.0 million for the years ended December 31, 2010 and 2009, respectively. Michigan's stockholders' equity and total assets as of December 31, 2009 were $32.0 million and $224.5 million, respectively. We recorded goodwill of approximately $4.6 million and other intangible assets of approximately

$958,000, none of which are deductible for federal income tax purposes. Pursuant to the terms of our acquisition agreement with West Bend, West Bend has guaranteed us against any deficiency in excess of $1.0 million in the loss and loss expenses of Michigan as of November 30, 2010. Conversely, we have agreed to return 50% of any redundancy in excess of $1.0 million. Any such deficiency or redundancy will be based on a final actuarial review of the development of such reserves to be conducted three years after November 30, 2010. Through December 1, 2010, Michigan and West Bend were parties to quota-share reinsurance agreements whereby Michigan ceded 75% (80% prior to 2008) of its business to West Bend. Michigan and West Bend agreed to terminate the reinsurance agreement in effect as of November 30, 2010 on a run-off basis. West Bend's obligations related to all past reinsurance agreements with Michigan remain in effect for all policies effective prior to December 1, 2010. West Bend and Michigan entered into a trust agreement on December 1, 2010. Under the terms of the trust agreement, for the sole benefit of Michigan, West Bend placed into trust assets with a fair value equal to the amount of unearned premiums and unpaid losses and loss adjustment expenses, reduced by any net premium balances not yet paid by Michigan, that West Bend had assumed pursuant to such reinsurance agreements as of November 30, 2010. The amount of assets required to be held in trust is adjustable monthly based upon the remaining net obligations of West Bend. West Bend may terminate the trust agreement on the earlier of December 1, 2020 or the date when the obligations of West Bend are equal to or less than $5.0 million. As of December 31, 2010, West Bend's net obligations under the reinsurance agreements were approximately $58.0 million, and the fair value of assets held in trust was approximately $64.0 million.

We recorded the assets that we acquired and the liabilities that we assumed at their estimated acquisition date fair value. The fair value adjustments we made are preliminary in nature and are subject to change as we obtain further data and complete our valuation analysis. The following is a summary of the estimated fair value of the net assets we acquired at the date of the Michigan acquisition based on purchase price allocations:

	(in thousands)
Assets acquired:	
Investments	$ 68,693
Premiums receivable	27,803
Prepaid reinsurance premiums	25,054
Reinsurance receivable	83,818
Goodwill	4,571
Other intangible assets	958
Other	3,004
Total assets acquired	213,901
Liabilities assumed:	
Losses and loss expenses	104,815
Unearned premiums	33,688
Reinsurance balances payable	16,899
Accrued expenses	9,990
Other	6,213
Total liabilities assumed	171,605
Net assets acquired	$ 42,296

We recorded goodwill of $4.6 million in connection with the Michigan acquisition. The goodwill consists largely of economies of scale we expect to realize from integrating the operations of Michigan into those of the Donegal Insurance Group and benefits we expect to derive from Michigan's relationships with its independent agents and policyholders.

We intend to operate Michigan as a subsidiary and continue to maintain its trade name for the foreseeable future. We have therefore established a trade name intangible asset in the amount of $958,000, which represents the estimated value of the future benefits we will derive from the continued use of the trade name. We will not amortize the trade name intangible asset because we have determined that the trade name intangible asset has an indefinite life. We will evaluate the trade name intangible asset for impairment annually or upon the occurrence of certain future events.

Our consolidated financial statements for the year ended December 31, 2010 include the operations of Michigan from December 1, 2010, the date we acquired it. Effective on December 1, 2010, Michigan entered into a 50% quota-share reinsurance agreement with third-party reinsurers and a 25% quota-share reinsurance agreement with Donegal Mutual to replace the 75% quota-share reinsurance agreement Michigan maintained with West Bend through November 30, 2010. Donegal Mutual includes the business it assumes from Michigan in its pooling agreement with Atlantic States. Our total revenues related to the operations of Michigan and Atlantic States' allocation with respect to Donegal Mutual's quota-share reinsurance agreement for the period December 1, 2010 through December 31, 2010 were approximately $2.4 million. Michigan's results of operations for the period December 1, 2010 through December 31, 2010 did not significantly impact our consolidated net income for 2010.

The following table presents our unaudited pro forma historical results for the years ended December 31, 2010 and 2009 as if we had acquired Michigan at January 1, 2009 and Michigan had entered into a 25% quota-share reinsurance agreement with Donegal Mutual as of that date:

	Year Ended December 31,	
	2010	2009
	(in thousands, except per share data)	
Total revenues	$ 458,231	$ 423,184
Income before income tax benefit	13,619	15,232
Income tax benefit	(741)	(146)
Net Income	14,360	15,378
Class A earnings per share — basic and diluted	0.58	0.62
Class B earnings per share — basic and diluted	0.52	0.55

Significant pro forma income statement adjustments for the year ended December 31, 2009 included a $3.8 million decrease in premiums earned related to the recognition of the pro forma fair value adjustment associated with the net unearned premium liability as of January 1, 2009. We have prepared the unaudited pro forma results above for comparative purposes only. These unaudited pro forma results are not necessarily indicative of the results of operations that actually would have resulted had the acquisition occurred at January 1, 2009, nor are the pro forma results necessarily indicative of future operating results.

During 2008, we acquired all of the outstanding stock of Sheboygan. We accounted for this acquisition as a business combination.

In December 2006, Donegal Mutual consummated an affiliation with Sheboygan. As part of the affiliation, Donegal Mutual entered into a management agreement with and purchased a $3.5 million surplus note issued by Sheboygan. During 2007, Sheboygan's board of directors adopted a plan of conversion to convert to a stock insurance company. Following policyholder and regulatory approval of the plan of conversion, we acquired all of the outstanding stock of

Sheboygan as of December 1, 2008 for approximately $12.0 million in cash, including payment of the principal amount of the surplus note ($3.5 million) and accrued interest ($32,171) to Donegal Mutual. The payment also included a surplus contribution ($8.5 million) to Sheboygan to support future premium growth. We have included Sheboygan's results of operations in our consolidated results from December 1, 2008. At December 31, 2010 and 2009, Sheboygan had amounts due to policyholders pursuant to the plan of conversion of $334,019 and $316,927, respectively.

The acquisition of Sheboygan enabled us to extend our insurance business to Wisconsin. Sheboygan, organized under the laws of Wisconsin in 1899, operates as a property and casualty insurer in Wisconsin. Personal lines coverages represent a majority of Sheboygan's premiums written, with the balance coming from farmowners and mercantile and service businesses. Sheboygan's largest lines of business are homeowners, private passenger automobile liability and physical damage. We based the purchase price of Sheboygan upon an independent valuation of Sheboygan as of September 30, 2008.

5 — Investments

The amortized cost and estimated fair values of fixed maturities and equity securities at December 31, 2010 and 2009 are as follows:

2010				
Held to Maturity	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 1,000,000	$ 84,320	$—	$ 1,084,320
Obligations of states and political subdivisions	59,852,427	2,893,921	—	62,746,348
Corporate securities	3,246,980	25,027	—	3,272,007
Residential mortgage-backed securities	667,022	39,042	18	706,046
Totals	$64,766,429	$3,042,310	$18	$67,808,721

2010				
Available for Sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 57,283,889	$ 484,282	$ 452,352	$ 57,315,819
Obligations of states and political subdivisions	388,091,036	6,838,193	5,300,094	389,629,135
Corporate securities	67,518,441	649,969	1,073,486	67,094,924
Residential mortgage-backed securities	88,409,620	1,850,670	453,967	89,806,323
Fixed maturities	601,302,986	9,823,114	7,279,899	603,846,201
Equity securities	2,503,565	7,693,231	35,182	10,161,614
Totals	$603,806,551	$17,516,345	$7,315,081	$614,007,815

2009				
Held to Maturity	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 2,000,000	$ 80,260	$ —	$ 2,080,260
Obligations of states and political subdivisions	61,736,351	3,011,092	24,034	64,723,409
Corporate securities	6,243,138	72,300	13,034	6,302,404
Residential mortgage-backed securities	3,827,637	72,059	29	3,899,667
Totals	$73,807,126	$3,235,711	$37,097	$77,005,740

