

REPORT ON EXAMINATION

OF THE

HARLEYSVILLE INSURANCE COMPANY OF NEW YORK

AS OF

DECEMBER 31, 2004

DATE OF REPORT

MAY 31, 2006

EXAMINER

STEVEN C. GREGORY

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

May 31, 2006

Honorable Howard Mills
Acting Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22453 dated January 26, 2006 attached hereto, I have made an examination into the condition and affairs of Harleysville Insurance Company of New York as of December 31, 2004, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Harleysville Insurance Company of New York.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company's administrative offices located at 355 Maple Avenue, Harleysville, Pennsylvania.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1999. This examination covered the five-year period from January 1, 2000 through December 31, 2004. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 2004. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners ("NAIC"):

- History of Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

Harleysville Insurance Company of New York was incorporated under the laws of the State of New York on October 18, 1976 as New York Casualty Insurance Company. The Company adopted its present name on July 1, 2001. It became licensed on December 15, 1976 and commenced business on January 1, 1977, with a paid-in capital of \$1,300,000 and contributed surplus of \$900,000. Resources were realized through the sale of 1,000 shares of \$1,300 par value per share common stock at \$2,200 each to Carlton Holding Corporation ("Carlton Holding") Watertown, New York.

As of the examination date, capital paid in is \$2,000,700 consisting of 1,539 shares of common stock at \$1,300 par value per share. Gross paid in and contributed surplus is \$3,995,891. There were no changes in capital and paid in and contributed surplus from the prior examination date to the current examination date.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen or more than seventeen members. At December 31, 2004, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Roger J. Beekley Royersford, PA	Vice President, Harleysville Insurance Company of New York and Harleysville Mutual Insurance Company
Thomas E. Clark Newton, PA	Senior Vice President, Branch Operations Harleysville Mutual Insurance Company
Mark R. Cummins Green Lane, PA	Assistant Treasurer, Harleysville Insurance Company of New York Treasurer, Executive Vice President and Chief Investment Officer, Harleysville Mutual Insurance Company
Richard H. Kelsey Calcium, NY	Controller/Treasurer and Assistant Secretary, Harleysville Insurance Company of New York
Robert J. Lockwood Harleysville, PA	Vice President, IMR Claims

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Bruce J. Magee Berwyn, PA	Senior Vice President and Chief Financial Officer, Harleysville Mutual Insurance company
Theodore A. Majewski Fleetwood, PA	Senior Vice President – Personal Lines, Harleysville Mutual Insurance Company
William E. Morgan Watertown, NY	Vice President, Underwriting Harleysville Insurance Company of New York
Dennis J. Otmaskin Hopkinton, MA	President and Chief Operating Officer Harleysville Insurance Company of New York and Harleysville Worcester Insurance Company
Matthew L. Patkus Harleysville, PA	Executive Vice President – Field Operations, Harleysville Mutual Insurance Company
Catherine B. Strauss Wyndmoor, PA	Executive Vice President, Human Resources and Public Affairs, Harleysville Mutual Insurance Company
John Szczech Delmar, NY	Commercial Lines Business Development Manager, Harleysville Mutual Insurance Company
Robert G. Whitlock, Jr. North Wales, PA	Vice President, Harleysville Insurance Company of New York Senior Vice President and Chief Actuary, Harleysville Mutual Insurance Company

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were well attended with each member attending 100% of the annual meetings for which they were eligible to attend.

As of December 31, 2004, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Dennis J. Otmaskin	President and Chief Operating Officer
Robert A. Kauffman	Secretary
Richard H. Kelsey	Controller/Treasurer & Assistant Secretary
Roger J. Beekley	Vice President
David K. Bond	Vice President
Theodore A. Majewski	Vice President
William E. Morgan	Vice President
M. Lee Patkus	Vice President
Robert G. Whitlock, Jr.	Vice President
Angela K. Bauer	Assistant Treasurer
Mark R. Cummins	Assistant Treasurer
Kevin A. Mulvey	Assistant Vice President

B. Territory and Plan of Operation

As of December 31, 2004, the Company was licensed to transact business in the jurisdictions of Connecticut, Maryland, Michigan, New York and Virginia.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Worker's compensation and employer's liability
16	Fidelity and surety
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The Company may also write such workers' compensation insurance as may be incidental to coverage contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurance described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69th Congress as amended, 33 USC Section 901 et seq. as amended). The Company is also licensed to write special risks pursuant to the provisions of Article 63 of the New York Insurance Law.

