ASSOCIATION EXAMINATION REPORT
on
SOUTHERN INSURANCE COMPANY of VIRGINIA
Glen Allen, Virginia
as of
December 31, 2007

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

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I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Southern Insurance Company of Virginia as of December 31, 2007, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed to the original the seal of the Bureau at the City of Richmond, Virginia this 31st day of March, 2009

Alfred W. Gross

Alfred W. Gross
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
January 14, 2009

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (E) Committee
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Honorable Scott H. Richardson
Secretary-Southeastern Zone, NAIC
Commissioner of Insurance
South Carolina Department of Insurance
Columbia, South Carolina

Dear Sirs:

Pursuant to your instructions and in conformity with § 38.2-1317 of the Code of Virginia, a financial condition examination of

SOUTHERN INSURANCE COMPANY OF VIRGINIA

Glen Allen, Virginia

hereinafter referred to as the Company, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Company is a stock property and casualty insurer and is licensed under and subject to the general insurance laws contained in Title 38.2 of the Code of Virginia. The Company was last examined by representatives of the State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2004. This examination, covering the period from January 1, 2005 through December 31, 2007, was conducted by the Bureau, representing the Southeastern Zone of the National Association of Insurance Commissioners (NAIC).

HISTORY

The Company was granted a charter on April 9, 1936 by the State Corporation Commission (Commission) and was licensed by the Bureau on May 21, 1937. In 1944, the management of the Company was assumed by duly elected officers and directors, all affiliated with the Northern Neck Mutual Fire Association of Virginia. In July of 1984, the Commission approved the assumption of the management of the Company by Donegal Mutual Insurance Company (Donegal Mutual).

In December of 1988, the Company converted from a mutual insurance company to a stock insurance company and was acquired by Donegal Mutual. The acquisition was completed by the issuance of 1,000,000 shares of common capital stock to Donegal Group Inc. (DGI), a subsidiary of Donegal Mutual, for consideration of $3,000,000. The conversion and acquisition of control were approved by the Commission. The Company changed its name from Southern Mutual Insurance Company to Southern Insurance Company of Virginia.

Effective April 18, 1996, the Company's Articles of Incorporation were amended to increase the number of shares that the Company is authorized to issue to 3,000,000 shares of common stock with a par value of $1.25 per share.

On April 29, 1996, the Company declared and issued a stock dividend of 0.6 shares for each share outstanding. There were 1,000,000 shares outstanding on that date. The 600,000 new shares, with a par value of $1.25 per share, resulted in $750,000 of additional common capital stock. On January 15, 1998, the Company declared and issued a stock dividend of 0.175 shares for each share outstanding. There were 1,600,000 shares outstanding on that date. The 280,000 new shares, with a par value of $1.25 per share, resulted in $350,000 of additional common capital stock. At December 31, 2007, the Company has 1,880,000 shares of common stock outstanding with a par value of $1.25 per share.

On March 8, 2001, the Company and Southern Heritage Insurance Company (SHIC), a Georgia domestic, and an affiliate of the Company, entered into an Agreement and Plan of Merger whereby SHIC would merge with and into the Company, with the Company as the surviving entity. On May 1, 2002, the merger of SHIC and the Company was completed. This transaction received the approval of both Virginia and Georgia. Simultaneous with the merger, the Company paid a cash dividend of $3,000,000 to DGI.

In December of 2003 and 2004, the Company received capital contributions from DGI in the amount of $5,000,000 and $6,500,000, respectively.

MANAGEMENT AND CONTROL

The Articles of Incorporation provide that the affairs of the corporation shall be managed by a board of directors consisting of a minimum of 7 persons and a maximum of 12 persons, as provided in the bylaws. The directors shall serve in three groups, with each group containing one third of the total number of directors, or as near as may be, for staggered terms of three years. Each year, the terms of the directors in one group shall expire at the annual shareholders' meeting, and directors shall be chosen to succeed those whose terms expire.

