DONEGAL GROUP INC
Form S-2/A
February 05, 2002

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON FEBRUARY 5, 2002
REGISTRATION NO. 333-63102

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

AMENDMENT NO. 5

TO
FORM S-2
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

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
(888) 877-0600
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Donald H. Nikolaus, President
Donegal Group Inc.
1195 River Road
Marietta, Pennsylvania 17547
(888) 877-0600
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copy to:
Kathleen M. Shay, Esquire
Duane Morris LLP
4200 One Liberty Place
Philadelphia, PA 19103-7396
(215) 979-1000

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. [X]

If the registrant elects to deliver its latest annual report to security holders, or a complete and legible facsimile thereof, pursuant to Item 11(a)(1) of this Form, check the following box. [X]

If this Form is filed to register additional securities for an offering pursuant to Section 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this Form is a post-effective amendment filed pursuant to Section 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

PROSPECTUS

DONEGAL GROUP INC.

2001 AGENCY STOCK PURCHASE PLAN

300,000 SHARES OF CLASS A COMMON STOCK

Donegal Group is offering 300,000 shares of Class A common stock to eligible insurance agencies under its 2001 Agency Stock Purchase Plan. Our Class A common stock is listed for trading on the Nasdaq Stock Market under the symbol "DGICA." On ______________________, 2002, the last reported sale price of our Class A common stock on the Nasdaq National Market System was $

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per share.

We will offer the shares of Class A common stock under the plan directly to eligible agencies through our officers and will not use a broker or a dealer. In addition, we will not pay commissions, discounts or any other payments to any person for services in connection with the offer or sale of shares of Class A common stock under the plan. We will pay all costs of administering the plan. Participants will not incur brokerage commissions or service charges for the purchase of shares under the plan. Donegal Group will retain all proceeds from the sale of shares of Class A common stock under the plan.

Donegal Group's principal executive offices are located at 1195 River Road, Marietta, PA 17547; telephone (888) 877-0600. A copy of our 2000 Annual Report to Stockholders accompanies this prospectus. You should retain this prospectus for future reference.

SEE "RISK FACTORS" BEGINNING ON PAGE 3 FOR A DISCUSSION OF CERTAIN FACTORS THAT YOU SHOULD CONSIDER BEFORE YOU INVEST IN OUR CLASS A COMMON STOCK.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is ________________________, 2002.

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PROSPECTUS SUMMARY

This summary highlights some information from this prospectus. It may not contain all of the information that is important to you. To understand this offering fully, you should read the entire prospectus carefully, including the risk factors.

We are an insurance holding company that offers property and casualty insurance through our wholly owned subsidiaries and participates in a pooling agreement with our affiliate, Donegal Mutual Insurance Company, known as the Mutual Company. Our operations are interrelated with the operations of the Mutual Company, and various reinsurance arrangements exist between our insurance subsidiaries and the Mutual Company. In addition, the Mutual Company provides us and some of our insurance subsidiaries with all of our personnel.

Donegal Group is authorized to issue 30,000,000 shares of Class A common stock, 10,000,000 shares of Class B common stock and 2,000,000 shares of preferred stock. The Class A common stock and the Class B common stock are identical, except with respect to voting rights and the payment of dividends. The Mutual Company currently owns approximately 62.2% of our Class A common stock and 62.2% of our Class B common stock.

We are offering to eligible independent insurance agencies of our subsidiaries and affiliated insurance companies, including the Mutual Company, an opportunity to acquire a proprietary interest in us through the plan. We adopted the plan to foster the common interests of us and our agencies in achieving long-term profitable growth for the Donegal Group of companies.

We have reserved 300,000 shares of Class A common stock for sale to eligible agencies under the plan for the five-year period ending March 31, 2007. The purchase price for shares of Class A common stock purchased from us under the plan will be 90% of the average closing prices of the Class A common stock on the Nasdaq National Market System on the last ten trading days of each applicable subscription period.

We will offer shares under the plan directly to eligible agencies through our officers and will not use a broker or a dealer. In addition, we will not pay commissions, discounts or any other payments to any person for services in connection with the sale of shares of Class A common stock under the plan. We will pay all costs of administering the plan. Participants will not incur brokerage commissions or service charges for the purchase of shares under the plan.

RISK FACTORS

YOU SHOULD CONSIDER CAREFULLY THE FACTORS SET FORTH BELOW, AS WELL AS ALL OTHER INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS, BEFORE YOU DECIDE TO PURCHASE SHARES OF CLASS A COMMON STOCK.

THE CYCLICAL NATURE OF THE PROPERTY AND CASUALTY INSURANCE INDUSTRY MAY REDUCE OUR REVENUES AND PROFIT MARGINS.

The property and casualty insurance industry is highly cyclical, and individual lines of business experience their own cycles within the overall industry cycle. Premium rate levels are related to the availability of insurance coverage, which varies according to the level of surplus in the industry. The level of surplus in the industry varies with returns on invested capital and regulatory barriers to withdrawal of surplus. Increases in surplus have generally been accompanied by increased price competition among property and casualty insurers. If we find it necessary to reduce premiums or limit premium increases due to these competitive pressures on pricing, it may cause a reduction in our profit margins and revenues, increase our ratios of claims and expenses to premiums and result in lower profitability for us.

Volatile and unpredictable developments also offset significantly the cyclical trends in the industry and the industry's profitability. These developments include natural disasters (such as storms, earthquakes, hurricanes, floods and fires), fluctuations in interest rates and other changes in the investment environment that affect the market prices of our investments and the income from those investments, inflationary pressures that affect the size of losses and judicial decisions that affect our liabilities. The occurrence of these developments may adversely affect our business and financial condition.

THE NATURE OF THE INSURANCE INDUSTRY LIMITS OUR ABILITY TO CHANGE PRICES TO REFLECT RISKS AND TO ESTIMATE OUR RESERVES ACCURATELY.

One of the distinguishing features of the property and casualty industry is that its products generally are priced before its costs are known. Our products are priced in this manner because premium rates usually are determined at the time the policy is issued and before losses are reported. Changes in statutory and case law can also dramatically affect the liabilities associated with known

risks after the insurance policy is issued. The number of competitors and the similarity of products offered, as well as regulatory constraints, limit our ability to increase prices in response to declines in profitability. Our reported profits and losses are also determined, in part, by the establishment and adjustment of reserves reflecting estimates made by management as to the amount of losses and loss adjustment expenses that will ultimately be incurred in the settlement of claims. Our ultimate liability for all losses and loss adjustment expenses reserved at any given time will likely be greater or less than these estimates, and material shortfalls in the estimates may have a material adverse effect on us in future periods.

WE COMPETE WITH MANY INSURERS THAT ARE FINANCIALLY STRONGER THAN WE ARE.

The property and casualty insurance industry is intensely competitive. Competition is based on many factors, including the perceived financial strength of the insurer, premiums charged, policy terms and conditions, policyholder service, reputation and experience. We 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 are better capitalized than we are, have substantially greater financial, technical and operating resources and have equal or higher ratings from A.M. Best Company, Inc.

The superior capitalization of many of our competitors enables them to withstand lower profit margins and, therefore, to market their products more aggressively, to take advantage more quickly of new marketing opportunities and offer lower premium rates. Moreover, if our competitors price their premiums more aggressively and we meet their pricing, our profit margins and revenues may be reduced and our ratios of claims and expenses to premiums may increase.

Our competition may become increasingly better capitalized in the future as the traditional barriers between insurance companies and banks and other financial institutions erode and as the property and casualty industry continues to consolidate. Our ability to compete against our larger, better capitalized competitors depends largely on our ability to provide superior policyholder service and to maintain our historically strong relationships with independent insurance agents, on whom we are entirely dependent to generate premium volume.

We cannot assure you that we will maintain our current competitive position in the markets in which we operate, or that we will be able to expand our operations into new markets. If we fail to do so, our business could be materially adversely affected.

WE ARE A REGIONAL INSURANCE COMPANY THAT OFFERS INSURANCE PRODUCTS IN A LIMITED NUMBER OF STATES.

We are headquartered in Pennsylvania and engage in the insurance business in approximately 15 Middle Atlantic and Southern states. In 2000, the majority of our direct premiums written, including those of the Mutual Company and our insurance subsidiaries, were geographically dispersed as follows: 63% in Pennsylvania, 15% in Virginia and 6% in Maryland. Any single catastrophic occurrence, destructive weather pattern, general economic trend or other condition disproportionately affecting losses or business conditions in these states could adversely affect our results of operations, although we and the Mutual Company maintain reinsurance against catastrophic losses in excess of $3,000,000 per occurrence and our insurance subsidiaries maintain various catastrophe reinsurance agreements with the Mutual Company that limit the maximum liability under any one catastrophe.

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THE REINSURANCE AGREEMENTS ON WHICH WE RELY ON DO NOT RELIEVE US FROM LIABILITY TO OUR POLICYHOLDERS.

We rely on reinsurance agreements to limit our maximum net loss from large single risks or risks in concentrated areas, and to increase our capacity to write insurance. Each reinsurance agreement satisfies all applicable regulatory requirements. Reinsurance, however, does not relieve us from liability to our policyholders. To the extent that a reinsurer may be unable to pay losses for which it is liable under the terms of its reinsurance agreement with us, we remain liable for such losses. However, in an effort to reduce the risk of non-payment, we require all of our 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 our management, is equivalent to a company with at least an A rating. If our reinsurers incur losses from their reinsurance arrangements with us, it is probable that the reinsurance premiums payable by us in the future could increase.

WE ARE SUBJECT TO EXTENSIVE STATE INSURANCE REGULATION.