2009				
Available for Sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 41,061,366	$ 154,076	$ 585,363	$ 40,630,079
Obligations of states and political subdivisions	346,798,545	12,587,395	1,019,462	358,366,478
Corporate securities	26,971,526	866,136	71,859	27,765,803
Residential mortgage-backed securities	88,914,148	2,356,647	329,483	90,941,312
Fixed maturities	503,745,585	15,964,254	2,006,167	517,703,672
Equity securities	3,804,064	6,338,360	227,798	9,914,626
Totals	$507,549,649	$22,302,614	$2,233,965	$527,618,298

The amortized cost and estimated fair value of fixed maturities at December 31, 2010, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Held to maturity		
Due in one year or less	$ 2,997,301	$ 3,022,079
Due after one year through five years	13,810,698	14,522,647
Due after five years through ten years	45,524,127	47,723,927
Due after ten years	1,767,281	1,834,021
Residential mortgage-backed securities	667,022	706,047
Total held to maturity	$ 64,766,429	$ 67,808,721
Available for sale		
Due in one year or less	$ 9,898,080	$ 9,970,843
Due after one year through five years	105,006,683	106,936,765
Due after five years through ten years	154,749,181	155,998,372
Due after ten years	243,239,422	241,133,898
Residential mortgage-backed securities	88,409,620	89,806,323
Total available for sale	$601,302,986	$603,846,201

The amortized cost of fixed maturities on deposit with various regulatory authorities at December 31, 2010 and 2009 amounted to $10,181,518 and $9,761,979, respectively.

Investments in affiliates consisted of the following at December 31, 2010 and 2009:

	2010	2009
DFSC	$8,526,577	$8,844,347
Other	465,000	465,000
Total	$8,991,577	$9,309,347

We made an additional equity investment in DFSC in the amount of $100,000 during 2009. Other income and expenses in our consolidated statements of income include (expenses) income of ($268,341), $471,097 and $112,065 for 2010, 2009 and 2008, respectively, representing our share of DFSC's income or loss. In addition, other comprehensive (loss) income in our statements of comprehensive income includes net unrealized (losses) gains of ($32,129), $93,647 and $193,241 for 2010, 2009 and 2008, respectively, representing our share of DFSC's unrealized investment gains or losses.

Other investment in affiliates represents our investment in statutory trusts that hold our subordinated debentures that we discuss in Note 10 — Borrowings.

We derive net investment income, consisting primarily of interest and dividends, from the following sources:

	2010	2009	2008
Fixed maturities	$23,995,220	$24,458,118	$23,379,999
Equity securities	42,869	69,287	552,575
Short-term investments	91,665	199,735	1,079,325
Other	46,095	47,514	36,008
Investment income	24,175,849	24,774,654	25,047,907
Investment expenses	(4,226,135)	(4,144,071)	(2,292,123)
Net investment income	$19,949,714	$20,630,583	$22,755,784

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

	2010	2009	2008
Gross realized gains:			
Fixed maturities	$ 4,136,455	$ 2,654,648	$ 1,641,249
Equity securities	1,791,585	2,179,331	2,397,716
	5,928,040	4,833,979	4,038,965
Gross realized losses:			
Fixed maturities	533,918	102,143	311,900
Equity securities	998,402	252,278	6,697,781
	1,532,320	354,421	7,009,681
Net realized gains (losses)	$ 4,395,720	$ 4,479,558	$ (2,970,716)
Change in difference between fair value and cost of investments:			
Fixed maturities	$(11,571,194)	$18,779,926	$ (7,235,434)
Equity securities	1,547,487	3,154,823	(3,440,944)
Totals	$(10,023,707)	$21,934,749	$(10,676,378)

We held fixed maturities and equity securities with unrealized losses representing declines that we considered temporary at December 31, 2010 as follows:

	Less than 12 months		12 months or longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 23,901,400	$ 452,352	$ —	$ —
Obligations of states and political subdivisions	171,609,617	5,208,910	1,406,325	91,184
Corporate securities	44,101,089	1,061,972	490,970	11,514
Residential mortgage-backed securities	35,930,054	453,967	750	18
Equity securities	313,888	35,182	—	—
Totals	$275,856,048	$7,212,383	$1,898,045	$102,716

We held fixed maturities and equity securities with unrealized losses representing declines that we considered temporary at December 31, 2009 as follows:

	Less than 12 months		12 months or longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$26,703,601	$ 585,364	$ —	$ —
Obligations of states and political subdivisions	17,971,018	256,527	29,582,488	786,970
Corporate securities	1,284,405	23,525	666,941	61,366
Residential mortgage-backed securities	23,514,855	328,969	477,421	543
Equity securities	2,139,457	227,798	—	—
Totals	$71,613,336	$1,422,183	$30,726,850	$848,879

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 write down the investment to its fair value, and we reflect the amount of the write-down as a realized loss in our results of operations when we consider the decline in value of an individual investment to be other than temporary. We individually monitor all investments for other-than-temporary declines in value. Generally, we assume there has been an other-than-temporary decline in value if an individual equity security has depreciated in value by more than 20% of original cost and has been in such an unrealized loss position for more than six months. We held five equity securities that were in an unrealized loss position at December 31, 2010. Based upon our analysis of general market conditions and underlying factors impacting these equity securities, we considered these declines in value to be temporary. 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 an 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. 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, company or geographic events that have negatively impacted the value of a security and rating agency downgrades. We held 302 debt securities that were in an unrealized loss position at December 31, 2010. 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 did not recognize any impairment losses in 2010 or 2009. We included losses of $1.2 million in net realized investment gains (losses) in 2008 for certain equity investments trading below cost on an other-than-temporary basis.

We had no sales or transfers from the held to maturity portfolio in 2010, 2009 or 2008.

We have no derivative instruments or hedging activities.

6 — Fair Value Measurements

We account for financial assets using a framework that establishes a hierarchy that ranks the quality and reliability of inputs, or assumptions, used 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 broker quotes we obtain from independent pricing services through a bank trustee. We classify our fixed maturity investments 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 residential mortgage-backed securities.

We reclassified one equity security to Level 3 during 2009. We utilized a fair value model that incorporated significant other unobservable inputs, such as estimated volatility, to estimate the equity security's fair value. We are restricted from selling certain shares we obtained in the initial public offering for a period of 18 to 24 months, and the fair value we determined as of December 31, 2010 reflects this selling restriction. We recorded an unrealized gain of $1.3 million and $3.4 million related to this security in other comprehensive income for the years ended December 31, 2010 and 2009, respectively.

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 for substantially all of our fixed maturity and equity investments. We generally obtain one price per security. The 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 using proprietary pricing applications, which include available relevant market information, benchmark yields, sector curves and matrix pricing. The pricing services do not use broker quotes in determining the fair values of our investments. We review the estimates of fair value the pricing services provide to determine if the estimates obtained are representative of fair values based upon our general knowledge of the market, our research findings related to unusual fluctuations in value and our comparison of such values to execution prices for similar securities. As of December 31, 2010 and 2009, we received one estimate per security from one of the pricing services, and we priced all but an insignificant amount of our Level 1 and Level 2 investments using those prices. In our review of the estimates provided by the pricing services as of December 31, 2010 and 2009, we did not identify any 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. The carrying values in the balance sheet for premiums receivable and reinsurance receivables and payables for premiums and paid losses and loss expenses approximate their fair values. The carrying amounts reported in the balance sheet for our subordinated debentures approximate their fair values.