The bylaws provide for the Company's officers to be a chairman of the board, a president, a vice president, a secretary, a treasurer and such other assistant vice presidents, assistant secretaries and assistant treasurers as the board may decide. The offices of president, secretary and treasurer are to be held by different persons and the president shall be a member of the board of directors. Directors and officers at December 31, 2007 were as follows:

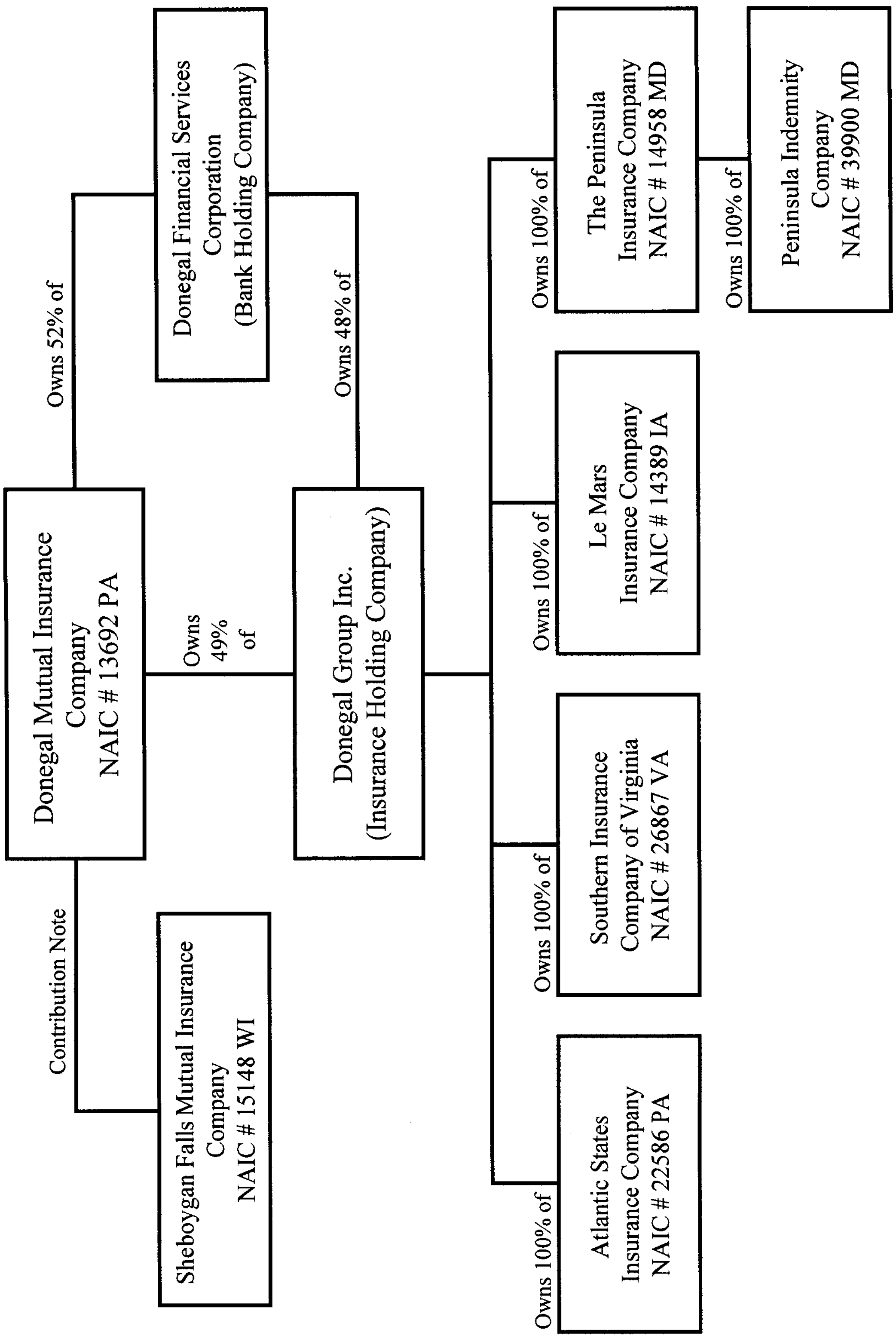
Directors	Principal Occupation
Robert S. Bolinger	Retired Lancaster, Pennsylvania
Patricia A. Gilmartin	Insurance Agent Associated Donegal Insurance Brokers Marietta, Pennsylvania
Philip H. Glatfelter, II	Retired Columbia, Pennsylvania
John E. Hiestand	Self-Employed H & H Associates Maytown, Pennsylvania
John J. Lyons	President and Chief Operating Officer – Retired Keefe Managers LLC New York, New York
Jon M. Mahan	Managing Director, Investment Banking Division Stifel Nicolaus & Company, Incorporated Baltimore, Maryland