We are subject to the laws and regulations of the states in which we conduct business. These laws and regulations address many aspects of our business and financial condition, including licensure, the payment of dividends, the establishment of premium rates, the settlement of claims, the transfer of control and the requirement that we participate in assigned risk pools. Certain of the following laws and regulations could have a material adverse effect on our results of operations:

- state insurance regulations that require us to file proposed premium rates in advance of premium rate increases;

- state insurance regulations that mandate required levels of statutory surplus;

- private rating organization review of our levels of statutory surplus and claims-paying ability; and

- National Association of Insurance Commissioners, known as the NAIC, and state insurance department review of our risk-based capital levels.

Changes in the level of regulation of the insurance industry and laws or regulations themselves or interpretations by regulatory authorities could also have a material adverse effect on our operations. Specific regulatory developments that could have a material adverse effect on our operations include the potential repeal of the McCarran-Ferguson Act, which exempts insurance companies from a variety of federal regulatory requirements, possible rate rollback regulation and legislation to control premiums, policy terminations and other policy terms.

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THE MUTUAL COMPANY IS OUR LARGEST SHAREHOLDER AND PROVIDES US WITH OUR FACILITIES AND SERVICES.

The Mutual Company currently owns approximately 62.2% of our outstanding

Class A common stock and 62.2% of our outstanding Class B common stock and will continue to own approximately the same percentages of these classes of stock after completion of this offering. Accordingly, the Mutual Company will continue to control the election of members of our board of directors. Although the Mutual Company could exercise its control in ways that are contrary to the interests of our stockholders other than the Mutual Company, we and the Mutual Company have established a coordinating committee consisting of two outside directors from each company who do not also serve as directors of the other company. Subsequent to approval of a matter by the separate boards of directors of Donegal Group and the Mutual Company, this committee is responsible for reviewing and approving all matters involving actual or potential conflicts of interest, including any changes to the pooling and other agreements between us and the Mutual Company, and this committee's decisions are binding on both us and the Mutual Company. In order for an intercompany transaction to be approved, our representatives on the committee must conclude that the transaction is fair and equitable to us.

We are dependent upon the Mutual Company for the retention of agents and the underwriting of insurance, the servicing of policyholder claims and all other aspects of our operations. All of our officers are officers and employees of the Mutual Company. The Mutual Company also provides all of the facilities and data processing and administrative services required to conduct our business, for which we pay a pro rata portion of the cost.

BECAUSE WE PARTICIPATE IN AN INSURANCE POOLING ARRANGEMENT WITH THE MUTUAL COMPANY, OUR RESULTS OF OPERATIONS ARE DEPENDENT UPON THE FINANCIAL SUCCESS OF THE MUTUAL COMPANY.

Our insurance subsidiary, Atlantic States Insurance Company, participates in an intercompany pooling arrangement with the Mutual Company, under which the parties share the premiums earned and underwriting results on substantially all of the property and casualty insurance business written by both companies. Under the terms of the intercompany pooling agreement, Atlantic States cedes all of its insurance business to the Mutual Company and assumes from the Mutual Company 70% of the total pooled insurance business of the Mutual Company and Atlantic States. The allocations of pool participation percentages between the Mutual Company and Atlantic States are based on the pool participants' relative amounts of capital and surplus, expectations of future relative amounts of capital and surplus and our ability to raise capital for Atlantic States.

Because of the pooled business we assume, our insurance operations are interrelated with the insurance operations of the Mutual Company and our results of operations are dependent upon the financial success of the Mutual Company. Although the underwriting pool is intended to produce a more uniform and stable underwriting result from year to year for the participants in the pool than they would experience individually and to spread the risk of loss among all the participants, if the Mutual Company experiences unusually severe or frequent losses or does not adequately price its premiums, our results of operations could suffer. Our results of operations also may suffer if the Mutual Company did not participate in the pooling arrangement because the pool participants would then be limited to policy exposures of a size commensurate with their own capital and surplus instead of having at their disposal the capacity of the entire pool.

OUR BUSINESS DEPENDS IN PART ON THE MARKETING EFFORTS OF INDEPENDENT INSURANCE AGENTS, AND IT IS POSSIBLE THAT THESE AGENTS MAY NOT MARKET OUR PRODUCTS SUCCESSFULLY OR SELL OUR PRODUCTS WITHIN THE GUIDELINES WE SPECIFY.

We market and sell almost all of our insurance products through independent, non-exclusive insurance agents. These agents are not obligated to promote our insurance products exclusively and they also sell our competitors' insurance products. Our business depends in part on the marketing efforts of these agents and we must offer insurance products and services that meet the requirements of these independent agencies. If these agencies do not market our products successfully or give priority to other insurers, our business may be adversely impacted.

We also grant certain agents the authority to bind insurance without our prior approval within underwriting and pricing limits that we specify. However, we generally review all coverages placed by our agents and may cancel the coverage if it is inconsistent with our guidelines and permissible to cancel under applicable insurance regulations. If we are unable to cancel the coverage placed by an agent prior to a claim being placed by the insured, our risk may be increased and our profitability may suffer.

OUR ESTABLISHED RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES ARE BASED ON ESTIMATES, AND IT IS POSSIBLE THAT OUR ULTIMATE LIABILITY WILL EXCEED THESE ESTIMATES.

We establish reserves for losses and loss adjustment expenses based on estimates of amounts needed to pay reported and unreported claims and related loss adjustment expenses. These estimates are based on facts and circumstances then known to us. Reserves are based on estimates of future trends and claims severity, judicial theories of liability and other factors.

The establishment of appropriate reserves is an inherently uncertain process, and there can be no assurance that the ultimate liability will not exceed our loss and loss adjustment expense reserves and have an adverse effect on our results of operations and financial condition. As is the case for most property and casualty insurance companies, we have found it necessary in the past to revise estimated liabilities as reflected in our loss and loss adjustment expense reserves, and further adjustments could be required in the future. However, our management believes that adequate provision has been made for our loss and loss adjustment expense reserves. This belief is based on our internal procedures, which analyze our 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.

OUR SUBSIDIARIES ARE RESTRICTED IN PAYING US DIVIDENDS, ON WHICH WE DEPEND FOR THE PAYMENT OF CORPORATE EXPENSES.

As a holding company, we rely primarily on our subsidiaries for dividends and other permitted payments to meet our obligations for corporate expenses. Payment of dividends to us by our subsidiaries is subject to regulatory restrictions and depends on the surplus of our subsidiaries. From time to time, the NAIC and various state insurance regulators consider

modifying the method of determining the amount of dividends that may be paid by an insurance company without prior regulatory approval.

OUR CHARTER DOCUMENTS, DELAWARE CORPORATE LAW AND PENNSYLVANIA INSURANCE LAW MAY INHIBIT A TAKEOVER.

Certain provisions of our certificate of incorporation and by-laws and

Delaware and Pennsylvania law may discourage a future unsolicited takeover of Donegal Group. These provisions could have the effect of discouraging certain attempts to acquire us or remove current management, including current members of our board of directors, even if some of our stockholders deemed these attempts to be in their best interests.

Our certificate of incorporation authorizes us to issue two classes of common stock, Class A common stock and Class B common stock. The holders of the Class A common stock are entitled to one-tenth of one vote per share, while the holders of the Class B common stock are entitled to one vote per share, on all matters submitted to a vote of our stockholders. In addition, our certificate of incorporation does not grant any holder of our stock the right to cumulate votes in the election of directors. The Mutual Company currently owns approximately 62.2% of our Class A common stock and 62.2% of our Class B common stock and has effective voting control over us. This ownership by the Mutual Company could avert or prevent a change in control of us unless the Mutual Company, after consideration of all relevant factors including the interests of our stockholders other than the Mutual Company, is in favor of such a change.

Our board of directors, without stockholder approval, has the authority to issue preferred stock with voting and conversion rights that could adversely affect the voting power of the Class A common stock. The issuance of preferred stock could have the effect of delaying, averting or preventing a change in control of us. No preferred stock has been issued, and our board of directors does not intend to issue any preferred stock at the present time.

Our by-laws provide for a classified board of directors, consisting of three classes as nearly equal in size as possible. The classification of our board of directors could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring, control of us.

As a Delaware corporation we are subject to certain anti-takeover provisions of Delaware law, including certain business combination transaction prohibitions. In addition, we are subject to Pennsylvania insurance laws and regulations that prohibit any person from acquiring a greater than 10% interest in us without the prior approval of the Insurance Commissioner of the Commonwealth of Pennsylvania. These provisions could make it more difficult for a third party to gain control of us, deny stockholders the receipt of a premium on their Class A common stock and have a depressive effect on the market price of the Class A common stock.

CAUTIONARY NOTICE REGARDING FORWARD LOOKING STATEMENTS

Certain statements contained in, or incorporated by reference in, this prospectus are forward-looking in nature. These statements can be identified by the use of forward-looking words such as "believes," "expects," "may," "will," "should," "intends," "plans" or "anticipates," or the negative thereof or comparable terminology, or by discussions of strategy. You are cautioned that our business and operations are subject to a variety of risks and uncertainties and, consequently, our actual results may materially differ from those projected by any forward-looking statements. Certain of these risks and uncertainties are discussed under the heading "Risk Factors."

DESCRIPTION OF THE 2001 AGENCY STOCK PURCHASE PLAN

We describe the provisions of the plan below, in question and answer form. As used in the plan, the term "subsidiary and affiliated insurance companies" means insurance companies that are our subsidiaries and the Mutual Company. The plan was approved by our board of directors on March 8, 2001 and was amended and restated on September 17, 2001 and December 20, 2001.

PURPOSE AND ADVANTAGES OF THE PLAN

1. What is the purpose of the plan?

The plan provides an eligible agency, as described in Question and Answer 6, an opportunity to acquire a long-term proprietary interest in us through the purchase of our Class A common stock at a discount from current market prices. In offering the plan, we seek to foster the common interests of Donegal Group and the eligible agencies in achieving long-term profitable growth for us. Accordingly, we have created the plan for the purpose of facilitating the purchase of and long-term investment in shares of our Class A common stock by an eligible agency. We expect that an eligible agency that purchases shares under the plan will hold these shares on a long-term basis, as the plan is not intended to benefit an agency that demonstrates a pattern of immediate resale of shares acquired. As discussed in Question and Answer 6 below regarding eligibility, immediate resale of shares will be a factor in our determination whether an otherwise eligible agency should remain eligible for continued participation in the plan.