We evaluate our assets and liabilities on a regular basis 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 as of December 31, 2010:

		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)
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 57,315,820	$ —	$ 57,315,820	$ —
Obligations of states and political subdivisions	389,629,135	—	389,629,135	—
Corporate securities	67,094,923	—	67,094,923	—
Residential mortgage-backed securities	89,806,323	—	89,806,323	—
Equity securities	10,161,614	1,152,250	1,436,476	7,572,888
Totals	$614,007,815	$1,152,250	$605,282,677	$7,572,888

The following table presents our fair value measurements for our investments in available-for-sale fixed maturity and equity securities as of December 31, 2009:

		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)
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 40,630,079	$ —	$ 40,630,079	$ —
Obligations of states and political subdivisions	358,366,478	—	358,366,478	—
Corporate securities	27,765,803	—	27,765,803	—
Residential mortgage-backed securities	90,941,312	—	90,941,312	—
Equity securities	9,914,626	2,426,567	1,256,405	6,231,654
Totals	$527,618,298	$2,426,567	$518,960,077	$6,231,654

The following table presents a roll forward of the significant unobservable inputs for our Level 3 equity securities for 2010 and 2009:

	2010	2009
Balance, January 1	$6,231,654	$ —
Reclassification to Level 3	—	4,958,531
Sales of securities	—	(1,293,600)
Change in net unrealized gains	1,341,234	2,566,723
Balance, December 31	$7,572,888	$ 6,231,654

7 — Deferred Policy Acquisition Costs

Changes in our insurance subsidiaries' deferred policy acquisition costs are as follows:

	2010	2009	2008
Balance, January 1	$ 32,844,179	$ 29,541,281	$ 26,235,072
Acquisition costs deferred	67,955,400	63,594,898	61,556,209
Amortization charged to earnings	(66,354,000)	(60,292,000)	(58,250,000)
Balance, December 31	$ 34,445,579	$ 32,844,179	$ 29,541,281

8 — Property and Equipment

Property and equipment at December 31, 2010 and 2009 consisted of the following:

	2010	2009	Estimated Useful Life
Office equipment	$ 8,324,930	$ 8,177,197	5-15 years
Automobiles	1,966,152	1,591,133	3 years
Real estate	5,016,722	5,016,722	15-50 years
Software	2,518,826	1,631,763	5 years
	17,826,630	16,416,815	
Accumulated depreciation	(10,757,544)	(9,824,592)	
	$ 7,069,086	$ 6,592,223	

Depreciation expense for 2010, 2009 and 2008 amounted to $1.2 million, $1.0 million and $1.0 million respectively.

9 — Liability for Losses and Loss Expenses

The establishment of an appropriate liability for losses and loss expenses is an inherently uncertain process, and we can provide no assurance that our insurance subsidiaries' ultimate liability 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, since 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 estimates have exceeded their actual liabilities. Changes in our insurance subsidiaries' estimate of their liability for losses and loss expenses generally reflect actual payments and their evaluation of information received since the prior reporting date.

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

	2010	2009	2008
Balance at January 1	$263,598,844	$239,809,276	$226,432,402
Less reinsurance recoverable	(83,336,726)	(78,502,518)	(76,280,437)
Net balance at January 1	180,262,118	161,306,758	150,151,965
Acquisition of Sheboygan	—	—	2,173,374
Acquisition of Michigan	26,960,063	—	—
Incurred related to:			
Current year	277,193,930	241,012,436	221,617,127
Prior years	(2,885,072)	9,822,960	2,683,837
Total incurred	274,308,858	250,835,396	224,300,964
Paid related to:			
Current year	179,069,304	152,292,967	143,369,098
Prior years	84,565,436	79,587,069	71,950,447
Total paid	263,634,740	231,880,036	215,319,545
Net balance at December 31	217,896,299	180,262,118	161,306,758
Plus reinsurance recoverable	165,422,373	83,336,726	78,502,518
Balance at December 31	$383,318,672	$263,598,844	$239,809,276

We presented the liability for losses and loss expenses that we assumed in connection with our acquisition of Michigan net of reinsurance recoverable of $77.9 million. Our insurance subsidiaries recognized a (decrease) increase in their liability for losses and loss expenses of prior years of ($2.9) million, $9.8 million and $2.7 million in 2010, 2009 and 2008, respectively. Our insurance subsidiaries made no significant changes in their reserving philosophy, key reserving assumptions or claims management personnel, and have made no significant offsetting changes in estimates that increased or decreased their loss and loss expense reserves in these years. The majority of the 2010 development related to decreases in the liability for losses and loss expenses of prior years for Atlantic States and Peninsula. The 2010 development represented 1.6% of the December 31, 2009 net carried reserves and resulted primarily from lower-than-expected severity in the private passenger automobile liability and homeowners lines of business in accident years prior to 2009. The 2009 development represented 6.0% of the December 31, 2008 net carried reserves and resulted primarily from higher-than-expected severity in the private passenger automobile liability, homeowners and workers' compensation lines of business in accident year 2008. The 2008 development represented 1.2% of the December 31, 2007 net carried reserves and resulted primarily from higher-than-expected severity in the private passenger automobile liability line of business in accident year 2007.

10 — Borrowings

Line of Credit

In June 2010, we renewed our existing credit agreement with Manufacturers and Traders Trust Company ("M&T") relating to a $35.0 million unsecured, revolving line of credit that will expire in June 2013. We may request a one-year extension of the credit agreement as of each anniversary date of the agreement. In October 2010, we requested and received approval of an increase in the credit amount to $60.0 million. In December 2010, we borrowed $35.0 million in connection with our acquisition of Michigan. As of December 31, 2010, we had $35.0 million in outstanding borrowings and had the ability to borrow $25.0 million at interest rates equal to M&T's current prime rate or the then current LIBOR rate plus between 1.75% and 2.25%, depending on our leverage ratio. We pay a fee of 0.2% per annum on the loan commitment amount regardless of usage. The credit agreement requires our compliance with certain covenants, which include minimum levels of our net worth, leverage ratio and statutory surplus and the A.M. Best ratings of our insurance subsidiaries. We complied with all requirements of the credit agreement during the year ended December 31, 2010.

Michigan has an agreement with the Federal Home Loan Bank ("FHLB") of Indianapolis. Through its membership, Michigan has issued debt to the FHLB of Indianapolis in exchange for cash advances in the amount of $617,371 as of December 31, 2010. The interest rate on the advances is variable and was .50% at December 31, 2010. The advances are due in 2011. The table below presents the amount of FHLB of Indianapolis stock purchased, collateral pledged and assets related to Michigan's agreement at December 31, 2010.

FHLB stock purchased and owned as part of the agreement	$ 125,000
Collateral pledged, at par (carrying value $3,139,987)	3,450,000
Borrowing capacity currently available	2,962,700

Subordinated Debentures

On May 15, 2003, we received $15.0 million in net proceeds from the issuance of subordinated debentures. We redeemed these debentures on August 15, 2008.

On October 29, 2003, we received $10.0 million in net proceeds from the issuance of subordinated debentures. The debentures mature on October 29, 2033 and are callable at our option, at par. The debentures carry an interest rate equal to the three-month LIBOR rate plus 4.10%, which is adjustable quarterly. At December 31, 2010, the interest rate on these debentures was 4.14% and was next subject to adjustment on January 29, 2011. As of December 31, 2010 and 2009, our consolidated balance sheets included an

investment in a statutory trust of $310,000 and subordinated debentures of $10.3 million related to this transaction.

On May 24, 2004, we received $5.0 million in net proceeds from the issuance of subordinated debentures. The debentures mature on May 24, 2034 and are callable at our option, at par. The debentures carry an interest rate equal to the three-month LIBOR rate plus 3.85%, which is adjustable quarterly. At December 31, 2010, the interest rate on these debentures was 4.13% and was next subject to adjustment on February 24, 2011. As of December 31, 2010 and 2009, our consolidated balance sheets included an investment in a statutory trust of $155,000 and subordinated debentures of $5.2 million related to this transaction.

In January 2002, West Bend purchased a surplus note from Michigan for $5.0 million to increase Michigan's statutory surplus. On December 1, 2010, Donegal Mutual purchased the surplus note from West Bend at face value. The surplus note carries an interest rate of 5.00%, and any repayment of principal requires prior insurance regulatory approval.