Directors (continued)	Principal Occupation
S. Trezevant Moore, Jr.	Chief Operating Officer American Healthcare Providers Insurance Services Company Philadelphia, Pennsylvania
Donald H. Nikolaus	President and Chief Executive Officer Donegal Mutual Insurance Company Marietta, Pennsylvania
R. Richard Sherbahn	Insurance Broker Sherbahn Associates, Inc. Lancaster, Pennsylvania
Richard D. Wampler, II	Principal – Retired Brown Schultz Sheridan & Fritz Camp Hill, Pennsylvania

Officers:

Donald H. Nikolaus	President and Chief Executive Officer
Philip H. Glatfelter, II	Chairman of the Board
Kevin G. Burke	Senior Vice President, Human Resources
Charles M. Ferraro	Senior Vice President and Chief Information Officer
Cyril J. Greenya	Senior Vice President and Chief Underwriting Officer
Richard G. Kelley	Senior Vice President, Sales and Business Development
Jeffrey D. Miller	Senior Vice President and Chief Financial Officer
Robert G. Shenk	Senior Vice President, Claims
William H. Shupert	Senior Vice President, Underwriting
Daniel J. Wagner	Senior Vice President and Treasurer
William A. Folmar	Vice President, Claims
Jeffrey A. Jacobsen	Vice President, Personal Lines Underwriting
David S. Krenkel	Vice President, Marketing and Advertising
Chester J. Szczepanski	Vice President and Chief Actuary
Vincent A. Viozzi	Vice President, Investments
James R. Parker	Regional Vice President
Wayne H. Smith	Regional Vice President
Sheri O. Smith	Secretary

The Company is a wholly-owned subsidiary of DGI. DGI is 49% owned by Donegal Mutual, with the remaining 51% publicly held and traded on the NASDAQ Exchange under the symbols DGICA and DGICB. At December 31, 2007, Donegal Mutual held approximately 42% and 74% of DGI's Class A and Class B shares, respectively. The following chart illustrates this relationship at December 31, 2007.


Donegal Mutual Insurance Company NAIC # 13692 PA
Owns 52% of
Donegal Financial Services Corporation (Bank Holding Company)
Owns 48% of
Owns 49% of
Donegal Group Inc. (Insurance Holding Company)
Contribution Note
Sheboygan Falls Mutual Insurance Company NAIC # 15148 WI
Owns 100% of
Atlantic States Insurance Company NAIC # 22586 PA
Owns 100% of
Southern Insurance Company of Virginia NAIC # 26867 VA
Owns 100% of
Le Mars Insurance Company NAIC # 14389 IA
Owns 100% of
The Peninsula Insurance Company NAIC # 14958 MD
Owns 100% of
Peninsula Indemnity Company NAIC # 39900 MD

RELATED PARTY TRANSACTIONS

Expense Reimbursement Agreement

The Company, and certain of its affiliates, entered into an Amended and Restated Services Allocation Agreement which went into effect on November 1, 2006. The agreement provides for Donegal Mutual to perform services in the areas of underwriting, claims, reinsurance, investments, information services, and personnel and professional services.

The Company reimburses Donegal Mutual for these services monthly. Total annual reimbursements relating to this agreement during the period under review were $3,906,907, $4,204,811, and $4,664,538 for 2005, 2006, and 2007, respectively.

Tax Sharing Agreement

The Company's federal income tax return, pursuant to a tax sharing agreement, is consolidated with DGI, Atlantic States Insurance Company, Le Mars Insurance Company, The Peninsula Insurance Company and Peninsula Indemnity Company. The agreement provides for the terms and conditions for the calculation, payment and any subsequent adjustments of each party's tax liability.

Reinsurance and Retrocession Agreement

Effective July 1, 1996, the Company entered into a reinsurance and retrocession agreement with Donegal Mutual. This agreement provides that the Company will cede and Donegal Mutual will accept 100% of the Company's net losses incurred, including allocated loss adjusting expense incurred. Thereafter, Donegal Mutual will retrocede and the Company will accept 100% of those same net incurred losses assumed by Donegal Mutual. The agreement does not transfer risk; therefore, despite its name, the agreement is not a true reinsurance agreement. The primary purpose of the agreement is to allow the Company to obtain the same A.M. Best rating as Donegal Mutual. If a reinsurance agreement does not transfer insurance risk, all or part of the agreement shall be accounted for and reported utilizing deposit accounting. However, since the net effect of the transactions involved pursuant to this agreement were totally offset and no funds were exchanged between the parties, the transactions are not reflected on the Company's financial statements. This information was included by the Company in the Notes to Financial Statements section of its 2007 Annual Statement.