2. What are the advantages of the plan?

Under the plan, an eligible agency can utilize three convenient payment methods for the purchase of our Class A common stock at a 10% discount from the current market price. You will not pay any brokerage commissions or service charges in connection with your purchase.

ADMINISTRATION

3. Who administers the plan for participants?

A committee consisting of three persons appointed from time to time by our board of directors administers the plan. The committee may adopt rules and regulations for carrying out the plan. The committee's interpretations or constructions of the provisions of the plan are final and conclusive unless our board of directors takes contrary action.

Our board of directors appointed Donald H. Nikolaus, Ralph G. Spontak and Daniel J. Wagner to serve on the committee. We do not compensate members of the committee for administering the plan. Donald H. Nikolaus is President, Chief Executive Officer and a director of Donegal Group and the Mutual Company. Ralph G. Spontak is Senior Vice President, Chief Financial Officer and Secretary of Donegal Group and the Mutual Company. Mr. Spontak is also a director of the Mutual Company. Daniel J. Wagner is Treasurer of Donegal Group and the Mutual Company. The address and telephone number of each member of the committee is c/o Donegal Group Inc., 1195 River Road, Marietta, PA 17547; telephone (888) 877-0600.

4. Where can I obtain additional information about the plan and its administrators?

You can obtain additional information about the plan and its administrators by contacting Ralph G. Spontak, our Senior Vice President, Chief Financial Officer and Secretary, at (888) 877-0600.

5. What is the term of the plan?

The plan will be in effect from March 15, 2002 through March 31, 2007 unless our board of directors terminates the plan earlier. The board of directors has the right to terminate the plan at any time without notice provided that no participant's existing rights are adversely affected by the termination. During the term of the plan there will be ten consecutive semi-annual subscription periods. Each subscription period extends from April 1 through September 30 and from October 1 through March 31, respectively, beginning with April 1, 2002 and ending on March 31, 2007.

PARTICIPATION

6. What agencies are eligible to participate?

An eligible agency is an independent insurance agency that brings value to Donegal Group, the Mutual Company and our subsidiary and affiliated insurance companies, directly or indirectly, as determined by us in our discretion, and with which we seek a long-term relationship. Only eligible agencies may participate in the plan. The eligibility criteria we will consider includes the agency's volume of direct premiums written, the ability of the agency to increase sales and grow the volume of direct premiums written, the historic loss ratio of the agency's direct premiums written and whether the agency has been placed on rehabilitation by us, meaning that we notify the agency of operational deficiencies, or had its binding authority revoked. We may base eligibility on agency segmentation class or any other factors that indicate value to the companies, directly or indirectly, in our discretion.

We will periodically review an eligible agency's continued eligibility. A pattern of immediate resale of shares acquired under the plan by an eligible agency will be a factor in our determination whether an agency should remain eligible for continued participation in the plan. Immediate resales would tend to indicate that an agency is not seeking to share in the long-term profitable growth of the companies. If Donegal Group determines to discontinue an agency's participation in the plan, the agency will receive written notice from us that its eligibility to participate in the plan has been discontinued. This notice will be sent to the agency as promptly as possible, but in no event later than two weeks after the end of the subscription period during which the decision was made. A decision by us, in our discretion, to discontinue the eligibility of an agency under the plan will be treated as an automatic withdrawal from the plan. See Questions and Answers 24 and 25 below.

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7. How may an eligible agency participate in the plan?

An eligible agency may enroll in the plan by completing and filing a subscription agreement, as described in Question and Answer 8, with us. We will send to each eligible agency a subscription agreement, a copy of this prospectus and any prospectus supplements and a copy of our most recent Annual Report to Stockholders prior to the beginning of the first enrollment period following the agency's designation as an eligible agency.

8. What does a subscription agreement provide?

A subscription agreement allows each eligible agency to decide and identify

the date on which the agency desires to become enrolled in the plan, the amounts of contribution and the payment method(s) selected for purchases under the plan. Eligible agencies that participated in our former Agency Stock Purchase Plan may participate in the plan by checking the appropriate box on the subscription agreement. Prior contribution amounts and payment method(s) will be carried over from the former Agency Stock Purchase Plan unless new instructions are given in the subscription agreement.

9. When may an eligible agency enroll in the plan?

If an eligible agency chooses the direct bill commission payment method, as explained in Question and Answer 15, enrollment in the plan may occur only during the enrollment period preceding each subscription period, which is from the 15th through the 31st day of March and from the 15th through the 30th day of September of each year commencing with March 15, 2002. 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 applicable enrollment period. Once enrolled in the direct bill commission payment method, an eligible agency's participation in the plan continues for each succeeding subscription period until the agency ceases to be an eligible agency or withdraws from enrollment in the plan.

If an eligible agency chooses the lump-sum payment method, as explained in Question and Answer 17, an eligible agency may enroll by submitting a supplemental subscription agreement to us and making a lump-sum payment by the last day of the applicable subscription period, September 30 or March 31.

If an eligible agency chooses the contingent commission payment method, as explained in Question and Answer 18, an eligible agency may enroll by submitting a subscription agreement during the enrollment period immediately preceding each October 1 through March 31 subscription period.

10. May an eligible agency transfer its subscription rights to another person or agency?

No. An eligible agency may not assign its subscription payments or rights to subscribe to any other person, and any such attempted assignment is void, except for permitted designations as described in Question and Answer 23.

COSTS AND EXPENSES

11. Are there any expenses to participants in connection with purchases under the plan?

No. Eligible agencies are not obligated to pay any brokerage commissions or other charges with respect to the purchase of Class A common stock under the plan.

PURCHASES

12. How many shares are available to be purchased under the plan?

Our board of directors reserved 300,000 shares of our Class A common stock for sale under the plan.

13. What is the price of shares of Class A common stock purchased under the plan?

The subscription price for each share of Class A common stock purchased under the plan is 90% of the average of the closing prices of the Class A common stock on the Nasdaq National Market System on the last ten trading days of the applicable subscription period.

14. How may an eligible agency pay for shares purchased under the plan?

An eligible agency can pay for shares purchased under the plan by means of three payment methods: Direct bill commission deduction, lump-sum payment or contingent commission deduction.

15. What is the direct bill commission payment method?

Under the direct bill commission payment method, an eligible agency may elect to purchase Class A common stock under the plan through deductions from its monthly direct bill commission payment by designating that a minimum of 1% and up to a maximum of 10% of the eligible agency's monthly direct bill commission payments be withheld from the eligible agency's direct bill commission payments. Direct bill commission payments are subject to the total subscription limit under all payment methods of $12,000 per subscription period. "Direct bill commission payments" means those commissions that are earned and 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 our records.

16. May an eligible agency that chooses the direct bill commission payment method change the method or amount of contribution made or withheld under the plan?

Yes. An eligible agency choosing the direct bill commission payment method may change the rate of contribution by filing a new subscription agreement with us during the enrollment period for the next subscription period. This change will become effective during the next subscription period.

17. What is the lump-sum payment method?

Under the lump-sum payment method, an eligible agency may, by September 30 and March 31 of each subscription period, elect to make lump-sum cash payments for the purchase of Class A common stock under the plan. Lump-sum cash payments may not be less than $1,000 per subscription period and are subject to the total subscription limit under all methods of $12,000 per subscription period.

18. What is the contingent commission payment method?

An eligible agency may designate a percentage of the contingent commission payable to it under the terms of the applicable agency contingency plan (or its equivalent) to be withheld for the purchase of Class A common stock under the plan during the enrollment period immediately preceding the October 1 through March 31 subscription period. Contingent commission payments are subject to the total subscription limit under all payment methods of $12,000 per subscription period.

19. Are there limitations on the amount of contributions or purchases that can be made?

Yes. Each eligible agency's total contributions for purchases from all

payment methods (described in Questions and Answers 15, 17 and 18 above) may not exceed $12,000 during each subscription period. At the close of each subscription period, we will total each agency's contributions from all payment methods. If at any time throughout a subscription period, an eligible agency's total payments exceed the $12,000 maximum amount and the agency so requests, we will return the excess amount without interest to the agency within a reasonable period. Any amount not returned will be applied to the purchase of Class A common stock during the next subscription period without reducing the $12,000 limitation applicable to that subscription period.

20. How are purchases made under the plan?

We will maintain on our books a plan account for each enrolled eligible agency. All contributions made by an eligible agency through deductions from an eligible agency's direct bill commission payments and contingent commission withholding and lump-sum payments during a subscription period, up to $12,000, are held in a separate bank account maintained by us until the shares purchased under the plan are issued to the eligible agency. At the end of each subscription period, the amount credited to each eligible agency's plan account will be divided by the subscription price for the subscription period, and the eligible agency's plan account will

be credited with the number of whole shares that results. Any amount remaining in the plan account will be carried forward to the next subscription period without reducing the $12,000 limitation applicable to that subscription period or, if requested by the eligible agency, returned to the eligible agency. If the number of shares subscribed for during any subscription period exceeds the number of shares available for sale under the plan, the remaining available shares will be allocated among the participating eligible agencies in proportion to their total plan account balances, without regard to any amount carried forward from a previous subscription period.

SHARES; CERTIFICATES FOR SHARES

21. May an eligible agency transfer, pledge, hypothecate or assign shares credited to the agency's plan account?

An eligible agency may not transfer, pledge, hypothecate or assign its subscription rights under the plan or shares credited to its plan account, except for permitted designations as described in Question and Answer 23.

22. Are stock certificates issued for shares of Class A common stock purchased?

We will issue and deliver to each eligible agency stock certificates for the shares it has purchased under the plan within a reasonable time after purchase, but in no event later than two weeks after the end of the subscription period during which the shares were purchased.