11 — Reinsurance

Unaffiliated Reinsurers

Our insurance subsidiaries and Donegal Mutual purchase certain third-party reinsurance on a combined basis. Le Mars, Michigan, Peninsula and Sheboygan also have separate third-party reinsurance programs that provide certain coverage that is commensurate with their relative size and exposures. Our insurance subsidiaries use several different reinsurers, all of which, consistent with the requirements of our insurance subsidiaries and Donegal Mutual, have 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 external reinsurance our insurance subsidiaries and Donegal Mutual purchase includes "excess of loss reinsurance," under which their losses are automatically reinsured, through a series of contracts, over a set retention (generally $750,000), and "catastrophic reinsurance," under which they recover, through a series of contracts, 100% of an accumulation of many losses resulting from a single event, including natural disasters, over a set retention (generally $3.0 million). Our insurance subsidiaries' principal third party reinsurance agreement in 2010 was a multi-line per risk excess of loss treaty that provided 100% coverage up to $1.0 million for both property and liability losses over the set retention. For property insurance, our insurance subsidiaries also had excess of loss treaties that provided for additional coverage over the multi-line treaty up to $2.5 million per loss. For liability insurance, our insurance subsidiaries had excess of loss treaties that provided for additional coverage over the multi-line treaty up to $40.0 million per occurrence. For workers' compensation insurance, our insurance subsidiaries had excess of loss treaties that provided for additional coverage over the multi-line treaty up to $10.0 million on any one life. Our insurance subsidiaries and Donegal Mutual had property catastrophe coverage through a series of layered treaties up to aggregate losses of $100.0 million for any single event. As many as ten reinsurers provided coverage on any one treaty with no reinsurer taking more than 27.0% of any one treaty. The amount of coverage provided under each of these types of reinsurance depends upon the amount, nature, size and location of the risks being reinsured. Donegal Mutual and our insurance subsidiaries also purchased facultative reinsurance to cover exposures from losses that exceeded the limits provided by our respective treaty reinsurance.

Through December 1, 2010, Michigan and West Bend were parties to quota-share reinsurance agreements whereby Michigan ceded 75% (80% prior to 2008) of its business to West Bend. Michigan and West Bend agreed to terminate the reinsurance agreement in effect as of November 30, 2010 on a run-off basis. West Bend's obligations related to all past reinsurance agreements with Michigan remain in effect for all policies effective prior to December 1, 2010 as we discuss in Note 4—Business Combinations.

The following amounts represent ceded reinsurance transactions with unaffiliated reinsurers during 2010, 2009 and 2008.

	2010	2009	2008
Premiums written	$24,357,938	$19,758,224	$19,458,572
Premiums earned	$26,551,687	$19,870,265	$19,348,674
Losses and loss expenses	$19,764,441	$ 6,796,388	$11,129,036
Prepaid reinsurance premiums	$26,991,912	$ 1,985,821	$ 2,097,870
Liability for losses and loss expenses	$92,945,915	$22,692,993	$27,258,815

Total Reinsurance

The following amounts represent our total ceded reinsurance transactions with both affiliated and unaffiliated reinsurers during 2010, 2009 and 2008:

	2010	2009	2008
Premiums earned	$144,554,336	$127,203,132	$119,073,801
Losses and loss expenses	$111,080,953	$ 87,129,668	$ 74,112,920
Prepaid reinsurance premiums	$ 89,365,771	$ 56,040,728	$ 51,436,487
Liability for losses and loss expenses	$165,442,373	$ 83,336,726	$ 78,502,518

The following amounts represent the effect of reinsurance on premiums written for 2010, 2009 and 2008:

	2010	2009	2008
Direct	$ 279,627,255	$ 250,989,795	$ 241,371,353
Assumed	262,574,572	244,046,312	246,755,110
Ceded	(150,679,539)	(131,807,381)	(123,185,408)
Net premiums written	$ 391,522,288	$ 363,228,726	$ 364,941,055

The following amounts represent the effect of reinsurance on premiums earned for 2010, 2009 and 2008:

	2010	2009	2008
Direct	$ 269,394,549	$ 246,074,766	$ 235,212,229
Assumed	253,189,916	236,153,843	230,436,838
Ceded	(144,554,336)	(127,203,132)	(119,073,801)
Net premiums earned	$ 378,030,129	$ 355,025,477	$ 346,575,266

12 — Income Taxes

Our provision for income tax consists of the following:

	2010	2009	2008
Current	$ 757,400	$ 3,096,798	$7,382,694
Deferred	(2,380,430)	(1,250,187)	(832,628)
Federal tax (benefit) provision	$(1,623,030)	$ 1,846,611	$6,550,066

Our effective tax rate is different from the amount computed at the statutory federal rate of 35% for 2010, 2009 and 2008. The reasons for such difference and the related tax effects are as follows:

	2010	2009	2008
Income before income taxes	$ 9,844,149	$20,676,689	$32,092,044
Computed “expected” taxes	3,445,452	7,236,841	11,232,215
Tax-exempt interest	(6,183,795)	(6,237,961)	(5,668,566)
Dividends received deduction	(996)	(17,574)	(62,470)
Other, net	1,116,309	865,305	1,048,887
Federal income tax (benefit) provision	$(1,623,030)	$ 1,846,611	$ 6,550,066

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2010 and 2009 are as follows:

	2010	2009
Deferred tax assets:		
Unearned premium	$14,826,320	$13,043,976
Loss reserves	6,954,685	5,715,157
Net operating loss carryforward - acquired companies	2,497,122	2,497,122
Other	5,518,681	4,000,325
Total gross deferred assets	29,796,808	25,256,580
Less valuation allowance	(746,368)	(746,368)
Net deferred tax assets	29,050,440	24,510,212
Deferred tax liabilities:		
Deferred policy acquisition costs	13,204,370	11,505,045
Net unrealized gains	3,649,494	7,120,393
Other	208,407	797,825
Total gross deferred tax liabilities	17,062,271	19,423,263
Net deferred tax asset	$11,988,169	$ 5,086,949

We provide a valuation allowance when we believe it is more likely than not that we will not realize some portion of the tax asset. We established a valuation allowance of $746,368 related to a portion of the net operating loss carryforward of Le Mars at January 1, 2004. We have determined that we are not required to establish a valuation allowance for the other net deferred tax assets of $29.1 million and $24.5 million at December 31, 2010 and 2009, respectively, since it is more likely than not that we will realize these deferred tax assets through reversals of existing temporary differences, future taxable income, carrybacks to taxable income in prior years and the implementation of tax-planning strategies.

At December 31, 2010, we have a net operating loss carryforward of $7.1 million, which is available to offset our taxable income. This amount will begin to expire in 2011 if not utilized and is subject to an annual limitation in the amount that we can use in any one year of approximately $376,000. We also have an alternative minimum tax credit carryforward of $4.0 million with an indefinite life.

13 — Stockholders' Equity

On April 19, 2001, our stockholders approved an amendment to our certificate of incorporation. Among other things, the amendment reclassified our common stock as Class B common stock and effected a one-for-three reverse split of our Class B common stock effective April 19, 2001. The amendment also authorized a new class of common stock with one-tenth of a vote per share designated as Class A common stock. Our board of directors also declared a dividend of two shares of Class A common stock for each share of Class B common stock, after the one-for-three reverse split, held of record at the close of business April 19, 2001.

Each share of Class A common stock outstanding at the time of the declaration of any dividend or other distribution payable in cash upon the shares of Class B common stock is entitled to a dividend or distribution payable at the same time and to stockholders of record on the same date in an amount at least 10% greater than any dividend declared upon each share of Class B common stock. In the event of our merger or consolidation with or into another entity, the holders of Class A common stock and the holders of Class B common stock are entitled to receive the same per share consideration in such merger or consolidation. In the event of our liquidation, dissolution or winding-up, any assets available to common stockholders will be distributed pro-rata to the holders of Class A common stock and Class B common stock after payment of all of our obligations.

In February 2009, our board of directors authorized a share repurchase program, pursuant to which we may purchase up to 300,000 shares of our Class A common stock at market prices prevailing from time to time in the open market subject to the provisions of Securities and Exchange Commission Rule 10b-18 and in privately negotiated transactions. We purchased 9,702 and 7,669 shares of our Class A common stock under this program during 2010 and 2009, respectively. As of December 31, 2010, we had the authority to purchase 282,629 shares under this program.

As of December 31, 2010, our treasury stock consisted of 662,301 and 72,465 shares of Class A common stock and Class B common stock, respectively. As of December 31, 2009, our treasury stock consisted of 652,599 and 72,465 shares of Class A common stock and Class B common stock, respectively.

14 — Stock Compensation Plans

Equity Incentive Plans

During 1996, we adopted an Equity Incentive Plan for Employees. During 2001, we adopted a nearly identical plan that made a total of 2,666,667 shares of Class A common stock available for issuance to employees of our subsidiaries and affiliates. During 2005, we amended the plan to make a total of 4,000,000 shares of Class A common stock available for issuance. During 2007, we adopted a nearly identical plan that made a total of 3,500,000 shares of Class A common stock available for issuance to employees of our subidiaries and affiliates. Each plan provides for the granting of awards by our board of directors in the form of stock options, stock appreciation rights, restricted stock or any combination of the above. The plans provide that stock options may become exercisable up to ten years from date of grant, with an option price not less than fair market value on date of grant. We have not granted any stock appreciation rights.