Dividends

During the period of this examination, the Company paid dividends to DGI in the amount of $400,000, $1,000,000, and $3,000,000 in 2005, 2006, and 2007, respectively. These dividends did not constitute extraordinary dividends, and thus did not require prior approval from the Commission.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2007, the Company is a named insured on a financial institution bond providing fidelity coverage with a single loss limit of $1,500,000, subject to a single loss deductible of $7,500, and subject to a $1,500,000 aggregate limit of liability. This coverage is also provided for forgery or alteration, computer systems fraud, and trading loss. Additionally, the Company had other property and liability coverage in force at December 31, 2007.

TERRITORY AND PLAN OF OPERATION

The Company is licensed in the Commonwealth of Virginia to transact the business of fire, miscellaneous property, farmowners' multiple peril, homeowners' multiple peril, commercial multiple peril, ocean marine, inland marine, workers' compensation–employers' liability, liability other than automobile, automobile liability, automobile physical damage, aircraft liability, air physical damage, fidelity, surety, glass, burglary and theft, boiler and machinery and water damage.

The Company is also licensed in Alabama, Arkansas, Georgia, Louisiana, New York, North Carolina, Pennsylvania, South Carolina and Tennessee. The primary concentration of business is in Virginia, Georgia, North Carolina and Tennessee. The Company does not currently write business in Arkansas and New York.

Applications for insurance are submitted through a network of independent agents in the Company's operating area. Policies may be issued by the home office or by the agent. Commissions vary between 3% and 20%, based on the line of business. Agents also participate in contingent commission plans, provided they meet minimum premium thresholds and fall within certain loss ratio parameters.

GROWTH OF THE COMPANY

The following data, obtained from annual statements and from examination reports, indicates the growth of the Company for the ten-year period ended December 31, 2007:

Year	Admitted Assets	Liabilities	Common Capital Stock	Gross Paid In and Contributed Surplus	Unassigned Funds
1998	$20,946,024	$14,557,708	$2,350,000	$2,752,270	$1,286,046
1999	23,690,980	16,397,124	2,350,000	2,752,270	2,191,586
2000	26,389,237	17,306,650	2,350,000	2,752,270	3,980,317
2001	30,112,615	19,249,134	2,350,000	2,752,270	5,761,211
2002*	80,980,594	49,736,697	2,350,000	35,267,585	(6,373,688)
2003	93,357,377	52,707,882	2,350,000	40,267,585	(1,968,090)
2004	108,244,346	57,990,544	2,350,000	46,767,585	1,136,217
2005	117,481,245	60,678,474	2,350,000	46,767,585	7,685,186
2006	123,610,567	61,408,631	2,350,000	46,767,585	13,084,351
2007	130,797,616	66,290,342	2,350,000	46,767,585	15,389,689

	Premiums Earned	Loss and Loss Adjustment Expenses Incurred	Other Underwriting Expenses	Net Underwriting Gains or (Losses)
1998	$11,840,751	$8,667,526	$3,831,304	($658,079)
1999	13,517,603	9,983,718	3,964,129	(430,244)
2000	14,413,261	9,885,436	3,108,760	1,419,065
2001	14,987,627	10,293,781	3,299,021	1,394,825
2002*	47,197,886	30,183,023	15,965,651	1,049,212
2003	46,885,317	28,674,770	14,010,568	4,199,979
2004	50,573,132	33,655,878	16,854,628	62,626
2005	55,423,131	34,188,126	18,726,781	2,508,224
2006	58,306,181	35,883,960	19,592,802	2,829,419
2007	63,050,804	38,530,808	22,942,897	1,577,099

* SHIC was merged into the Company in 2002. The 2001 numbers are those prior to the merger.