23. In whose name are accounts maintained and certificates registered when issued?

Accounts in the plan will be maintained in the name of the eligible agency. Consequently, certificates when issued for full shares will be registered in the same name. An eligible agency may, upon written request to us, (a) designate that shares be issued to a shareholder, partner, other principal or other licensed employee of an eligible agency or (b) designate that any retirement plan maintained by or for the benefit of an eligible agency or a shareholder, partner, other principal or other licensed employee of the eligible agency may

purchase shares instead of the eligible agency through lump-sum payments made by the designee. These permitted designations are subject to the maximum amount limitation of $12,000, compliance with all laws that apply, including the Employee Retirement Income Security Act of 1974, payment by the eligible agency or its designee of any required transfer taxes and satisfaction of our usual requirements for recognition of a transfer of our Class A common stock.

WITHDRAWAL FROM THE PLAN

24. How and when may an eligible agency withdraw from the plan?

An enrolled eligible agency may withdraw from the plan at any time by notifying us in writing, signed on behalf of the eligible agency by an authorized representative. We will treat a termination of agency status for any reason as an automatic withdrawal. If an agency withdraws from the plan, that agency may not resubscribe until after the next full subscription period has elapsed, and then only if we have redesignated the agency an eligible agency.

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25. What happens to any shares held in and amounts credited to an eligible agency's plan account at the time of withdrawal?

Promptly after the time of withdrawal or termination of an agency's eligibility, but in no event later than two weeks after the end of the subscription period during which the withdrawal or termination occurred, we will issue certificates representing the whole shares held under the plan in the name of the agency, and will refund any amount credited to an eligible agency's plan account at the time of withdrawal to the participant in cash without interest.

OTHER INFORMATION

26. What happens if Donegal Group declares a stock split or stock dividend or changes or exchanges its Class A common stock for shares of stock or other securities of its own or another corporation?

Our committee will make appropriate adjustments in the total number and kind of shares that are reserved for sale under the plan if our outstanding shares of Class A common stock are increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of Donegal Group, or of another corporation, by reason of reorganization, merger, consolidation, recapitalization, reclassification, stock split-up, stock dividend (either in shares of our Class A common stock or of another class of our stock), spin-off or combination of shares.

27. What are the federal income tax consequences of an eligible agency's participation in the plan?

At the time of purchase, and where an eligible agency purchases shares of Class A common stock in its own name, the eligible agency will be treated as having received ordinary income in an amount equal to the difference between the subscription price paid and the then fair market value of the Class A common stock acquired. At the end of each calendar year, we will mail to each participating agency a Form 1099 reflecting the amount of ordinary income earned under the plan. We will be entitled to a tax deduction at the same time in a corresponding amount. The participating agency's basis in the Class A common stock purchased under the plan will be equal to the purchase price plus the amount of ordinary income recognized.

When an agency disposes of shares of Class A common stock purchased under the plan, any amount received in excess of the value of the shares of Class A common stock on which the agency was previously taxed will be treated as a long-term or short-term capital gain, depending upon the holding period of the shares. If the amount received is less than that value, the loss will be treated as a long-term or short-term capital loss, depending upon the holding period of the shares (which begins on the day after each share is acquired).

You are strongly advised to consult with a tax advisor to determine the tax consequences of a given transaction, particularly if a taxpayer other than you has been designated by you to become a participant in the plan.

28. May the plan be changed or discontinued?

Yes. Our board of directors has the right to amend, modify or terminate the plan at any time without notice if your existing rights are not adversely affected as a result of the amendment, modification or termination.

29. How may eligible agencies sell shares of Class A common stock purchased under the plan?

As discussed in Question and Answer 22, we will issue and deliver to eligible agencies the stock certificates for the shares purchased under the plan after the end of the subscription period during which the shares were purchased. Participants will have the sole discretion as to whether or when to sell their shares and may transfer or dispose of them at any time without restriction after receipt of their stock certificates. An agency may choose to sell shares through the broker of his or her choice.

DESCRIPTION OF CAPITAL STOCK

GENERAL

Our authorized Class A Common stock consists of 30,000,000 shares. As of October 31, 2001, 5,992,602 shares of our Class A common stock were issued and outstanding. We also have authorized 10,000,000 shares of Class B common stock, of which 2,980,537 shares were issued and outstanding on October 31, 2001, and 2,000,000 shares of preferred stock issuable from time to time in separate series upon resolution of our board of directors, none of which are outstanding. Except as otherwise required by the Delaware General Corporation Law, known as the DGCL, or as otherwise provided in our certificate of incorporation with respect to dividends and voting rights, each share of Class A common stock and each share of Class B common stock have identical powers, preferences and limitations.

Our certificate of incorporation provides that the holders of shares of Class A common stock are entitled to one-tenth of one vote per share held on any matter to be voted on by our stockholders, while the holders of shares of Class B common stock are entitled to one vote per share. Except as otherwise required under the DGCL or our certificate of incorporation, the holders of Class A common stock and the holders of Class B common stock vote together as a single class on all matters presented to our stockholders for a vote.

At any election of directors, the nominees receiving the highest number of votes cast by the holders of the Class A common stock and the Class B common stock for the number of directors to be elected will be elected as directors.

Under the DGCL and our certificate of incorporation, the affirmative vote of the holders of a majority of the Class A common stock and the Class B common stock, voting as a single class, is sufficient to amend our certificate of incorporation, to authorize additional shares of capital stock of any class, to approve any merger or consolidation of us with or into any other entity or the sale of all or substantially all of our assets or to approve our dissolution.

Under the DGCL, the holders of shares of Class A common stock are entitled to vote as a separate class on any proposal to change the par value of the Class A common stock or to alter or change the rights, preferences and limitations of the Class A common stock in a way that would affect the holders of shares of Class A common stock adversely. Similarly, the holders of shares of Class B common stock are entitled to vote as a separate class on any proposal to change the par value of the Class B common stock or to alter or change the rights, preferences and limitations of the Class B common stock in a way that would affect the holders of shares of Class B common stock adversely. In addition, under the DGCL, the number of authorized shares of Class A common stock or Class B common stock may be increased or decreased, but not below the number of shares then outstanding, by the affirmative vote of the holders of a majority of the respective class of common stock voting as a separate class.

Our certificate of incorporation provides that each share of Class A common stock outstanding at the time of the declaration of any cash dividend or other distribution payable upon the shares of Class B common stock is entitled to a cash 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 cash dividend declared upon each share of Class B common stock. Each share of Class A common stock and Class B common stock is equal in respect to dividends or other distributions payable in shares of capital stock except that the dividends or distributions may be made (1) in shares of Class A common stock to the holders of Class A common stock and in shares of Class B common stock to the holders of Class B common stock, (2) in shares of Class A common stock to the holders of Class A common stock and to the holders of Class B common stock or (3) in any other authorized class or series of capital stock to the holders of Class A common stock and to the holders of Class B common stock.

There are no redemption or sinking fund provisions applicable to the Class A common stock or to the Class B common stock. All the shares of Class A common stock offered by us pursuant to this prospectus, when issued and paid for, will be fully paid and non-assessable.

Each holder of Class A common stock and each holder of Class B common stock is entitled to receive the same per share consideration in a merger or consolidation of us into another entity except that, if the consideration paid to our stockholders consists in whole or in part of shares of another entity, the shares of the other entity issued to the holders of our Class B common stock may have greater voting rights than the shares of the other entity issued to the holders of our Class A common stock.

Neither the Class A common stock nor the Class B common stock is convertible into another class of common stock or any other security of Donegal Group.

The transfer agent and registrar for our Class A common stock is EquiServe.

CERTAIN CHARTER AND BY-LAW PROVISIONS; DELAWARE ANTI-TAKEOVER PROVISIONS

Our certificate of incorporation, by-laws and the DGCL contain certain provisions that may enhance the likelihood of continuity and stability in the composition of our board of directors and may discourage a future unsolicited takeover of Donegal Group. These provisions could have the effect of discouraging certain attempts to acquire us or remove current management, including current members of our board of directors, even if some of our stockholders deemed these attempts to be in their best interests.

Our certificate of incorporation authorizes us to issue two classes of common stock, Class A common stock and Class B common stock. The holders of the Class A common stock are entitled to one-tenth of one vote per share, while the holders of the Class B common stock are entitled to one vote per share, on all matters submitted to a vote of our stockholders. In addition, our certificate of incorporation does not grant any holder of our stock the right to cumulate votes in the election of directors. The Mutual Company currently owns approximately 62.2% of our Class A common stock and 62.2% of our Class B common stock and has effective voting control over us. This ownership by the Mutual Company could avert or prevent a change in control of us unless the Mutual Company, after consideration of all relevant factors including the interests of our stockholders other than the Mutual Company, is in favor of such a change.

Our board of directors, without stockholder approval, has the authority to issue preferred stock with voting and conversion rights that could adversely affect the voting power of the Class A common stock. The issuance of preferred stock could have the effect of delaying, averting or preventing a change in control of us. No preferred stock has been issued, and our board of directors does not intend to issue any preferred stock at the present time.

Our by-laws provide for a classified board of directors consisting of three classes as nearly equal in size as possible. The classification of our board of directors could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring, control of us.

We are a Delaware corporation that is subject to certain anti-takeover provisions of the DGCL. The business combination provisions contained in Section 203 of the DGCL defines an interested stockholder of a corporation as any person that (1) owns, directly or indirectly, or has the right to acquire, 15% or more of the outstanding voting stock of the corporation or (2) is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock of the corporation at any time within the three-year period immediately prior to the date on which it is sought to be determined whether the person is an interested stockholder; and the affiliates and the associates of the person. Under Section 203, a Delaware corporation may not engage in any business combination with any interested stockholder for a period of three years following the date the stockholder became an interested stockholder, unless (1) prior to that date the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder, (2) upon consummation of the transaction which resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced (excluding, for determining the number of shares outstanding, (a) shares owned by persons who are directors and officers and (b) employee stock plans, in certain instances) or (3) on or after that date the business combination is approved by the board of directors

and authorized at an annual or special meeting of stockholders by at least 66-2/3% of the outstanding voting stock that is not owned by the interested stockholder.