During 1996, we adopted an Equity Incentive Plan for Directors. During 2001, we adopted a nearly identical plan that made 355,556 shares of Class A common stock available for issuance to our directors and those of our subsidiaries and affiliates. During 2007, we adopted a nearly identical plan that made 400,000 shares of Class A common stock available for issuance to our directors and the directors of our subsidiaries and affiliates. We may make awards in the form of stock options. The plan also provides for the issuance of 311 shares of restricted stock to each director on the first business day of January in each year. As of December 31, 2010, we had 394,500 unexercised options under these plans. In addition, we issued 5,598, 4,665 and 4,665 shares of restricted stock on January 2, 2010, 2009 and 2008, respectively.

We measure all share-based payments to employees, including grants of employee stock options, using a fair-value-based method and record such 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 other than Donegal Mutual, 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, expected term, dividend yield and expected volatility. The risk-free interest rate is the implied yield currently available on U.S. Treasury zero coupon issues with a remaining term equal to the expected term used as the assumption in the model. We base the expected term of an option award on our historical experience of similar awards. We determine the

dividend yield by dividing the per share dividend by the grant date stock price. We base the expected volatility on the volatility of our stock price over a historical period comparable to the expected term.

The weighted-average grant date fair value of options granted during 2010 was $1.26. We calculated this fair value based upon a risk-free interest rate

of 1.04%, expected life of 3 years, expected volatility of 29% and expected dividend yield of 4%.

The weighted-average grant date fair value of options granted during 2009 was $1.63. We calculated this fair value based upon a risk-free interest rate of 1.50%, expected life of 3 years, expected volatility of 24% and expected dividend yield of 3%.

The weighted-average grant date fair value of options granted during 2008 was $2.06. We calculated this fair value based upon a risk-free interest rate of 2%, expected life of 3 years, expected volatility of 21% and expected dividend yield of 2%.

We charged compensation expense for our stock compensation plans against income before income taxes of $46,733, $232,872 and $205,288 for the years ended December 31, 2010, 2009 and 2008, respectively, with a corresponding income tax benefit of $15,889, $79,176 and $71,851. As of December 31, 2010 and 2009, our total unrecognized compensation cost related to nonvested share-based compensation granted under the plan was $255,105 and $91,026, respectively. We expect to recognize this cost over a weighted average period of 1.8 years.

We account for share-based compensation to employees and directors of Donegal Mutual as share-based compensation to employees of a controlling entity. As such, we measure the fair value of the award at the grant date and recognize the fair value as a dividend to the controlling entity. These provisions apply to options granted to the employees and directors of Donegal Mutual, the employer of record for the employees that provide services to us. We recorded implied dividends of $1,309,734, $62,991 and $1,749,063 for the years ended December 31, 2010, 2009 and 2008, respectively.

We did not receive any cash from option exercises in 2010 or 2009. Cash received from option exercises under all stock compensation plans for the year ended December 31, 2008 was $2,358,916. The actual tax benefit realized for the tax deductions from option exercises of share-based compensation was $683,881 for the year ended December 31, 2008.

All options issued prior to 2001 converted to options on Class A and Class B common stock as a result of our recapitalization. No further shares are available for plans in effect prior to 2007.

Information regarding activity in our stock option plans follows:

	Number of Options	Weighted-Average Exercise Price Per Share
Outstanding at December 31, 2007	2,384,722	$17.36
Granted — 2008	1,368,500	17.52
Exercised — 2008	(247,955)	9.51
Forfeited — 2008	(82,835)	17.80
Outstanding at December 31, 2008	3,422,432	17.98
Granted — 2009	5,000	17.50
Forfeited — 2009	(137,333)	17.97
Outstanding at December 31, 2009	3,290,099	17.98
Granted — 2010	1,787,500	14.00
Forfeited — 2010	(15,500)	15.69
Expired — 2010	(1,063,432)	15.76
Outstanding at December 31, 2010	3,998,667	$16.80
Exercisable at:		
December 31, 2008	1,767,810	$17.74
December 31, 2009	2,451,556	$18.13
December 31, 2010	1,805,751	$19.40

Shares available for future option grants at December 31, 2010 total 845,072 shares under all plans.

The following table summarizes information about fixed stock options at December 31, 2010:

Exercise Price	Number of Options Outstanding	Weighted-Average Remaining Contractual Life	Number of Options Exercisable
$14.00	1,779,500	5.0 years	—
17.50	1,237,000	2.5 years	824,584
18.70	3,000	2.5 years	2,000
21.00	958,667	1.0 years	958,667
21.00	20,500	2.0 years	20,500
Total	3,998,667		1,805,751

Employee Stock Purchase Plans

During 1996, we adopted an Employee Stock Purchase Plan. During 2001, we adopted a nearly identical plan that made 533,333 shares of Class A common stock available for issuance.

The 2001 plan extends over a 10-year period and provides for shares to be offered to all eligible employees at a purchase price equal to the lesser of 85% of the fair market value of our Class A common stock on the last day before the first day of each enrollment period (June 1 and December 1 of each year) under the plan or 85% of the fair market value of our common stock on the last day of each subscription period (June 30 and December 31 of each year). A summary of plan activity follows:

	Shares Issued	
	Price	Shares
January 1, 2008	$12.98	14,593
July 1, 2008	13.49	11,498
January 1, 2009	14.25	10,770
July 1, 2009	12.93	11,304
January 1, 2010	12.85	11,717
July 1, 2010	10.45	12,403

On January 1, 2011, we issued an additional 13,243 shares at a price of $11.02 per share under this plan.

Agency Stock Purchase Plans

During 1996, we adopted an Agency Stock Purchase Plan. During 2001, we adopted a nearly identical plan that made 533,333 shares of Class A common stock available for issuance. The plan provides for agents of our insurance subsidiaries and Donegal Mutual to invest up to $12,000 per subscription period (April 1 to September 30 and October 1 to March 31 of each year) under various methods. We issue stock at the end of each subscription period at a price equal to 90% of the average market price during the last ten trading days of each subscription period. During 2010, 2009 and 2008, we issued 56,879, 48,427 and 48,054 shares, respectively, under this plan. Expense recognized under the plan was not material.

15 — Statutory Net Income, Capital and Surplus and Dividend Restrictions

The following is selected information, as filed with insurance regulatory authorities, for our insurance subsidiaries as determined in accordance with accounting practices prescribed or permitted by such insurance regulatory authorities:

	2010	2009	2008
Atlantic States			
Statutory capital and surplus	$191,775,057	$189,679,919	$182,403,593
Statutory unassigned surplus	$131,817,978	$133,732,099	$128,742,729
Statutory net income	$ 11,002,447	$ 12,445,231	$ 18,412,955
Southern			
Statutory capital and surplus	$ 63,609,630	$ 64,519,825	$ 64,272,437
Statutory unassigned surplus	$ 12,612,044	$ 15,402,239	$ 15,154,851
Statutory net (loss) income	$ (2,083,206)	$ (1,017,998)	$ 1,608,947
Le Mars			
Statutory capital and surplus	$ 25,539,580	$ 28,288,730	$ 27,914,815
Statutory unassigned surplus	$ 12,485,531	$ 15,277,563	$ 15,322,075
Statutory net (loss) income	$ (3,166,242)	$ 716,138	$ 1,886,785
Peninsula			
Statutory capital and surplus	$ 41,932,367	$ 38,986,329	$ 39,137,131
Statutory unassigned surplus	$ 23,580,784	$ 20,832,470	$ 21,337,717
Statutory net income	$ 2,336,947	$ 1,023,349	$ 4,082,064
Sheboygan			
Statutory capital and surplus	$ 11,671,405	$ 11,857,971	$ 11,176,704
Statutory unassigned (deficit) surplus	$ (479,140)	$ (243,626)	$ (855,467)
Statutory net (loss) income	$ (286,613)	$ 588,098	$ (1,110,861)
Michigan			
Statutory capital and surplus	$ 37,343,663	$ 33,942,137	$ 29,801,758
Statutory unassigned surplus	$ 10,240,870	$ 6,689,663	$ 4,047,086
Statutory net income	$ 3,026,178	$ 2,589,784	$ 4,502

Our principal source of cash for payment of dividends are dividends from our insurance subsidiaries. State insurance laws require our insurance subsidiaries to maintain certain minimum capital and surplus on a statutory basis. Our insurance subsidiaries are subject to regulations that restrict 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 may further impact their ability to pay dividends. At December 31, 2010, our insurance subsidiaries had statutory capital and surplus substantially above the RBC requirements. Amounts available for distribution to us as dividends from our insurance subsidiaries without prior approval of insurance regulatory authorities in 2011 are $19,177,506 from Atlantic States, $0 from Southern, $2,553,958 from Le Mars, $4,193,237 from Peninsula, $0 from Sheboygan and $3,734,366 from Michigan.