The Company wrote business only in the State of New York during the examination period. The following schedule shows the direct premiums written by the Company for the period under examination:

<u>Calendar Year</u>	<u>Total Direct Premiums Written</u>
2000	\$ 69,257,006
2001	\$ 83,182,750
2002	\$ 98,168,690
2003	\$106,926,121
2004	\$106,917,802

Based on the kinds of insurance for which the Company is licensed, and the Company's current capital structure, and pursuant to the requirements of Articles 13, 41 and 63 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$3,700,000.

C. Reinsurance

i. Inter-company Pooling Agreement ("Pooling Agreement")

The Company participates in an inter-company pooling agreement (entitled "Proportional Reinsurance Agreement") with Harleysville Mutual Insurance Company ("HMIC"), which is the lead company, and its affiliates. The pooling agreement became effective January 1, 1986 and the Company was added effective January 1, 1991. The pooling agreement was approved by this Department prior to the Company becoming a party to it.

Pursuant to the provisions of the pooling agreement, each pool participant cedes all of its net insurance business to HMIC and assumes from HMIC its participation percentage of the pooled business. The participation percentages at December 31, 2004 were as follows:

<u>Company</u>	<u>Percentage</u>
Harleysville Mutual Insurance Company	23%
Harleysville Insurance Company of New Jersey	19%
Harleysville Preferred Insurance Company	18%
Harleysville Worcester Insurance Company	15%
Harleysville Lake States Insurance Company	8%
Harleysville Pennland Insurance Company	5%
Harleysville-Atlantic Insurance Company	5%
Harleysville Insurance Company	3%
Harleysville Insurance Company of New York	2%
Mid-America Insurance Company	1%
Harleysville Insurance Company of Ohio	<u>1%</u>
Total	100%

The pooling agreement provides that settlement shall be made within ninety (90) days after the close of the quarter. The Department's current policy is to require that reports be provided within 30 days after the close of each quarter and that settlements be made within 15 days after receipt of the report. Therefore, it is recommended that the Company amend the pooling agreement to require that settlements shall be made within forty-five (45) days after the close of the quarter, pursuant to Department guidelines.

As of the prior examination date, HMIC was not licensed or accredited in New York State; therefore, HMIC maintained a trust account pursuant to Department Regulation 114 to allow the Company to take reinsurance credit for losses ceded pursuant to the pooling agreement. Effective December 10, 2002, HMIC became an accredited reinsurer with the State of New York in accordance with Department Regulation 20 and Section 1301(a)(14) of the New York Insurance Law. As a result, the aforementioned trust agreement was no longer required.

Prior to January 1, 1986, when the current pooling agreement became effective, HMIC had another pooling agreement that became effective in 1983. Effective December 31, 1985, the prior pooling agreement was amended to transfer 100% of the outstanding reserves of all participants to HMIC. This was done to remove any potential environmental reserves from the subsidiaries' balance sheets in order to effectuate the initial public offering of the Harleysville Group, Inc. At the time of the initial public offering, HMIC owned 70% of the stock of the Harleysville Group, Inc.

ii. Assumed Reinsurance

The majority of the Company's assumed business is generated through its participation in the pooling agreement. The Company also assumes a minimal amount of reinsurance in connection with various mandated FAIR Plans, workers compensation pools and automobile facilities and automobile insurance plans.

iii. Ceded Reinsurance

The inter-company pooling agreement calls for the Company and other pool participants to obtain any outside reinsurance they deem necessary prior to participating in mutual net risk sharing through their 100% cession to HMIC. The ceded reinsurance is effected through a uniform treaty program whereby each of the pool members is listed as a signatory and named reinsured on each of the several contracts involved. Harleysville Mutual Insurance Company, the ultimate parent of the Company, handles the accounting for the ceded reinsurance on a centralized basis. However, each pool member receives its own individual report and Schedule F data reflecting the individual companies on a stand-alone basis.

As of December 31, 2004, the Company had the following ceded reinsurance program in place:

Type of Treaty, Effective Date, Limits of Retention and Limits of Liability for Reinsurer

Property Per Risk Excess of Loss

Effective January 1, 2002-Continuous (3 Layers)

\$8.5 million excess of \$1.5 million per risk, each occurrence, limit \$17 million each occurrence. A separate cover, for losses incurred as a result of terrorism, provided \$12 million in the aggregate for all risks each occurrence.