The restrictions imposed by Section 203 will not apply to a corporation if the corporation, by the action of its stockholders holding a majority of the outstanding stock, adopts an amendment to its certificate of incorporation or by-laws expressly electing not to be governed by Section 203. The amendment will not be effective until 12 months after adoption and will not apply to any business combination between the corporation and any person who became an interested stockholder of the corporation on or prior to the adoption of the amendment.

We have not elected to opt out of Section 203, and the restrictions imposed by Section 203 apply to us. Section 203 could, under certain circumstances, make it more difficult for a third party to gain control of us, deny stockholders the receipt of a premium on their Class A common stock and have a depressive effect on the market price of the Class A common stock.

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In addition, we are subject to Pennsylvania insurance laws and regulations that prohibit any person from acquiring a greater than 10% interest in us without the prior approval of the Insurance Commissioner of the Commonwealth of Pennsylvania. These provisions could make it more difficult for a third party to gain control of us, deny stockholders the receipt of a premium on their Class A common stock and have a depressive effect on the market price of the Class A common stock.

LIMITATION OF LIABILITY; INDEMNIFICATION

As permitted by the DGCL, Article 6 of our certificate of incorporation provides that our directors will not be personally liable to us or our stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (1) for any breach of the director's duty of loyalty to us or our stockholders, (2) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (3) under Section 174 of the DGCL, relating to prohibited dividends, distributions and repurchases or redemptions of stock or (4) for any transaction from which the director derives an improper personal benefit.

Article 5 of our by-laws includes provisions for indemnification of our directors and officers to the fullest extent permitted by the DGCL as now in effect or as in effect at a later date. Insofar as indemnification for liabilities arising under the federal securities laws may be permitted to directors, officers and persons controlling us under these provisions, we have been informed that in the opinion of the SEC this indemnification is against public policy as expressed in federal securities laws and is unenforceable.

PLAN OF DISTRIBUTION

We have reserved 300,000 shares of Class A common stock for sale to eligible agencies under the plan for the five-year period ending March 31, 2007. We will offer the shares of Class A common stock under the plan directly to eligible agencies through our officers and will not use a broker or a dealer. In addition, we will not pay commissions, discounts or any other payments to any person for services in connection with the offer or sale of shares of Class A common stock under the plan. We will pay all costs of administering the plan. Participants will not incur brokerage commissions or service charges for the

purchase of shares under the plan.

USE OF PROCEEDS

No minimum amount of proceeds is required to be received by Donegal Group in this offering. Donegal Group will retain all proceeds from the sale of the shares of Class A common stock under the plan. We intend to use the proceeds from sales of these shares for general corporate purposes, including making investments in and advances to our subsidiaries.

EXPERTS

The consolidated financial statements and schedules of Donegal Group as of December 31, 2000 and 1999, and for each of the years in the three-year period ended December 31, 2000, have been included in this prospectus and in the registration statement in reliance upon the report of KPMG LLP, independent accountants, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing.

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LEGAL OPINION

The validity of the issuance of the shares of Class A common stock offered with this prospectus will be passed upon for us by Duane Morris LLP, Philadelphia, Pennsylvania. As of November 14, 2001, attorneys of Duane Morris LLP who have recently provided substantive legal services beneficially owned 10,052 shares of our outstanding Class A common stock, and 4,921 shares of our outstanding Class B common stock, of which 5,926 shares represent shares of Class A common stock purchasable under currently exercisable stock options and 2,963 shares represent shares of Class B common stock purchasable under currently exercisable stock options. In addition, Frederick W. Dreher, a partner of Duane Morris LLP, is a director of the Mutual Company and is one of its members on the coordinating committee. The Mutual Company is a holder of approximately 62.2% of our Class A common stock and 62.2% of our Class B common stock.

AVAILABLE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any reports, statements or other information we file at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room. Our filings with the SEC are also available to the public from commercial document retrieval services and at the worldwide web site maintained by the SEC at "http://www.sec.gov."

We filed with the SEC in Washington, D.C. a registration statement on Form S-2 under the Securities Act with respect to the securities covered by this prospectus. As permitted by the rules and regulations of the SEC, this prospectus does not contain all of the information set forth in the registration statement. For further information with respect to Donegal Group and the securities covered by this prospectus, reference is made to the registration statement, including the exhibits filed or incorporated in the registration statement. Statements contained in this prospectus concerning the provisions of documents filed with, or incorporated by reference in, the registration statement as exhibits are necessarily summaries of those documents and each statement is qualified in its entirety by reference to the copy of the

applicable documents filed with the SEC. Copies of the registration statement and its exhibits are on file at the offices of the SEC and may be obtained upon payment of the prescribed fee or may be examined without charge at the public reference room of the SEC described above or at the worldwide web site maintained by the SEC described above.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

We incorporate the following documents in this prospectus by reference:

(a) Our Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the SEC on March 29, 2001;

(b) Our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2001, June 30, 2001 and September 30, 2001, as filed with the SEC on May 14, 2001, August 14, 2001 and November 15, 2001, respectively;

(c) Our 2000 Annual Report to Stockholders (only those portions consisting of the following are incorporated by reference in this Registration Statement: (i) the description of the business of Donegal Group included as part of the Management's Discussion and Analysis of Results of Operation and Financial Condition on page 10 thereof; (ii) the consolidated financial statements, notes thereto and independent auditors' report thereon on pages 13 through 28 thereof; (iii) the information set forth under "Market Information" on the inside back cover thereof; (iv) the selected financial data set forth under "Financial Highlights" on the inside front cover thereof; and (iv) the "Management's Discussion and Analysis of Results of Operations and Financial Condition" on pages 10 through 12 thereof) included as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the SEC on March 29, 2001. The remaining portions of the 2000 Annual Report to Stockholders are not incorporated by reference, consisting of pages 1, 2, 3, 4, 5, 6, 7, 8, 29 and 30, inclusive, the information on the inside back cover other than the information under "Market Information" and the front and back outside cover pages of the 2000 Annual Report to Stockholders, and are not part of this registration statement.

Any statement incorporated in this prospectus shall be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained in this prospectus or in any other subsequently filed document which also is or is deemed to be incorporated by reference in this prospectus modifies or supersedes such statement and any statement contained in this prospectus shall be deemed to be modified or superseded for all purposes to the extent that a statement contained in any subsequently filed document that is deemed to be incorporated by reference modifies or supersedes such statement.

All documents filed by us pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and prior to the filing of a post-effective amendment that indicates that all securities offered have been sold or that deregisters all securities then remaining unsold, shall be deemed to be incorporated by reference in this prospectus and to be a part hereof from the date of filing of such documents.

We will provide without charge to each person, including any beneficial owner, to whom this prospectus is delivered, on request, a copy of any or all documents incorporated by reference in this prospectus, other than exhibits to those documents unless the exhibits are specifically incorporated by reference. Requests should be directed to:

Ralph G. Spontak
Senior Vice President and Chief Financial Officer
Donegal Group Inc.
1195 River Road
Marietta, PA 17547
(888) 877-0600

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SELECTED CONSOLIDATED FINANCIAL DATA

	Nine Months Ended (Unaudited)		Year Ended Dece	
	9/30/01	9/30/00	2000	1999
INCOME STATEMENT DATA:				
Premiums earned	$124,291,595	$111,684,838	$151,646,199	$145,517,4
Investment income, net	11,988,347	12,009,023	16,394,747	13,590,6
Realized investment gains (losses)	(448,462)	442,927	170,852	(38,7
Total revenues	137,654,981	125,919,756	170,581,587	161,739,3
Income before income taxes	8,768,865	8,318,883	11,743,028	3,844,6
Income taxes (benefit)	2,093,579	2,086,727	2,906,248	(2,950,5
Net income	6,675,286	6,232,156	8,836,780	6,795,1
Basic earnings per share	0.75	0.72	1.01	0.
Diluted earnings per share	0.74	0.72	1.01	0.
Cash dividends per share of common stock	--	0.18	0.36	0.
Cash dividends per share of Class A common stock	0.20	--	--	
Cash dividends per share of Class B common stock	0.18	--	--	
BALANCE SHEET DATA:				
Total investments	$304,531,291	$284,214,690	$289,344,642	$268,010,8
Total assets	461,645,296	420,825,850	426,008,780	389,688,8
Debt obligations	28,200,000	40,000,000	40,000,000	37,000,0
Stockholders' equity	124,072,961	111,369,391	114,129,591	103,792,3
Stockholders' equity per share	13.83	12.65	12.88	12.

	Year Ended December 31,	
	1997	1996
INCOME STATEMENT DATA:		

Premiums earned	$108,817,880	$107,223,496
Investment income, net	11,849,538	11,154,109
Realized investment gains (losses)	311,155	170,127
Total revenues	123,199,214	120,665,132
Income before income taxes	13,924,355	10,123,045
Income taxes (benefit)	3,681,070	2,178,854
Net income	10,243,285	7,944,191
Basic earnings per share	1.28	1.02
Diluted earnings per share	1.27	1.01
Cash dividends per share of common stock	0.29	0.25
Cash dividends per share of Class A common stock	--	--
Cash dividends per share of Class B common stock	--	--
BALANCE SHEET DATA:		
Total investments	$209,968,608	$197,400,467
Total assets	296,695,369	281,435,890
Debt obligations	10,500,000	8,500,000
Stockholders' equity	89,768,653	78,827,107
Stockholders' equity per share	11.16	9.92

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

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

Donegal Group is a regional insurance holding company doing business in the Mid-Atlantic and Southern states through its five wholly owned property-casualty insurance subsidiaries, Atlantic States Insurance Company, known as Atlantic States, Southern Insurance Company of Virginia, known as Southern, Southern Heritage Insurance Company, known as Southern Heritage, Delaware Atlantic Insurance Company, known as Delaware, Pioneer Insurance Company of New York, known as Pioneer-New York, and Pioneer Insurance Company of Ohio, known as Pioneer-Ohio, collectively known as the Insurance Subsidiaries. Donegal Group has three operating segments: the investment function, the personal lines of insurance and the commercial lines of insurance. Products offered in the personal lines of insurance consist primarily of homeowners and private passenger automobile policies. Products offered in the commercial lines of insurance consist primarily of commercial automobile, commercial multiple peril and workers' compensation policies. The Insurance Subsidiaries are subject to regulation by insurance departments in those states in which they operate and undergo periodic examination by those departments. The Insurance Subsidiaries are also subject to competition from other insurance carriers in their operating areas. Donegal Group was formed in September 1986 by the Mutual Company, which owns 62% of the outstanding common shares of Donegal Group as of December 31, 2000.