16 — Reconciliation of Statutory Filings to Amounts Reported Herein

Our insurance subsidiaries must file financial statements with state insurance regulatory authorities using accounting principles and practices established by those authorities, which we refer to as statutory accounting principles (“SAP”). Accounting principles used to prepare these statutory financial statements differ from financial statements prepared on the basis of generally accepted accounting principles.

Reconciliations of statutory net income and capital and surplus, as determined using SAP, to the amounts included in the accompanying financial statements are as follows:

	Year Ended December 31,		
	2010	2009	2008
Statutory net income of insurance subsidiaries	$ 9,163,680	$ 13,754,818	$ 25,946,589
Increases (decreases):			
Deferred policy acquisition costs	1,601,400	3,302,898	3,306,209
Deferred federal income taxes	2,380,430	1,250,187	811,722
Salvage and subrogation recoverable	748,000	542,000	270,000
Consolidating eliminations and adjustments	(12,776,620)	(13,521,106)	(23,708,578)
Parent-only net income	10,350,289	13,501,281	18,916,036
Net income as reported herein	$ 11,467,179	$ 18,830,078	$ 25,541,978

	Year Ended December 31,		
	2010	2009	2008
Statutory capital and surplus of insurance subsidiaries	$371,871,702	$333,332,774	$324,904,680
Increases (decreases):			
Deferred policy acquisition costs	34,445,579	32,844,179	29,541,281
Deferred federal income taxes	(14,834,855)	(15,676,995)	(5,914,123)
Salvage and subrogation recoverable	9,955,000	9,207,000	8,665,000
Non-admitted assets and other adjustments, net	4,889,231	2,913,878	2,795,785
Fixed maturities	4,430,879	13,135,848	(3,419,625)
Parent-only equity and other adjustments	(30,654,726)	9,749,015	7,010,867
Stockholders’ equity as reported herein	$380,102,810	$385,505,699	$363,583,865

17 — Supplementary Cash Flow Information

The following reflects income taxes and interest paid during 2010, 2009 and 2008:

	2010	2009	2008

Income taxes	$1,100,000	$1,307,418	$9,325,000
Interest	$ 705,210	$1,828,278	$2,040,017

During 2009, we paid interest and penalties in the amount of $974,204 related to a premium tax litigation settlement. We recorded this amount as interest expense in accordance with our accounting policy.

18 — Earnings Per Share

We have two classes of common stock, which we refer to as Class A common stock and Class B common stock. Our Class A common stock is entitled to cash dividends that are at least 10% higher than the cash dividends declared and paid on our Class B common stock. Accordingly, we use the two-class method for the computation of 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 declared and an allocation of remaining undistributed earnings using a participation percentage reflecting the dividend rights of each class.

We present below a reconciliation of the numerators and denominators we used in the basic and diluted per share computations for our Class A common stock:

Year Ended December 31, (dollars in thousands, except per share data)	2010	2009	2008
Basic earnings per share:			
Numerator:			
Allocation of net income	$ 9,183	$ 15,049	$ 20,404
Denominator:			
Weighted-average shares outstanding	19,961,274	19,903,069	19,866,099
Basic earnings per share	$ 0.46	$ 0.76	$ 1.03
Diluted earnings per share:			
Numerator:			
Allocation of net income	$ 9,183	$ 15,049	$ 20,404
Denominator:			
Number of shares used in basic computation	19,961,274	19,903,069	19,866,099
Weighted-average effect of dilutive securities			
Add: Director and employee stock options	17,794	—	89,419
Number of shares used in per share computations	19,979,068	19,903,069	19,955,518
Diluted earnings per share	$ .46	$ .76	$ 1.02

We used the following information in the basic and diluted per share computations for our Class B common stock:

Year Ended December 31, (dollars in thousands, except per share data)	2010	2009	2008
Basic and diluted earnings per share:			
Numerator:			
Allocation of net income	$ 2,284	$ 3,781	$ 5,138
Denominator:			
Weighted-average shares outstanding	5,576,775	5,576,775	5,576,775
Basic and diluted earnings per share	$ 0.41	$ 0.68	$ 0.92

During 2010, 2009 and 2008, we did not include certain options to purchase shares of common stock in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price. The following reflects such options that remained outstanding at December 31, 2010, 2009 and 2008:

	2010	2009	2008
Options excluded from diluted earnings per share	2,219,167	3,290,099	1,018,167

19 — Condensed Financial Information of Parent Company

Condensed Balance Sheets

(in thousands)

December 31,	2010	2009
Assets		
Investment in subsidiaries/affiliates (equity method)	$422,144	$385,445
Short-term investments	15,695	15,445
Cash	841	1,105
Property and equipment	1,309	1,262
Other	1,078	875
Total assets	$441,067	$404,132
Liabilities and Stockholders' Equity		
Liabilities		
Cash dividends declared to stockholders	$ 2,871	$ 2,798
Borrowings under line of credit	35,000	—
Subordinated debentures	15,465	15,465
Payable for the purchase of Michigan	7,207	—
Other	421	364
Total liabilities	60,964	18,627
Stockholders' equity	380,103	385,505
Total liabilities and stockholders' equity	$441,067	$404,132

Condensed Statements of Income and Comprehensive Income
(in thousands)

Year Ended December 31,	2010	2009	2008
Statements of Income			
Revenues			
Dividends from subsidiaries	$12,000	$14,000	$20,000
Other	969	1,005	1,785
Total revenues	12,969	15,005	21,785
Expenses			
Operating expenses	2,328	1,019	1,558
Interest	778	773	1,822
Total expenses	3,106	1,792	3,380
Income before income tax benefit and equity in undistributed net income of subsidiaries	9,863	13,213	18,405
Income tax benefit	(487)	(288)	(511)
Income before equity in undistributed net income of subsidiaries	10,350	13,501	18,916
Equity in undistributed net income of subsidiaries	1,117	5,329	6,626
Net income	$11,467	$18,830	$25,542
Statements of Comprehensive Income			
Net income	$11,467	$18,830	$25,542
Other comprehensive (loss) income, net of tax			
Unrealized (loss) gain — parent	—	—	(60)
Unrealized (loss) gain — subsidiaries	(6,446)	13,293	(5,201)
Other comprehensive (loss) income, net of tax	(6,446)	13,293	(5,261)
Comprehensive income	$ 5,021	$32,123	$20,281

Condensed Statements of Cash Flows
(in thousands)

Year Ended December 31,	2010	2009	2008
Cash flows from operating activities:			
Net income	$ 11,467	$ 18,830	$ 25,542
Adjustments:			
Equity in undistributed net income of subsidiaries	(1,117)	(5,329)	(6,626
Other	547	(669)	924
Net adjustments	(570)	(5,998)	(5,702)
Net cash provided	10,897	12,832	19,840
Cash flows from investing activities:			
Net sale of fixed maturities	—	—	5,214
Net (purchase) sale of short-term investments	(249)	(2,609)	11,367
Net purchase of property and equipment	(492)	(644)	(408)
Investment in subsidiaries	(35,088)	(100)	(11,568)
Other	20	19	110
Net cash (used) provided	(35,809)	(3,334)	4,715
Cash flows from financing activities:			
Cash dividends paid	(11,405)	(10,998)	(10,026)
Issuance of common stock	1,199	1,386	3,857
Tax benefit on exercise of stock options	—	—	684
Redemption of subordinated debentures	—	—	(15,464)
Borrowings under line of credit	35,000	—	—
Repurchase of treasury stock	(146)	(393)	(3,511)
Net cash provided (used)	24,648	(10,005)	(24,460)
Net change in cash	(264)	(507)	95
Cash at beginning of year	1,105	1,612	1,517
Cash at end of year	$ 841	$ 1,105	$ 1,612

20 — Segment Information

We have three reportable segments, which consist of our investment function, our personal lines of insurance and our commercial lines of insurance. Using independent agents, our insurance subsidiaries market personal lines of insurance to individuals and commercial lines of insurance to small and medium-sized businesses.