Property Catastrophe Excess of Loss (3 Layers)

Effective July 1, 2004-July 1, 2005

\$155 million excess of \$30 million each loss occurrence. The reinsurer shall not be liable unless two or more risks are involved in the same loss occurrence. Losses arising from acts of terrorism are not covered.

Casualty First, Second, Third and Fourth Excess of Loss (4 layers)

Effective January 1, 2004-December 31, 2004

Casualty coverage, excess of loss, each loss occurrence \$38 million (all layers) excess of \$2 million Company's retention. Includes coverage for losses resulting from acts of terrorism.

Surety Excess of Loss and Surety First and Second Excess of Loss (three layers)

Two agreements: One agreement effective January 1, 2004 (term 1 year) provides 40% coverage and the other agreement effective January 1, 2002 (continuous) provides 60% coverage. Company retains the first \$2 million.

Reinsurer(s) liability for each layer is:

First Layer -95% of \$3 million (\$2,850,000) excess of \$2 million, each principal with an aggregate limit of \$6 million.

Second Layer-95% of \$5 million (\$4,275,000) excess of \$5 million, each principal with an aggregate limit of \$10 million.

Third Layer-90% of \$5 million (\$4,500,000) excess of \$10 million, each principal with an aggregate limit of \$10 million.

Casualty Excess of Loss

Effective January 1, 1999-Continuous (Endorsement effective January 1, 2002 provided exclusions relative to coverage for terrorism losses)

Commercial Umbrella and Commercial Blanket Excess	\$14 million excess of \$1million for each occurrence or in the aggregate.
Personal Umbrella	\$4 million excess of \$1 million for each occurrence or in the aggregate.

Workers' Compensation

Effective January 1, 2004-December 31, 2004

Statutory limits, Excess of Loss Contract

First layer – non-terrorist activity \$3 million excess of \$2 million

terrorist activity \$3 million excess of \$2 million with \$6 million aggregate

Second layer – \$5 million excess of \$5 million

Lawyers' Professional Liability

Effective January 1, 2003-Continuous

Covers Lawyers Professional Liability policies.

Limits: 100% of \$750,000 each claim excess of \$250,000 (Company's retention). 90% of each claim above \$1 million up to \$5 million or in the aggregate.

Quota Share Reinsurance of:

A. Employment Practices Liability

B. Non-Profit Directors, Officers and Employers Liability

Effective May 1, 1999 until terminated.

Limits of coverage for each of the above categories: For the first \$100,000, Company retains 50% (\$50,000), reinsurer assumes 50% (\$50,000). For the next \$900,000, Company retains 25% (\$225,000), reinsurer assumes 75% (\$675,000).

Boiler and Machinery

Effective January 1, 2001-Continuous

Covers 100% of Boiler and Machinery equipment breakdown under policies issued by the Company except for business classified as "Referral Risks" or policies to which a Systems Breakdown Endorsement has been attached. Reinsurer is liable for up to \$50,000,000 for any one accident.

Aggregate Catastrophe Agreement with Harleysville Mutual Insurance Company

In addition to the above treaties, effective January 1, 1997, HMIC agreed to reinsure 100% of the accumulated ultimate net losses, resulting from loss occurrences commencing during each calendar quarter that the agreement remains in effect, in excess of the Company's retention, which is an amount equal to \$5 million times the Company's pool participation (2%) under the Pooling Agreement, but not exceeding the ultimate net loss of an amount equal to \$20 million times the Company's pool participation percentage (2%). This treaty was terminated effective December 31, 2005.

All ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

D. Holding Company System

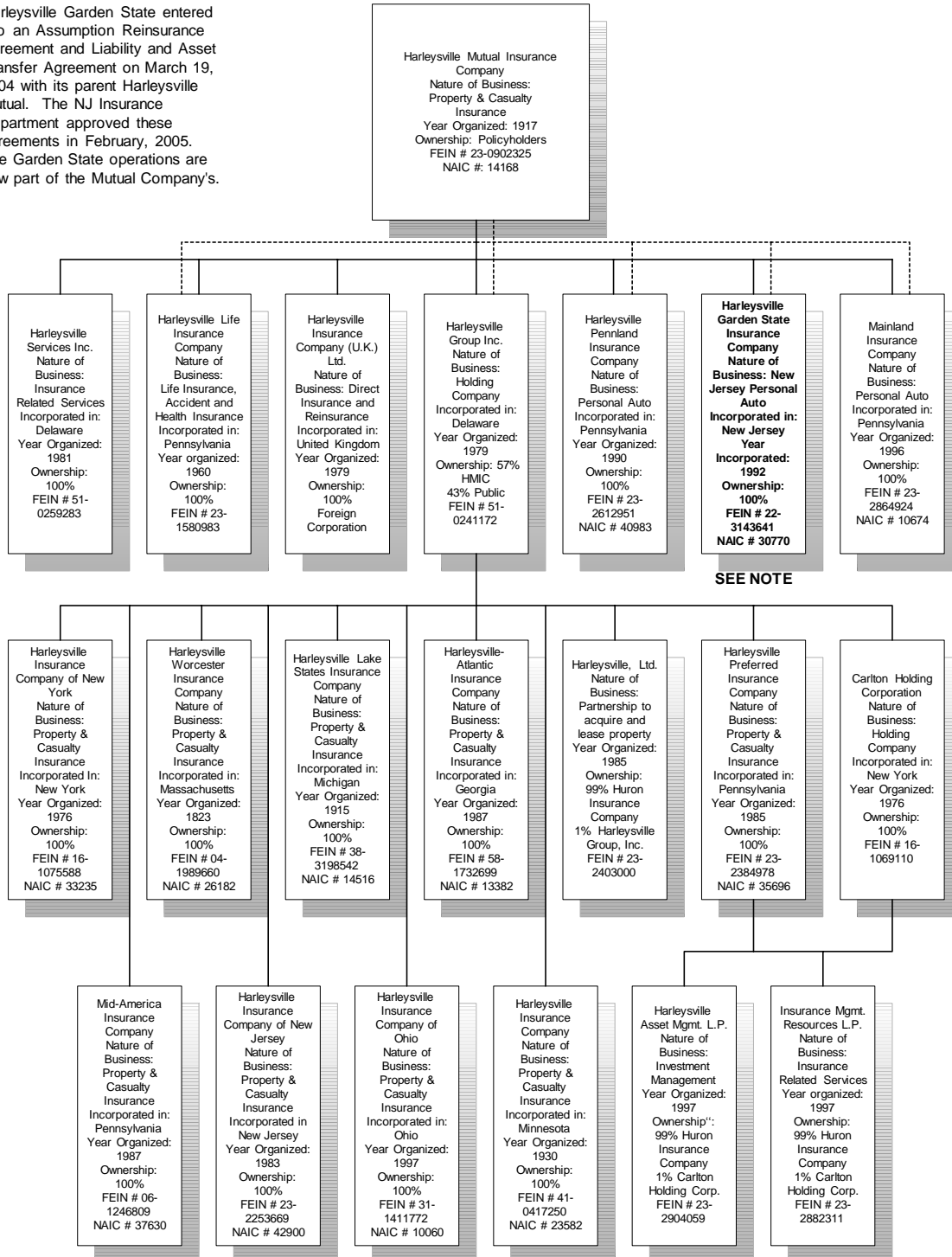
The Company is a member of the Harleysville Group, Inc. The Company is 100% owned by the Harleysville Group, Inc., a Delaware corporation, which is ultimately controlled by Harleysville Mutual Insurance Company, a Pennsylvania property and casualty insurer.

A review of the holding company registration statements filed with the Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is a chart of the holding company system at December 31, 2004:

NOTE

Harleysville Garden State entered into an Assumption Reinsurance Agreement and Liability and Asset Transfer Agreement on March 19, 2004 with its parent Harleysville Mutual. The NJ Insurance Department approved these agreements in February, 2005. The Garden State operations are now part of the Mutual Company's.



At December 31, 2004, the Company was party to the following agreements with other members of its holding company system:

1. Financial Tax Sharing Agreement

The Company entered into an amended tax sharing agreement with Harleysville Mutual Insurance Company, its ultimate parent, on January 29, 1999. Pursuant to the terms of this agreement HMIC files a consolidated income tax return for the holding company. The tax liability is allocated among the members, based on the pooled percentage in the consolidated income tax return, but no members' share will be greater than 100% of the amount that member would have been responsible for if it had filed a separate federal income tax return. The agreement was approved by the Department pursuant to Section 1505 of the New York Insurance Law on April 14, 1999.