Atlantic States participates in an intercompany pooling arrangement with the Mutual Company and assumes 70% of the pooled business (65% prior to July 1,

2000). Southern cedes 50% of its business to the Mutual Company, and prior to January 1, 2000, Delaware ceded 70% of its workers' compensation business to the Mutual Company. Because the Mutual Company places substantially all of the business assumed from Southern into the pool, from which Donegal Group has a 70% allocation, Donegal Group's results of operations include approximately 85% of the business written by Southern.

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

In addition to the Insurance Subsidiaries, Donegal Group also owned all of the outstanding stock of Atlantic Insurance Services, Inc., known as AIS, an insurance services organization, which provided inspection and policy auditing information on a fee-for-service basis to its affiliates and the insurance industry. Donegal Group sold all of the outstanding shares of AIS on October 1, 1999.

During 2000, Donegal Group acquired 45% of the outstanding stock of Donegal Financial Services Corporation, known as DFSC, a bank holding company. The remaining 55% of the outstanding stock of DFSC is owned by the Mutual Company.

Effective January 1, 2001, Donegal Group purchased all of the outstanding shares of Pioneer-New York from the Mutual Company, which previously owned 100% of Pioneer-New York. The acquisition had been accounted for as a reorganization of entities under common control, similar to a pooling of interests, as both Pioneer-New York and Donegal Group are under common management and control of the Mutual Company. As such, all financial data prior to January 1, 2001 has been restated to include the results of operation, financial position and cash flows of Pioneer-New York.

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RESULTS OF OPERATIONS - NINE MONTHS ENDED SEPTEMBER 30, 2001
TO NINE MONTHS ENDED SEPTEMBER 30, 2000

Revenues for the nine months ended September 30, 2001 were $137,654,981, an increase of $11,735,225, or 9.3%, over the same period of 2000. An increase in premiums earned of $12,606,757, or 11.3%, offset by a realized loss of $448,462 compared to a realized gain of $442,927 for the first nine months of 2000 accounted for most of the change. Premiums earned were affected by an increase from 65% to 70% in Atlantic States' share of the pooled business of itself and the Mutual Company, which was effective July 1, 2000. This change accounted for $4,273,297, or 3.8 percentage points of the earned premium increase, with the remaining increase coming from normal growth and rate increases. A decrease in the annualized average return on investments from 5.8% for the first nine months of 2000 to 5.3% for the first nine months of 2001 was offset by an increase in average invested assets of approximately $21,000,000. The realized loss in the first nine months of 2001 and 2000 included $1,067,970 and $285,228 in losses, which resulted from declines in the market value of securities that were determined to be other than temporary.

The GAAP combined ratio of insurance operations in the nine months ended September 30, 2001 was 101.1% compared to 102.4% for the same period in 2000. The GAAP combined ratio is the sum of the ratios of incurred losses and loss adjusting expenses to premiums earned (loss ratio), policyholders dividends to premiums earned (dividend ratio) and underwriting expenses to premiums earned (expense ratio). Donegal Group's loss ratio in the first nine months of 2001 was

67.7% compared to 69.5% for the same period of 2000. Donegal Group's expense ratio for the first nine months of 2001 was 32.4% compared to 32.1% for the first nine months of 2000. The dividend ratio remained virtually unchanged at 1.0% for the first nine months of 2001 compared to 0.9% for the first nine months of 2000.

Federal income taxes for the nine months ended September 30, 2001 represented 23.9% of the income before income taxes compared to a 25.1% for the same period of 2000. These rates vary from the expected rate of 34% primarily due to the effect of tax-exempt investment income.

RESULTS OF OPERATIONS - THREE MONTHS ENDED SEPTEMBER 30, 2001
TO THREE MONTHS ENDED SEPTEMBER 30, 2000

Revenues for the three months ended September 30, 2001 were $46,365,986, an increase of $2,136,926, or 4.8%, over the same period of 2000. An increase in premiums earned of $3,449,697, or 8.8%, offset by a decrease in investment income of $417,444, or 10.1%, along with realized losses of $562,301 compared to realized gains of $333,720 in the third quarter of 2000 accounted for most of this change. A decrease in the annualized average return on investments from 5.9% in the third quarter of 2000 to 5.1% in the third quarter of 2001 offset by an increase in average invested assets from $278,200,000 in the third quarter of 2000 to $290,500,000 in the third quarter of 2001, accounted for most of the investment income change. The realized loss in the third quarter of 2001 included $604,235 in losses, which resulted from declines in the market value of securities that were determined to be other than temporary. The realized gain in the third quarter of 2000 resulted from the normal turnover of Donegal Group's portfolio.

The GAAP combined ratio of insurance operations in the third quarter of 2001 was 104.3% compared to 101.3% for the same period in 2000. Donegal Group's loss ratio in the third quarter of 2001 was 70.5% compared to 68.4% for the same period of 2000. Weather-related claims of approximately $250,000 from one storm in August, 2001, an increase in the severity of claims and a worsening loss ratio in Donegal Group's commercial automobile line of business accounted for most of the increase in the loss ratio. The expense ratio for the third quarter of 2001 was 32.7% compared to 31.9% for the third quarter of 2000. The change in the expense ratio resulted primarily from expenses related to a travel production incentive for agents in 2001, which added 0.7% to the expense ratio compared to the third quarter of 2000. The dividend ratio increased slightly to 1.1% for the third quarter of 2001 compared to 0.9% for the same period of 2000.

Federal income taxes for the three months ended September 30, 2001 represented 9.2% of the income before income taxes compared to a 25.9% for the same period of 2000 due to tax exempt interest representing a much larger percentage of pretax income in the third quarter of 2001. These rates vary from the expected rate of 34% primarily due to the effect of tax-exempt investment income.

RESULTS OF OPERATIONS - SIX MONTHS ENDED JUNE 30, 2001
TO SIX MONTHS ENDED JUNE 30, 2000

Revenues for the six months ended June 30, 2001 were $91,288,995, an increase of $9,598,299, or 11.7%, over the same period of 2000. An increase in net premiums earned of $9,157,060, or 12.6%, represented most of this change.

Net premiums written of the Insurance Subsidiaries increased 15.6% in the first half of 2001 compared to the first half of 2000. An increase in Atlantic States' share of the pooled business of itself and the Mutual Company from 65% to 70%, effective July 1, 2000, accounted for 6.1 percentage points of the 15.6 percentage point increase in the premiums written. Investment income for the first six months of 2001 increased $396,768, or 5.0%. An increase in the annualized average return on investments from 5.8% in the first six months of 2000 to 5.9% in the first six months of 2001 and an increase in average invested assets from $270,400,000 in the first six months of 2000 to $282,900,000 in the first six months of 2001 accounted for the change. Realized investment gains were $113,839 in the first six months of 2001 compared to a gain of $109,207 for the same period of 2000. The realized gains in 2000 and 2001 were net of losses of $285,228 and $463,735, respectively, in losses, which resulted from changes in the market value of securities that were determined to be other than temporary.

The GAAP combined ratio of insurance operations in the first six months of 2001 was 99.4% compared to 103.0% for the same period in 2000. Donegal Group's loss ratio in the first six months of 2001 was 66.2% compared to 70.0% in the first six months of 2000. Donegal Group's expense ratio for the first six months of 2001 was 32.3% compared to 32.2% for the first six months of 2000. The dividend ratio increased slightly from 0.8% for the first six months of 2000 to 0.9% for the first six months of 2001.

Federal income taxes for the six months ended June 30, 2001 represented 26.0% of the income before income taxes compared to 24.5% for the same period of 2000. These rates vary from the expected rate of 34% primarily due to the effect of tax-exempt investment income.

RESULTS OF OPERATIONS - THREE MONTHS ENDED JUNE 30, 2001
TO THREE MONTHS ENDED JUNE 30, 2000

Revenues for the three months ended June 30, 2001 were $46,496,969, an increase of $5,163,606, or 12.5%, over the same period of 2000. An increase in net premiums earned of $5,204,856, or 14.3%, represented most of this change. Net premiums written of the Insurance Subsidiaries increased 17.7% in the second quarter of 2001 compared to the second quarter of 2000. An increase in Atlantic States' share of the pooled business of itself and the Mutual Company from 65% to 70%, effective July 1, 2000, accounted for 6.2 percentage points of the 17.7 percentage point increase in the premiums written. The remaining portion of the increase was primarily due to rate increases. Investment income for the second quarter of 2001 increased $335,651, or 8.6%. An increase in the annualized average return on investments from 5.8% in the second quarter of 2000 to 6.0% in the second quarter of 2001 and an increase in average invested assets from $269,700,000 in the second quarter of 2000 to $281,900,000 in the second quarter of 2001 accounted for the change. Realized investment losses were $6,968 in the second quarter of 2001 compared to a gain of $391,117 for the same period of 2000. The realized loss in 2001 included $463,735 in losses, which resulted from changes in the market value of securities that were determined to be other than temporary. The realized gains in 2000 resulted from the normal turnover of Donegal Group's portfolio.