We evaluate the performance of the personal lines and commercial lines primarily based upon our insurance subsidiaries' underwriting results as determined under SAP for our total business.

We do not allocate assets to the personal and commercial lines and review them in total for purposes of decision-making. We operate only in the United States and no single customer or agent provides 10 percent or more of our revenues.

Financial data by segment is as follows:

	2010	2009 (in thousands)	2008
Revenues:			
Premiums earned:			
Commercial lines	$117,755	$113,233	$121,567
Personal lines	260,900	242,313	225,143
SAP premiums earned	378,655	355,546	346,710
GAAP adjustments	(625)	(521)	(135)
GAAP premiums earned	378,030	355,025	346,575
Net investment income	19,950	20,631	22,756
Realized investment gains (losses)	4,396	4,480	(2,971)
Other	6,442	6,597	6,064
Total revenues	$408,818	$386,733	$372,424

	2010	2009 (in thousands)	2008
Income before income taxes:			
Underwriting (loss) income:			
Commercial lines	$ 2,252	$ 5,805	$13,819
Personal lines	(22,526)	(17,235)	(7,609)
SAP underwriting (loss) income	(20,274)	(11,430)	6,210
GAAP adjustments	2,458	3,636	3,530
GAAP underwriting (loss) income	(17,816)	(7,794)	9,740
Net investment income	19,950	20,631	22,756
Realized investment gains (losses)	4,396	4,480	(2,971)
Other	3,314	3,360	2,567
Income before income taxes	$ 9,844	$ 20,677	$32,092

21 — Guaranty Fund and Other Insurance-Related Assessments

Our insurance subsidiaries' liabilities for guaranty fund and other insurance-related assessments were $2,129,722 and $2,663,049 at December 31, 2010 and 2009, respectively. These liabilities included $440,553 and $517,610 related to surcharges collected by our insurance subsidiaries on behalf of regulatory authorities for 2010 and 2009, respectively.

22 — Interim Financial Data (unaudited)

	2010			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net premiums earned	$91,372,096	$ 93,002,409	$ 94,948,843	$ 98,706,781
Total revenues	97,914,750	101,525,354	103,750,318	105,715,668
Net losses and loss expenses	67,981,486	68,509,616	67,401,697	70,416,059
Net income	234,758	1,739,728	4,909,879	4,582,814
Net earnings per common share:				
Class A common stock — basic and diluted	0.01	0.07	0.20	0.18
Class B common stock — basic and diluted	0.01	0.06	0.18	0.16

	2009			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net premiums earned	$88,349,543	$87,540,345	$87,997,723	$ 91,137,866
Total revenues	95,501,614	94,823,420	94,882,167	101,526,206
Net losses and loss expenses	65,949,165	61,903,131	58,609,247	64,373,853
Net income	169,804	4,387,624	6,744,851	7,527,799
Net earnings per common share:				
Class A common stock — basic and diluted	0.01	0.18	0.27	0.30
Class B common stock — basic and diluted	0.01	0.16	0.24	0.27

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of Donegal Group Inc.

We have audited the accompanying consolidated balance sheets of Donegal Group Inc. and subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Donegal Group Inc. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Oversight Board (United States), Donegal Group Inc.'s internal control over financial reporting as of December 31, 2010 based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 14, 2011 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

KPMG LLP

Philadelphia, Pennsylvania
March 14, 2011

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as that term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, our management has conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2010, based on the framework and criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Framework").

Based on our evaluation under the COSO Framework, our management has concluded that our internal control over financial reporting was effective as of December 31, 2010.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Because of its inherent limitations, a system of internal control over financial reporting may not prevent or detect all misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2010 included internal controls at all consolidated entities other than Michigan Insurance Company (Michigan), which we acquired on December 1, 2010. Our management has not evaluated Michigan's internal controls over financial reporting, and our management's conclusion regarding the effectiveness of internal controls over financial reporting does not extend to Michigan's internal controls.

The effectiveness of our internal control over financial reporting has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Donald H. Nikolaus
President and Chief Executive Officer

Jeffrey D. Miller
Senior Vice President and Chief Financial Officer

March 14, 2011

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of Donegal Group Inc.

We have audited Donegal Group Inc.'s (the Company) internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Donegal Group Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Donegal Group Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Donegal Group Inc. acquired Michigan Insurance Company on December 1, 2010 and management excluded from its assessment of the effectiveness of Donegal Group Inc.'s internal control over financial reporting as of December 31, 2010, Michigan Insurance Company's internal control over financial reporting associated with total assets of approximately $213.5 million and total revenues of approximately $2.4 million included in the consolidated financial statements of Donegal Group Inc. as of and for the year ended December 31, 2010. Our audit of internal control over financial reporting of Donegal Group Inc. also excluded an evaluation of the internal control over financial reporting of Michigan Insurance Company as of December 31, 2010.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Donegal Group Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2010, and our report dated March 14, 2011 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

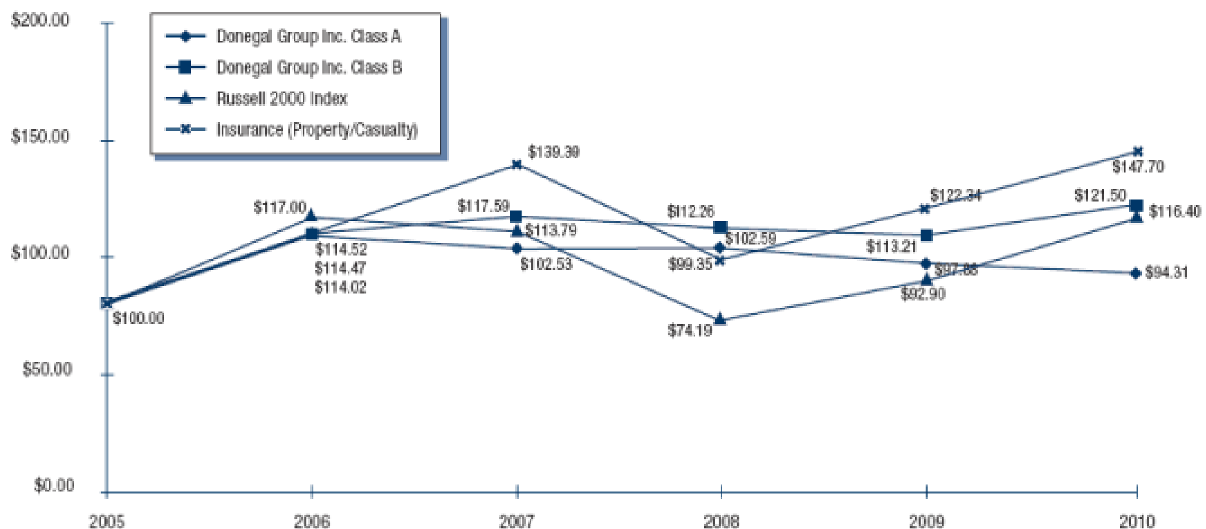
Philadelphia, Pennsylvania
March 14, 2011