REINSURANCE

As of December 31, 2007, the Company was a named reinsured on the following reinsurance agreements placed through Towers Perrin Forster & Crosby, Inc. (Towers Perrin), a reinsurance intermediary, except where noted. These agreements are described briefly as follows:

Type of Agreement	Business Covered	Company's Retention	Reinsurers' Limit of Liability
Multi-Line Excess of Loss*	Property	$250,000 each risk each loss	$150,000 each risk each loss, $600,000 each occurrence
Multi-Line Excess of Loss*	Casualty	$250,000 every loss occurrence	$150,000 each risk each loss, $600,000 each occurrence
Multi-Line Excess of Loss*	Property and Casualty Combination	$250,000 limited to one property loss combined with a casualty loss	$600,000 ultimate net loss
Underlying Property Catastrophe Excess Of Loss*	Property	$600,000 each and every loss occurrence	$2,400,000 in excess of $600,000 any one loss occurrence
Multi-Line Excess of Loss	Property	$400,000 each risk each loss	$600,000 each risk each loss in excess of $400,000 up to $2,400,000 per occurrence
Multi-Line Excess of Loss	Casualty	$400,000 each and every loss occurrence	$600,000 each and every loss occurrence

* Agreement executed directly with the Company's ultimate parent, Donegal Mutual, not through Towers Perrin.

Type of Agreement	Business Covered	Company's Retention	Reinsurers' Limit of Liability
Multi-Line Excess of Loss	Property and Casualty Combination	$400,000 each loss occurrence	$400,000 ultimate net loss in excess of $400,000 each loss occurrence
Property Per Risk Excess of Loss	Property	$1,000,000 any one risk each and every loss	100% of the ultimate net loss in excess of $1,000,000 any one risk in respect of each such loss; the limit of liability of the reinsurer is $1,500,000 any one risk any one loss, subject to a loss occurrence limit of $3,000,000
	Excess of Original Policy Limits, Extra Contractual Obligations and Loss Adjustment Expenses, including Declaratory Judgment Expenses, for risks with policy limits of $2,500,000 or less	$2,500,000	$300,000 each risk excess of $2,500,000
Per Person Excess of Loss	Pennsylvania Extraordinary Medical Benefit Coverage written under Automobile Insurance	$100,000 each person each and every loss occurrence	$900,000 in excess of $100,000 per person per occurrence

Type of Agreement	Business Covered	Company's Retention	Reinsurers' Limit of Liability
Per Occurrence Excess of Loss	Pennsylvania Extraordinary Medical Benefit Coverage written under Automobile Insurance	$200,000 ultimate net loss each and every occurrence	$800,000 per occurrence in excess of $200,000 per occurrence
Workers' Compensation Excess of Loss	Workers' Compensation	$1,000,000 ultimate net loss each and every occurrence	$4,000,000 ultimate net loss each and every loss occurrence in excess of $1,000,000
First Property Catastrophe Excess of Loss	Property	$3,000,000 ultimate net loss each and every loss occurrence	100% of the ultimate net loss in excess of $3,000,000 each and every loss occurrence, up to $12,000,000 each and every loss occurrence
Second Property Catastrophe Excess of Loss	Property	$15,000,000 ultimate net loss each and every loss occurrence	100% of the ultimate net loss in excess of $15,000,000 each and every loss occurrence, up to $20,000,000 each and every loss occurrence

Type of Agreement	Business Covered	Company's Retention	Reinsurers' Limit of Liability
Third Property Catastrophe Excess of Loss	Property	$35,000,000 ultimate net loss each and every loss occurrence	The ultimate net loss in excess of $35,000,000 each and every loss occurrence, up to $45,000,000 each and every loss occurrence
Fourth Property Catastrophe Excess of Loss	Property	$80,000,000 ultimate net loss each and every loss occurrence	The ultimate net loss in excess of $80,000,000 each and every loss occurrence, up to $20,000,000 each and every loss occurrence
First Casualty Excess of Loss	Casualty (to include Multiple Peril, General Liability, Workers' Compensation and Automobile)	$1,000,000 each and every loss occurrence	The ultimate net loss in excess of $1,000,000 each and every loss occurrence up to $2,000,000 each and every loss occurrence
Second Casualty Excess of Loss	Casualty (to include Multiple Peril, General Liability, Workers' Compensation and Automobile)	$3,000,000 each and every loss occurrence	The ultimate net loss in excess of $3,000,000 each and every loss occurrence up to $2,000,000 each and every loss occurrence