The GAAP combined ratio of insurance operations in the second quarter of 2001 was 99.9% compared to 101.4% for the same period in 2000. Donegal Group's loss ratio in the second quarter of 2001 was 67.1% compared to 68.1% in the second quarter of 2000. Donegal Group's expense ratio for the second quarter of 2001 was 32.1% compared to 32.7% for the second quarter of 2000. The dividend

ratio increased from 0.6% in the second quarter of 2000 to 0.8% in the second quarter of 2001.

Federal income taxes for the second quarter of 2001 represented 25.6% of the income before income taxes compared to 24.6% for the same period of 2000. These rates vary from the expected rate of 34% primarily due to the effect of tax-exempt investment income.

RESULTS OF OPERATIONS - THREE MONTHS ENDED MARCH 31, 2001
TO THREE MONTHS ENDED MARCH 31, 2000

Revenues for the three months ended March 31, 2001 were $44,792,026, an increase of $4,434,693, or 11.0%, over the same period of 2000. An increase in net premiums earned of $3,952,204, or 11.0%, represented most of this change. Net premiums written of the Insurance Subsidiaries increased 13.1% in the first quarter of 2001 compared to the first quarter of 2000. An increase in Atlantic States' share of the pooled business of itself and the Mutual Company from 65% to 70%, effective July 1, 2000, accounted for 6 percentage points of the 13.1 percentage point increase in the premiums written. Investment income for the first three months of 2001 increased $61,117, or 1.5%. A decrease in the annualized average return on investments from 6.0% in the first three months of 2000 to 5.6% in the first three months of 2001 offset by an increase in average invested assets from $267,300,000 in the first three months of 2000 to $288,300,000 in the first three months of 2001 accounted for the change. Realized investment gains were $120,807 in the first three months of 2001 compared to a loss of $281,910 for the same period of 2000. The realized losses in 2000 included $285,228 in losses, which resulted from changes in the market value of two securities that were determined to be other than temporary. The realized gains in 2001 resulted from the normal turnover of Donegal Group's portfolio.

The GAAP combined ratio of insurance operations in the first three months of 2001 was 98.8% compared to 104.6% for the same period in 2000.

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Donegal Group's loss ratio in the first three months of 2001 was 65.3% compared to 71.9% in the first three months of 2000. Donegal Group's expense ratio for the first three months of 2001 was 32.5% compared to 31.7% for the first three months of 2000. The change in the expense ratio resulted primarily from increases in incentive costs related to the improved combined ratio. The dividend ratio remained unchanged at 1.0%.

Federal income taxes for the three months ended March 31, 2001 represented 26.5% of the income before income taxes compared to 24.1% for the same period of 2000. These rates vary from the expected rate of 34% primarily due to the effect of tax-exempt investment income.

RESULTS OF OPERATIONS - YEAR ENDED DECEMBER 31, 2000
TO YEAR ENDED DECEMBER 31, 1999

Total revenues for 2000 were $170,581,587, which were $8,842,251, or 5.5%, greater than 1999. Net premiums earned increased to $151,646,199, an increase of $6,128,742, or 4.2%, over 1999. The change in Atlantic States' share of the pooling arrangement with the Mutual Company from 65% to 70%, effective July 1, 2000, accounted for $4,113,078 of the increase in net premiums earned. Direct premiums written of the combined pool of Atlantic States and the Mutual Company increased $13,851,692 or 9.0%. A 5.1% increase in the direct premiums written of

Southern, a 2.1% decrease in the direct premiums written of Delaware, a 13.2% increase in the direct premiums written of Pioneer-New York, a 25.4% increase in the direct premiums written of Pioneer-Ohio and a 15.6% decrease in the direct premiums written of Southern Heritage accounted for the majority of the remaining change. Donegal Group reported net realized investment gains of $170,852, compared to net realized investment losses of $38,702 in 1999. During 2000 certain investments trading below cost had declined on an other-than-temporary basis. Losses of $436,943 were included in net realized investment gains for these investments in 2000. Net realized gains and losses in 1999 resulted from normal turnover of Donegal Group's investment portfolio. As of December 31, 2000, 100.0% of Donegal Group's bond portfolio was classified as Class 1 (highest quality) by the National Association of Insurance Commissioners' Securities Valuation Office. Investment income increased $2,804,052 in 2000. An increase in the average invested assets from $264,758,816 to $278,677,748 and an increase in the average yield to 5.9% from 5.1% in 1999 accounted for the change.

The GAAP combined ratio of insurance operations was 101.8% in 2000 compared to 106.5% in 1999. The loss ratio in 2000 and 1999 was 68.8%. The commercial lines loss ratio decreased from 68.8% in 1999 to 66.9% in 2000. The personal lines loss ratio increased from 69.7% in 1999 to 70.3% in 2000. The expense ratio for 2000 was 32.1% compared to 36.8% in 1999, with the dividend ratio remaining unchanged at 0.9%. The expense ratio in 1999 was adversely affected by a charge to earnings resulting from a restructuring charge of $2,000,000, which increased the expense ratio by 1.4%.

Income tax expense (benefit) was $2,906,248 compared to $(2,950,556) in 1999. As discussed below, Donegal Group benefited from a federal income tax law change in 1999.

RESULTS OF OPERATIONS - YEAR ENDED DECEMBER 31, 1999
TO YEAR ENDED DECEMBER 31, 1998

Total revenues for 1999 were $161,739,336, which were $29,507,020, or 22.3%, greater than 1998. Net premiums earned increased to $145,517,457, an increase of $28,063,263, or 23.9%, over 1998. The acquisition of Southern Heritage accounted for $19,674,071, or 71% of the increase in earned premiums in 1999. Direct premiums written of the combined pool of Atlantic States and the Mutual Company increased $9,516,654 or 6.6%. A 9.4% increase in the direct premiums written of Southern, a 4.9% increase in the direct premiums written of Delaware, a 28.8% increase in the direct premiums written of Pioneer-New York and a 13.9% increase in the direct premiums written of Pioneer-Ohio accounted for the majority of the remaining change. Donegal Group reported net realized investment losses of $38,702 compared to net realized investment losses of $13,562 in 1998. Net realized losses in both years resulted from normal turnover of Donegal Group's investment portfolio. As of December 31, 1999, 99.9% of Donegal Group's bond portfolio was classified as Class 1 (highest quality) by the National Association of Insurance Commissioners' Securities Valuation Office. Investment income increased $1,246,902. An increase in the average invested assets from $235,737,693 to $264,758,816, offset by a decrease in the average yield to 5.1% from 5.2% in 1998, accounted for the change.

The GAAP combined ratio of insurance operations was 106.5% in 1999, compared to 100.1% in 1998. The loss ratio in 1999 was 68.8% compared to 62.8% in 1998. The increase in the loss ratio in 1999 resulted from a deterioration in operating results in both the commercial and personal lines segments of Donegal

Group. The commercial lines loss ratio increased from 54.9% in 1998 to 68.8% in 1999, with results in workers' compensation suffering the largest increase, from 46.9% in 1998 to 68.8%, in 1999. Homeowners results suffered the largest increase in personal lines as the loss ratio increased from 71.3% in 1998 to 76.0% in 1999. This increase was somewhat offset by a decrease in the private passenger automobile loss ratio from 70.9% in 1998 to 69.3% in 1999. The expense ratio for 1999 was 36.8% compared to 35.9% in 1998, with the dividend ratio decreasing from 1.4% in 1998 to 0.9% in 1999. The expense ratio was adversely affected by a charge to earnings resulting from a restructuring charge of $2,000,000 which increased the expense ratio by 1.4%. The dividend ratio decreased due to a higher loss ratio in workers' compensation in 1999 compared to 1998.

Donegal Group benefited from a federal income tax law change that was enacted during 1999, which allows net operating loss carryforwards of an acquired company to be used to offset future taxable income of other affiliated companies filing as part of a consolidated tax return. Prior law allowed such net operating loss carryforward to be used to offset taxable income of the acquired company only. Due to this law change, the net operating loss carryforward, obtained as part of the acquisition of Southern Heritage, may be used to offset taxable income generated by the other consolidated affiliates. Because of this change, management determined that a valuation allowance for Southern Heritage's net operating loss carryforward is no longer needed, and Donegal Group recognized a tax benefit of $3,004,524 in 1999.

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IMPACT OF NEW ACCOUNTING STANDARDS

ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Donegal Group has no derivative instruments or hedging activities as defined in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of SFAS No. 133," which statements became effective January 1, 2001. On January 1, 2001, Donegal Group transferred investments with an amortized cost of $51,640,154 and fair value of $52,444,675 from the held to maturity classification to the available for sale classification under the provisions of SFAS No. 133 and 138. The unrealized holding gain of $804,521 at January 1, 2001 will be reported in other comprehensive income. The transfer will not impact net income.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

INTEREST RATE RISK

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

Principal cash flows and related weighted-average interest rates by expected maturity dates for financial instruments sensitive to interest rates at December 31, 2001 are as follows:

	Principal Cash Flows	Weighted-Average Interest Rate
Fixed maturities and short-term investments:		
2001	$ 37,924,552	6.51%
2002	14,886,717	6.09%
2003	22,175,000	5.91%
2004	18,625,000	6.10%
2005	24,061,639	6.38%
Thereafter	158,397,081	6.18%
Total	$276,069,989	
Market value	$278,713,124	
Debt		
2001	$ 8,000,000	8.57%
2002	8,000,000	8.57%
2003	8,000,000	8.57%
2004	8,000,000	8.57%
2005	8,000,000	8.57%
Total	$ 40,000,000	
Fair Value	$ 40,000,000	

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

EQUITY PRICE RISK

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

The combined total of realized and unrealized equity investment gains and (losses) were $(650,229), $(394,931) and $(299,908) in 2000, 1999 and 1998, respectively. During these three years the largest total equity investment gain and (loss) in a quarter was $897,972 and $(1,395,103), respectively.