Comparison of Total Return on Our Common Stock with Certain Averages

The following graph provides an indicator of cumulative total stockholder returns on our common stock compared to the Russell 2000 Index and a peer group of property and casualty insurance companies selected by Value Line, Inc. The members of the peer group are as follows: 21st Century Holding Co., Acceptance Insurance Cos. Inc., ACE Ltd., Affirmative Insurance Holdings Inc., Allied World Assurance Co. Holdings Ltd., Allstate Corp., American Financial Group Inc., American Safety Insurance Holdings Ltd., AMERISAFE Inc., AmTrust Financial Services Inc., Arch Capital Group Ltd., Argo Group International Holdings Ltd., Aspen Insurance Holdings Ltd., AssuranceAmerica Corp., Assurant Inc., Baldwin & Lyons Inc. (Cl A), Baldwin & Lyons Inc. (Cl B), Berkshire Hathaway (CI B), Chubb Corp., Cincinnati Financial Corp., CNA Financial Corp., CNA Surety Corp., CNinsure, Inc., CNO Financial Group, Inc., Donegal Group Inc. (Cl A), Donegal Group Inc. (Cl B), Eastern Insurance Holdings Inc., eHealth Inc., EMC Insurance Group Inc., Employers Holdings Inc., Endurance Specialty Holdings Ltd., Erie Indemnity Co. (Cl A), Fairfax Financial Holdings Ltd., Fidelity National Financial Inc., First Mercury Financial Corp., Flagstone Reinsurance Holdings Ltd., Fortegra Financial Corp., Fremont Michigan InsuraCorp Inc., GAINSCO Inc., Global Indemnity PLC, Hallmark Financial Services Inc., Harleysville Group Inc., HCC Insurance Holdings Inc., Homeowners Choice Inc., Industrial Alliance Insurance & Financial Services Inc., Infinity Property & Casualty Corp., Kingsway Financial Services Inc., Maiden Holdings Ltd., Majestic Capital Ltd., Markel Corp., Meadowbrook Insurance Group Inc., Mercer Insurance Group Inc., Mercury General Corp., Montpelier Re Holdings Ltd., National Interstate Corp., Old Republic International Corp., OneBeacon Insurance Group Ltd. (Cl A), Penn Millers Holding Corp., Platinum Underwriters Holdings Ltd., PMI Group Inc., Progressive Corp., RLI Corp., Safety Insurance Group Inc., SeaBright Insurance Holdings Inc., Selective Insurance Group Inc., State Auto Financial Corp., Sun Life Financial Inc., The Hanover Insurance Group Inc., Tower Group Inc., Travelers Cos. Inc., United Fire & Casualty Co., United Insurance Holdings Corp., Universal Insurance Holdings Inc., Validus Holdings Ltd., W.R. Berkley Corp. and XL Group PLC.

Comparison of Five-Year Cumulative Total Return*

Donegal Group Inc. Class A, Donegal Group Inc. Class B, Russell 2000 Index and Value Line Insurance (Property/Casualty)



Assumes $100 invested at the close of trading on December 31, 2005 in Donegal Group Inc. Class A common stock, Donegal Group Inc. Class B common stock, Russell 2000 Index and Value Line Insurance (Property/Casualty).

	2005	2006	2007	2008	2009	2010
Donegal Group Inc. Class A	$100.00	$114.52	$102.53	$102.59	$ 97.88	$ 94.31
Donegal Group Inc. Class B	100.00	114.02	117.59	112.26	113.21	121.50
Russell 2000 Index	100.00	117.00	113.79	74.19	92.90	116.40
Insurance (Property/Casualty)	100.00	114.47	139.39	99.35	122.34	147.70

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* Cumulative total return assumes reinvestment of dividends.

Corporate

Annual Meeting

April 21, 2011 at the Company's headquarters at 10:00 a.m.

Form 10-K

A copy of Donegal Group's Annual Report on Form 10-K will be furnished free upon written request to Jeffrey D. Miller, Senior Vice President and Chief Financial Officer, at the corporate address.

Market Information

Donegal Group's Class A common stock and Class B common stock trade on the NASDAQ Global Select Market under the symbols "DGICA" and "DGICB." The following table shows the dividends paid per share and the stock price range for both classes of stock for each quarter during 2010 and 2009:

Quarter	High	Low	Cash Dividend Declared Per Share
2009 - Class A			
1st	$17.00	$12.25	$ —
2nd	17.47	13.61	.1125
3rd	16.60	14.31	.1125
4th	16.02	14.22	.225
2009 - Class B			
1st	$17.50	$13.06	$ —
2nd	16.68	13.41	.10
3rd	17.68	12.75	.10
4th	22.00	15.43	.20
2010 - Class A			
1st	$15.95	$13.94	$ —
2nd	15.00	12.12	.115
3rd	13.53	10.78	.115
4th	16.12	12.57	.23
2010 - Class B			
1st	$19.19	$16.03	$ —
2nd	19.16	15.84	.1025
3rd	18.30	14.59	.1025
4th	18.75	15.89	.2050

Corporate Offices
1195 River Road
P.O. Box 302
Marietta, Pennsylvania 17547-0302
(800) 877-0600
E-mail Address: info@donegalgroup.com
Donegal Web Site: www.donegalgroup.com

Transfer Agent
Computershare Trust Company, N.A.
P.O. Box 43078
Providence, Rhode Island 02940-3078
(800) 317-4445
Web Site: www.computershare.com
Hearing Impaired: TDD: 800-952-9245

Dividend Reinvestment and Stock Purchase Plan

The Company offers a dividend reinvestment and stock purchase plan through its transfer agent.

For information contact:
Donegal Group Inc.
Dividend Reinvestment and Stock Purchase Plan
Computershare Trust Company, N.A.
P.O. Box 43078
Providence, Rhode Island 02940-3078

Stockholders

The following represent the number of common stockholders of record as of December 31, 2010:

Class A common stock	1,243
Class B common stock	392

SUBSIDIARIES OF REGISTRANT

Registrant owned 100% of the outstanding stock of the following companies as of December 31, 2010, except as noted:

Name	State of Formation
Atlantic States Insurance Company	Pennsylvania
Southern Insurance Company of Virginia	Virginia
Le Mars Insurance Company	Iowa
The Peninsula Insurance Company	Maryland
Peninsula Indemnity Company*	Maryland
Donegal Financial Services Corporation**	Delaware
Province BankFSB***	U.S.
Sheboygan Falls Insurance Company	Wisconsin
Michigan Insurance Company	Michigan

* Wholly owned by The Peninsula Insurance Company.

** Registrant owns 48.2%. Donegal Mutual Insurance Company owns 51.8%.

*** Wholly owned by Donegal Financial Services Corporation.

REPORT AND CONSENT OF
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Donegal Group Inc.:

The audits referred to in our audit report dated March 14, 2011 with respect to the consolidated financial statements of Donegal Group Inc. and subsidiaries (Company) included the related financial statement schedule as of December 31, 2010 and 2009, and for each of the years in the three-year period ended December 31, 2010, included in the annual report on Form 10-K. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We consent to the incorporation by reference in the registration statements (Nos. 333-93785, 333-94301, 333-89644, 333-62970, 333-62974, 333-62976 and 333-142614) on Form S-8 and registration statements (Nos. 333-59828 and 333-63102) on Form S-3 of Donegal Group Inc. of our reports dated March 14, 2011, with respect to the consolidated balance sheets of Donegal Group Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2010, and the related financial statement schedule and the effectiveness of internal control over financial reporting as of December 31, 2010, which reports are incorporated by reference or appear in the December 31, 2010 annual report on Form 10-K of Donegal Group Inc.

/s/ KPMG LLP

Philadelphia, Pennsylvania

March 14, 2011

EXHIBIT 31.1

CERTIFICATION

I, Donald H. Nikolaus, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2010 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 15a-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.

/s/ Donald H. Nikolaus
Donald H. Nikolaus, President

Date: March 14, 2011

CERTIFICATION

I, Jeffrey D. Miller, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2010 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 15a-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.

/s/ Jeffrey D. Miller

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

Date: March 14, 2011

EXHIBIT 32.1

Statement of President
Pursuant to Section 1350 of Title 18 of the United States Code

Pursuant to Section 1350 of Title 18 of the United States Code, I, Donald H. Nikolaus, the President of Donegal Group Inc. (the “Company”), hereby certify that, to the best of my knowledge:

1. The Company’s Form 10-K Annual Report for the period ended December 31, 2010 (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/ Donald H. Nikolaus
Donald H. Nikolaus, President

Date: March 14, 2011

EXHIBIT 32.2

Statement of Chief Financial Officer
Pursuant to Section 1350 of Title 18 of the United States Code

Pursuant to Section 1350 of Title 18 of the United States Code, I, Jeffrey D. Miller, Vice President and Chief Financial Officer of Donegal Group Inc. (the "Company"), hereby certify that, to the best of my knowledge:

1. The Company's Form 10-K Annual Report for the period ended December 31, 2010 (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, Vice President
and Chief Financial Officer

Date: March 14, 2011