2. Salary Allocation Agreement

The Company executed a salary allocation agreement on March 12, 1996, with Harleysville Group, Inc. Pursuant to the agreement Harleysville Group, Inc. is to perform the payroll duties (payment of salaries and benefits) of the Company with respect to its employees. The Company reimburses Harleysville Group, Inc. on a monthly basis for these costs, as well as salary and employee benefits costs for services performed on behalf of the Company. The agreement was approved by the Department on February 26, 1996.

3. Management Services Agreement

The Company entered into a management services agreement effective February 1, 2000 with Insurance Management Resources, L.P. ("IMR"). Pursuant to the terms of this agreement IMR wishes to be active in the National Flood Insurance Plan ("NFIP") to generate fees by performing and/or arranging or providing for all necessary flood insurance program administrative services for the Company, which writes the flood business that is 100% reimbursed by the Federal Government. The agreement was approved by the Department on March 28, 2000 with implementation retroactive to February 1, 2000.

4. Equipment and Supplies Allocation Agreement

The Company executed an equipment and supplies allocation agreement on March 12, 1996 with its ultimate parent, Harleysville Mutual Insurance Company. Under this agreement, Harleysville Mutual provides the Company with all required equipment, office supplies, and other similar supplies or equipment, as well as necessary office space needed for the conduct of business of the Company. The Company reimburses

Harleysville Mutual for the costs of such equipment, supplies and office space on a monthly basis. The agreement was approved by the Department on February 26, 1996.

5. Accounts Receivable Agreement

The Company executed an accounts receivable agreement with Harleysville Mutual Insurance Company on May 8, 1996. Pursuant to the terms of the agreement HMIC collects receivables generated from insurance premiums and/or agents' commissions on policies issued by the Company. The amounts collected by HMIC are to be forwarded to the Company within fifteen days of the end of the month in which the receivable was collected. No fee shall be paid by the Company to HMIC. However, actual costs associated with the rendering of services may be paid by the Company pursuant to the salary allocation agreement and the equipment and supplies allocation agreement entered into between the Company and its immediate parent, Harleysville Group, Inc. and HMIC, respectively. The agreement was approved by the Department on April 29, 1996.

E. Abandoned Property Law

The Company's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York State Abandoned Property Law.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2004, based upon the results of this examination:

Net premiums written in 2004 to surplus as regards policyholders	1.59:1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	90.5%
Premiums in course of collection to surplus as regard policyholders	61.3% *

* The above ratio denoted with an asterisk falls outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners. This ratio falls outside the benchmark range due to the Company ceding all premiums net of reinsurance to the inter-company pool and assuming only 2% from the pool. This prevents the Company from growing its surplus in proportional to the direct business it writes but its participation in the pool allows protection of its existing surplus level.

The underwriting ratios presented below are on an earned/incurred basis and encompass the 5-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses incurred	\$ 65,949,634	61.76%
Loss adjustment expenses incurred	13,861,395	12.98
Other underwriting expenses incurred	36,369,659	34.06
Net underwriting gain or loss	<u>(9,404,920)</u>	<u>(8.81)</u>
Premiums earned	<u>\$106,775,768</u>	<u>100.00%</u>

G. Accounts and Records

Custodial Agreements

In response to General Interrogatory 23 on its 2004 annual statement, the Company indicated that its custodial agreements were in compliance with the requirements of the NAIC Financial Condition Examiners Handbook. A review of the Company's custodial agreements indicated that the agreements did not include the following provisions required pursuant to Part 1, Section IV J of the NAIC Financial Examiners Handbook:

- a. That the national bank, state bank, or trust company, as custodian is obligated to indemnify the insurance company for any insurance company's loss of securities in the custodian's custody, except that, unless domiciliary state law, regulation or administrative action otherwise require a stricter standard (Section 2.b. sets forth an example of such a stricter standard), the bank or trust company shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the custodian;
- b. If domiciliary state law, regulation or administrative action requires a stricter standard of liability for custodians of insurance company securities than that set forth in Section 2.a., then such stricter standard shall apply. An example of a stricter standard that may be used is that the custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the custodian's custody occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction;
- c. That in the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the

securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced;

d. That the national bank, state bank or trust company as custodian shall not be liable for any failure to take any action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosions, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control;

e. That in the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability.”