LIQUIDITY AND CAPITAL RESOURCES

Donegal Group generates sufficient funds from its operations and maintains a high degree of liquidity in its investment portfolio. The primary source of funds to meet the demands of claim settlements and operating expenses are premium collections, investment earnings and maturing investments. Donegal Group had no significant commitments for capital expenditures as of September 30, 2001.

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

As of September 30, 2001, pursuant to a credit agreement dated December 29, 1995 with Fleet National Bank of Connecticut, known as the Bank, Donegal Group had unsecured borrowings of $28,200,000. Per the terms of the credit agreement, Donegal Group may borrow up to $32,000,000 at interest rates equal to the Bank's then current prime rate or the then current London interbank Eurodollar bank rate plus 1.70%. At September 30, 2001, the interest rates on the outstanding balances were 5.28% on an outstanding eurodollar balance of $13,200,000 and 5.01% on an outstanding eurodollar rate balance of $15,000,000. In addition, Donegal Group pays a non-use fee at a rate of 3/10 of 1% per annum on the average daily unused portion of the Bank's commitment. On each July 27, the credit line is reduced by $8,000,000. Any outstanding loan in excess of the remaining credit line, after such reduction, will then be payable.

Donegal Group's principal source of cash with which to pay stockholder dividends is dividends from Atlantic States, Southern, Pioneer-Ohio, Pioneer-New York, Southern Heritage and Delaware, which are required by law to maintain certain minimum surplus on a statutory basis and are subject to regulations under which payment of dividends from statutory surplus is restricted and may require prior approval of their domiciliary insurance regulatory authorities. Atlantic States, Southern, Pioneer-Ohio, Pioneer-New York, Southern Heritage and Delaware are subject to Risk Based Capital or RBC requirements. At December 31, 2000, each of the six Insurance Subsidiaries' capital was substantially above the RBC requirements. At December 31, 2000, amounts available for distribution as dividends to Donegal Group without prior approval of the insurance regulatory authorities were $5,414,419 from Atlantic States, $908,259 from Southern, $581,132 from Pioneer-Ohio, $323,992 from Delaware, $973,796 from Southern Heritage and none from Pioneer-New York.

In June 2000, Delaware made a $3,800,000 dividend distribution to Donegal Group, which was approved by the Delaware Insurance Department.

CREDIT RISK

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

The Insurance Subsidiaries have reinsurance agreements in place with the Mutual Company and with a number of other major authorized reinsurers.

IMPACT OF INFLATION

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

LIABILITIES FOR LOSSES AND LOSS EXPENSES

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

Donegal Group maintains liabilities for the eventual payment of losses and loss expenses with respect to both reported and unreported claims. Liabilities for loss expenses are intended to cover the ultimate costs of settling all losses, including investigation and litigation costs from such losses. The amount of liability for reported losses is primarily based upon a case-by-case evaluation of the type of risk involved and knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss. The amount of liability for unreported claims and loss expenses is determined on the basis of historical information by line of insurance. Inflation is implicitly provided for in the reserving function through analysis of costs, trends and reviews of historical reserving results. Liabilities are closely monitored and are recomputed periodically by Donegal Group and the Mutual Company using new information on reported claims and a variety of statistical techniques. Liabilities for losses are not discounted.

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

Differences between liabilities reported in Donegal Group's financial statements prepared on a GAAP basis and financial statements prepared on a statutory accounting basis result from reducing statutory liabilities for anticipated salvage and subrogation recoveries. These differences amounted to $8,042,860, $7,736,942 and $7,963,559 at December 31, 2000, 1999 and 1998,

respectively.

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

	Year End	
	2000	1
		(in th
Net liability for unpaid losses and loss expenses at beginning of year	$ 99,234	$96
Net liabilities of acquired company	-	
Net beginning balance as adjusted	99,234	96
Provision for net losses and loss expenses for claims incurred in the current year	103,671	100
Increase (Decrease) in provision for estimated net losses and loss expenses for claims incurred in prior years	712	
Total incurred	104,383	100
Net losses and loss payments for claims incurred during:		
The current year	61,848	59
Prior years	39,060	37
Total paid	100,908	96
Net liability for unpaid losses and loss expenses at end of year	$102,709	$99

The following table sets forth the development of the liability for net unpaid losses and loss expenses for Donegal Group on a GAAP basis from 1990 to 2000, with supplemental loss data for 2000 and 1999.

"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 is increased or decreased as payments are made and more information becomes known about the severity of the remaining

unpaid claims. For example, the 1991 liability has developed an excess after nine years, in that reestimated net losses and loss expenses are expected to be $4,700,000 less than the estimated liability initially established in 1991 of $36,200,000.

The "Cumulative (excess) deficiency" shows the cumulative (excess) deficiency at December 31, 2000 of the liability estimate shown on the top line of the corresponding column. An excess in liability means that the liability established in prior years exceeded actual net losses and loss expenses or were reevaluated at less than the original amount. A deficiency in liability means that the liability established in prior years was less than actual net losses and loss expenses or were reevaluated at more than the original amount.

The "Cumulative amount of liability paid through" portion of the table shows the cumulative net losses and loss expense payments made in succeeding years for net losses incurred prior to the balance sheet date. For example, the 1991 column indicates that as of December 31, 2000 payments equal to $31,600,000 of the currently reestimated ultimate liability for net losses and loss expenses of $31,500,000 had been made.

	Year Ended December 31					
	1990	1991	1992	1993	1994	
				(in thousands)		
Net liability at end of year for unpaid losses and loss expenses.............	$31,898	$36,194	$44,339	$52,790	$63,317	$
Net liability reestimated as of:...........						
One year later...............	32,923	37,514	45,408	50,583	60,227	
Two years later..............	33,550	37,765	42,752	48,132	56,656	
Three years later............	32,803	35,446	40,693	44,956	54,571	
Four years later.............	31,004	33,931	38,375	42,157	51,825	
Five years later.............	30,041	32,907	37,096	41,050	50,493	
Six years later..............	29,595	32,234	36,682	40,572	49,593	
Seven years later............	29,417	31,976	36,730	39,991		
Eight years later............	29,175	31,685	36,437			
Nine years later.............	29,058	31,543				
Ten years later..............	29,000					
Cumulative (excess) deficiency.	$(2,898)	$(4,651)	$(7,902)	$(12,799)	$(13,724)	$(
	========	========	========	=========	=========	==
Cumulative amount of liability paid through:						
One year later...............	$13,003	$13,519	$16,579	$16,126	$19,401	$
Two years later..............	19,795	20,942	24,546	25,393	30,354	
Three years later............	24,178	25,308	29,385	32,079	38,684	
Four years later.............	26,413	27,826	32,925	36,726	43,655	
Five years later.............	27,439	29,605	34,757	39,122	46,331	
Six years later..............	28,157	30,719	35,739	40,440	47,802	
Seven years later............	28,627	31,173	36,518	40,903		

Eight years later...........	28,841	31,412	36,809
Nine years later............	28,948	31,585	
Ten years later.............	29,046		

	1997	1998	1999	2000
Net liability at end of year for unpaid losses and loss expenses............	$80,256	$96,015	$99,234	$102,709
Net liability reestimated as of:...........				
One year later..............	77,459	95,556	100,076	
Two years later.............	76,613	95,315		
Three years later...........	74,851			
Four years later............				
Five years later............				
Six years later.............				
Seven years later...........				
Eight years later...........				
Nine years later............				
Ten years later.............				
Cumulative (excess) deficiency.	$(5,405)	$(700)	$842	
	========	======	====	
Cumulative amount of liability paid through:				
One year later..............	$27,803	$37,236	$38,973	
Two years later.............	46,954	57,347		
Three years later...........	58,883			
Four years later............				
Five years later............				
Six years later.............				
Seven years later...........				
Eight years later...........				
Nine years later............				
Ten years later.............				

	Year Ended De		
	1993	1994	
		(in t	
Gross liability at end of year..............................	$70,093	$88,484	$1
Reinsurance recoverable......................................	17,303	25,167	
Net liability at end of year................................	52,790	63,317	
Gross reestimated liability - latest........................	55,642	72,804	
Reestimated recoverable - latest............................	15,651	23,211	
Net reestimated liability - latest..........................	39,991	49,593	
Gross cumulative deficiency (excess).........................	(14,451)	(15,680)	(
	1997	1998	

Gross liability at end of year..............................	$115,801	$136,727	$1
Reinsurance recoverable.....................................	35,545	40,712	
Net liability at end of year................................	80,256	96,015	
Gross reestimated liability - latest........................	112,624	133,456	1
Reestimated recoverable - latest............................	37,773	38,141	
Net reestimated liability - latest..........................	74,851	95,315	1
Gross cumulative deficiency (excess)........................	(3,177)	(3,271)	

DONEGAL GROUP INC. AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

The Stockholders and Board of Directors
Donegal Group Inc.

We have audited the accompanying consolidated balance sheets of Donegal Group Inc. and subsidiaries as of December 31, 2000 and 1999, 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, 2000. In connection with our audits of the consolidated financial statements, we also have audited the accompanying financial statement schedules. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

KPMG LLP
Philadelphia, Pennsylvania
February 23, 2001

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Donegal Group Inc.

CONSOLIDATED BALANCE SHEETS

December 31,	
ASSETS	
Investments	
Fixed maturities	
Held to maturity, at amortized cost (fair value $144,662,436 and $137,361,494)	$14
Available for sale, at fair value (amortized cost $114,524,472 and $105,955,784)	11

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   Equity securities, available for sale, at fair value (cost $12,500,558 and $9,067,428)       1
   Short-term investments, at cost, which approximates fair value                               1
-----------------------------------------------------------------------------------------------------
      Total investments                                                                         28
Cash
Accrued investment income
Premiums receivable
```