Type of Agreement	Business Covered	Company's Retention	Reinsurers' Limit of Liability
Third Casualty Excess of Loss	Casualty (to include Multiple Peril, General Liability, Workers' Compensation and Automobile)	\$5,000,000 each and every loss occurrence	The ultimate net loss in excess of \$5,000,000 each and every loss occurrence up to \$10,000,000 each and every loss occurrence
Fourth Casualty Excess of Loss	Casualty (to include Multiple Peril, General Liability, Workers' Compensation and Automobile)	\$15,000,000 each and every loss occurrence	The ultimate net loss in excess of \$15,000,000 each and every loss occurrence up to \$25,000,000 each and every loss occurrence

Effective July 1, 1996, the Company entered into a reinsurance and retrocession agreement with Donegal Mutual. This agreement provides for Donegal Mutual to accept 100% of the Company's net losses incurred, including allocated loss adjusting expense incurred. Donegal Mutual then retrocedes and the Company accepts 100% of the net incurred losses assumed by Donegal Mutual. This agreement provides for no risk transfer.

The Company also has in place various facultative reinsurance agreements, each negotiated directly with a separate reinsurer. These agreements provide for umbrella and commercial property coverage.

All of the above agreements contain an insolvency clause and, where applicable, a guarantee of the intermediary's credit.

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2005, through December 31, 2007. Assets were verified and liabilities were established at December 31, 2007. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet for which Specific Risk Analyses (SRA) were required had medium or low risk assessments as determined from the *National Association of Insurance Commissioners Examiners Handbook.* Analytical review procedures were applied for non-SRA items.

The services of Oliver Wyman Actuarial Consulting, Inc. were engaged pursuant to the provisions of Code of Virginia § 38.2-1318 E. This engagement was made to provide an actuarial report as to the reasonableness of the Company's total loss and loss adjustment expense reserves as of December 31, 2007.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report.

History
Corporate Records
Management and Control
Territory and Plan of Operation
Reinsurance
Fidelity Bond
Related Party Transactions
Accounts and Records
Financial Statements

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2007, a statement of income for the period ending December 31, 2007, a reconciliation of surplus for the period under review, and a statement of cash flow for the period ending December 31, 2007. The financial statements are presented in accordance with Statutory Accounting Principles.

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$94,960,835		$94,960,835
Common stocks	4,034,370		4,034,370
Real estate	1,261,070		1,261,070
Cash and short-term investments	9,834,710		9,834,710
Other invested assets	423,999	423,999	
Investment income due and accrued	1,092,448		1,092,448
Uncollected premiums and agents' balances in course of collection	210,077	361,394	(151,317)
Deferred premiums, agents' balances and installments booked but deferred and not yet due	15,766,420		15,766,420
Amounts recoverable from reinsurers	421,296		421,296
Net deferred tax asset	3,152,547		3,152,547
Guaranty funds receivable or on deposit	394,939		394,939
Electronic data processing equipment and software	30,298		30,298
Furniture and equipment	60,495	60,495	
Intangible assets	108,496	108,496	
Totals	$131,752,000	$954,384	$130,797,616

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		$19,172,551
Reinsurance payable on paid losses and loss adjustment expenses		204,901
Loss adjustment expenses		3,700,000
Commissions payable, contingent commissions and other similar charges		1,100,000
Other expenses		923,796
Taxes, licenses and fees		2,459,797
Current federal income taxes		160,539
Unearned premiums		35,834,635
Policyholder dividends declared and unpaid		107,000
Ceded reinsurance premiums payable		811,522
Amounts withheld or retained by company for account of others		41,457
Remittances and items not allocated		15,171
Payable for securities		1,758,973
Total liabilities		$66,290,342
Common capital stock	$2,350,000	
Gross paid in and contributed surplus	46,767,585	
Unassigned funds (surplus)	15,389,689	
Surplus as regards policyholders		64,507,274
Totals		$130,797,616

UNDERWRITING AND INVESTMENT EXHIBIT
STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned	$63,050,804
Deductions:	
Losses incurred	$34,554,585
Loss expenses incurred	3,976,223
Other underwriting expenses incurred	22,942,897
Total underwriting deductions	$61,473,705
Net underwriting gain	$1,577,099

INVESTMENT INCOME

Net investment income earned	$4,399,063
Net realized capital gains	154
Net investment gain	$4,399,217

OTHER INCOME

Finance and service charges not included in premiums	$603,769
Total other income	$603,769
Net income before dividends and federal income taxes	$6,580,085
Dividends to policyholders	123,500
Net income before federal income taxes	$6,456,585
Federal income tax incurred	1,410,456
Net income	$5,046,129