The Company has indicated that the reason the custodial agreements are missing these provisions is that they were executed prior to the date of the NAIC requirement. It is recommended the Company revise its custodian agreements to conform to the standards set forth in Part 1 Section IV J, of the NAIC Financial Examiner's Handbook.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2004 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	Assets Not <u>Admitted</u>	Net Admitted <u>Assets</u>
Bonds	\$29,783,897	\$0	\$29,783,897
Common stocks	5,856	0	5,856
Cash, cash equivalents and short-term investments	7,623,623	0	7,623,623
Investment income due and accrued	411,410	3,165	408,245
Uncollected premiums and agents' balances in the course of collection	10,077,331	1,070,209	9,007,122
Deferred premiums, agents' balances and installments booked but deferred and not yet due	20,313,043	0	20,313,043
Amounts recoverable from reinsurers	61,871	0	61,871
Net deferred tax asset	3,211,792	1,864,687	1,347,105
Furniture and equipment, including health care delivery assets	86,856	86,856	
Other assets nonadmitted	21,716	21,716	0
Aggregate write-ins for other than invested assets	<u>706,989</u>	<u>12,420</u>	<u>694,569</u>
Total assets	<u>\$72,304,384</u>	<u>\$3,059,053</u>	<u>\$69,245,331</u>

Liabilities

Losses	\$25,316,170
Loss adjustment expenses	6,117,421
Commissions payable, contingent commissions and other similar charges	310,565
Other expenses (excluding taxes, licenses and fees)	237,369
Taxes, licenses and fees (excluding federal and foreign income taxes)	401,759
Current federal and foreign income taxes	508,098
Unearned premiums	11,361,730
Advance premium	448,949
Policyholders (dividends declared and unpaid)	10,069
Ceded reinsurance premiums payable (net of ceding commissions)	4,173,126
Funds held by company under reinsurance treaties	39,049
Amounts withheld or retained by company for account of others	154,162
Provision for reinsurance	2,167
Payable to parent, subsidiaries and affiliates	1,587,291
Payable for securities	2,019,756
Securities lending obligation	<u>1,865,125</u>
Total liabilities	\$54,552,806

Surplus and Other Funds

Common capital stock	\$2,000,700
Gross paid in and contributed surplus	3,995,891
Unassigned funds (surplus)	<u>8,695,934</u>
Surplus as regards policyholders	<u>14,692,525</u>
Total liabilities surplus and other funds	<u>\$69,245,331</u>

NOTE:

The Internal Revenue Service has completed its audits of the Company's (Harleysville Group, Inc. and subsidiaries) consolidated federal income tax returns through tax year 2000. All material adjustments made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2001 through 2004. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$113,526 during the 5-year examination period January 1, 2000 through December 31, 2004, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$106,775,768
Deductions:		
Losses incurred	\$65,949,634	
Loss adjustment expenses incurred	13,861,395	
Other underwriting expenses incurred	<u>36,369,659</u>	
Total underwriting deductions		<u>116,180,688</u>
Net underwriting gain or (loss)		\$ (9,404,920)

Investment Income

Net investment income earned	\$8,602,157	
Net realized capital gain	<u>1,628</u>	
Net investment gain or (loss)		8,603,785

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (462,086)	
Finance and service charges not included in premiums	3,094,187	
Aggregate write-ins for miscellaneous income	<u>(905)</u>	
Total other income		<u>2,631,196</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$1,830,061
Dividends to policyholders		<u>486,318</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$1,343,743
Federal and foreign income taxes incurred		<u>662,824</u>
Net income		<u>\$680,919</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 1999			\$14,806,051
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$680,919		
Net unrealized capital gains or (losses)		\$ 1,355	
Change in net deferred income tax	601,519		
Change in non-admitted assets		924,018	
Change in provision for reinsurance		167	
Cumulative effect of changes in accounting principles	898,561		
Change in excess of statutory reserves over statement reserves	31,015		
Dividends to stockholders	<u>0</u>	<u>1,400,000</u>	
Total gains and losses	<u>\$2,212,014</u>	<u>\$2,325,540</u>	
Net decrease in surplus			<u>(113,526)</u>
Surplus as regards policyholders per report on examination as of December 31, 2004			<u>\$14,692,525</u>

4. LOSSES & LOSS ADJUSTMENT EXPENSES

The examination liabilities for losses of \$25,316,170 and loss adjustment expenses of \$6,117,421 are the same as reported by the Company as of December 31, 2004. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in its filed annual statements.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of the Department.

The general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims and complaint handling

No problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained eight (8) recommendations as follows (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that the Company comply with its by-laws and utilize the consent in writing format only when time is of the essence.	5
ii. It is recommended that Board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	5
B. <u>Reinsurance</u>	
i. The ceded reinsurance is affected through a uniform treaty program whereby each of the pool members is listed as signatory and named reinsured on each of the several contracts involved. It appears, therefore, that NYCIC and other pool members have joint, rather than separate outside reinsurance. The inclusion of NYCIC as named insured could result in direct settlement of disputed balances between NYCIC and the assuming company if such assuming company is unable to reach an agreement with Harleysville Mutual. This concern does not apply to the Company's facultative certificates because only one reinsured is named on such documents.	8
ii. It is recommended that the Company amend its ceded reinsurance agreements containing arbitration clauses to require that arbitration must take place in New York.	10
iii. The lawyers' professional liability quota share reinsurance contract	10

ITEMPAGE NO.

contains neither an arbitration clause nor an errors and omissions clause. Although not required by New York Insurance Law, it is recommended that the Company amend its reinsurance contracts to include these clauses.

The Company has complied with this recommendation.

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|-----|---|----|
| iv. | The Company's surety, fidelity and forgery excess of loss reinsurance contract does not contain the language required by Section 1308 of the New York Insurance Law for the Company to receive credit for the reinsurance. The amount was not material to the examination. It is recommended that the Company amend its contract to include the language contained in Section 1308 of the New York Insurance Law. | 10 |
|-----|---|----|

The Company has complied with this recommendation.

C. Accounts and Records

- | | | |
|----|---|----|
| i. | It is again recommended that the Company amend its custodian agreement to include the protective covenants and provisions which meet the guidelines established by the Department for the contents of such contracts. | 18 |
|----|---|----|

The Company has not complied with this recommendation as the custodian agreement not been updated since the prior examination. A similar comment appears in this report.

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| ii. | It is recommended that the Company maintain its records for the minimum periods required by Department Regulation 152. | 19 |
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The Company has complied with this recommendation.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Reinsurance</u>	
	It is recommended that the Company amend the pooling agreement to require that settlements shall be made within forty-five (45) days after the close of the quarter, pursuant to Department guidelines.	7
B.	<u>Accounts and Records</u>	
i.	It is recommended the Company revise its custodian agreements to conform to the standards set forth in Part 1 Section IV J, of the NAIC Financial Examiner's Handbook.	15

Respectfully submitted,

Steven C. Gregory

Steven C. Gregory, CFE, FLMI, AIE
Contract Examiner-In-Charge

STATE OF NEW YORK)
)SS:
)
COUNTY OF NEW YORK)

STEVEN C. GREGORY, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

Steven C. Gregory

Steven C. Gregory

Subscribed and sworn to before me
this _____ day of _____, 2006.

Appointment No 22453

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, HOWARD MILLS, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Steven Gregory

as proper person to examine into the affairs of the

HARLEYSVILLE INSURANCE COMPANY OF NEW YORK

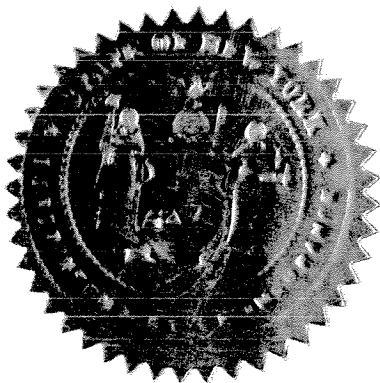
and to make a report to me in writing of the condition of the said

Company

with such other information as she shall deem requisite.

*In Witness Whereof, I have hereunto subscribed by the
name and affixed the official Seal of this Department, at
the City of New York,*

this 26th day of January, 2006



A handwritten signature in dark ink, appearing to read "Howard Mills", written over a horizontal line.

HOWARD MILLS
Superintendent of Insurance