RECONCILIATION OF CAPITAL AND SURPLUS FOR PERIOD UNDER REVIEW

	2005	2006	2007
Surplus as regards policyholders, December 31, previous year	$50,253,802	$56,802,771	$62,201,936
Net income	$5,444,954	$5,905,912	$5,046,129
Change in net unrealized capital gains	861,616	435,566	407,566
Change in net deferred income tax	(235,790)	(264,036)	(39,976)
Change in nonadmitted assets	878,189	321,723	(108,381)
Dividends to stockholders	(400,000)	(1,000,000)	(3,000,000)
Change in surplus as regards policyholders for the year	$6,548,969	$5,399,165	$2,305,338
Surplus as regards policyholders, December 31, current year	$56,802,771	$62,201,936	$64,507,274

CASH FLOW

Cash From Operations

Premiums collected net of reinsurance	$65,290,363
Net investment income	4,503,909
Miscellaneous income	603,769
Total	$70,398,041
Benefits and loss related payments	$35,549,968
Commissions, expenses paid and aggregate write-ins for deductions	26,187,871
Dividends paid to policyholders	141,500
Federal income taxes paid	1,193,096
Total	$63,072,435
Net cash from operations	$7,325,606

Cash From Investments

Proceeds from investments sold, matured or repaid:	
Bonds	$5,496,328
Stocks	5,725,402
Other invested assets	40,766
Miscellaneous proceeds	1,758,973
Total investment proceeds	$13,021,469
Cost of investments acquired (long-term only):	
Bonds	$6,474,990
Stocks	6,780,733
Other invested assets	145,562
Total investments acquired	$13,401,285
Net cash from investments	($379,816)

Cash From Financing and Miscellaneous Sources

Cash provided (applied):	
Dividends to stockholders	($3,000,000)
Other cash provided	51,519
Net cash from financing and miscellaneous sources	($2,948,481)
Net change in cash and short-term investments	$3,997,309

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Cash and short-term investments:	
Beginning of year	$5,837,401
End of year	9,834,710
Net change in cash and short-term investments	$3,997,309

RECOMMENDATIONS FOR CORRECTIVE ACTION

Management and Control

During the review of the Company's Information Systems, it was noted the Company does not have a comprehensive disaster recovery plan that encompasses all of the departments in the company. The Examiners recommend the Company develop, implement and maintain a disaster recovery plan to include all essential departments within the Company.

CONCLUSION

The courteous cooperation extended by the Company's officers and employees during the course of the examination is hereby gratefully acknowledged.

In addition to the undersigned, Jennifer K. Crawley, CFE, Mario A. Cuellar, CFE, Gina M. Gainer and Theresa C. Lewis, CFE of the Bureau participated in the work of the examination.

Respectfully submitted,

T. Bradford Earley, Jr. AIAF, CFE, CPCU
Insurance Principal Financial Analyst
Commonwealth of Virginia
Representing the Southeastern Zone, NAIC

SOUTHERN
INSURANCE COMPANY of VIRGINIA
A Donegal Insurance Group Company

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STATE CORP. COMMISSION
BUREAU OF INSURANCE
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March 17, 2009

Mr. David H. Smith, Chief Examiner
Commonwealth of Virginia
Bureau of Insurance
P.O. Box 1157
Richmond, VA 23218

Dear Mr. Smith:

We are writing in response to your letter dated March 11, 2009, in reference to the Examination Report as of December 31, 2007 for Southern Insurance Company of Virginia.

With respect to the Recommendation for Corrective Action presented on page 21 of the Examination Report, we hereby submit the following response:

Management and Control

The Company does have a Disaster Recovery Plan designed and implemented to provide alternative mainframe and network systems that would allow restoration of critical systems and functions in the event of a disaster. However, the Company recognizes the need for a Business Continuation Plan that covers all departments and aspects of its operations. A task team has been assigned, an outside consultant has been retained, and software has been acquired to facilitate development of a comprehensive Business Continuation Plan. The Company anticipates having a basic plan drafted no later than September 30, 2009 with a fully approved plan in place by December 31, 2009.

Please provide six (6) copies of the final report for our use. Thank you for your attention to this matter. If any questions arise, please feel free to contact me.

Sincerely,

Jeffrey D. Miller
Sr. Vice President and
Chief Financial Officer