

REPORT ON EXAMINATION AS TO THE CONDITION OF  
HARLEYSVILLE INSURANCE COMPANY OF NEW JERSEY  
MOUNT LAUREL, NEW JERSEY 08054

AS AT DECEMBER 31, 2009

N.A.I.C. GROUP CODE 0253

N.A.I.C. COMPANY CODE 42900

## TABLE OF CONTENTS

	<u>Page</u>
Salutation .....	1
Scope of Examination.....	2
Compliance with Prior Examination Report Recommendations.....	3
History and Kind of Business .....	3
Statutory Deposit.....	4
Territory and Plan of Operation.....	4
Corporate Records.....	5
Management and Control.....	6
Reinsurance and Retention.....	8
Holding Company System – Organizational Chart .....	12
Organizational Chart.....	13
Inter Company Agreements.....	14
Policy on Conflict of Interest.....	15
Employee Welfare and Pension Plans.....	15
Fidelity Bond and Other Insurance Coverage.....	16
Policy Forms and Underwriting Practices.....	16
Accounts and Records.....	16
Advertising and Sales Material.....	17
Treatment of Policyholders.....	17
Continuity of Operations.....	17
Financial Statements and Other Exhibits:.....	18
Exhibit A – Balance Sheet as of December 31, 2009.....	19
Exhibit B – Summary of Operations for the Five Year Period Ending December 31, 2009.....	20
Exhibit C – Capital and Surplus Account for the Five Year Period Ended December 31, 2009.....	21
Notes to the Financial Statements.....	22
Statement of NJDOBI Property and Casualty Actuary.....	23
Conclusion.....	24
Certification.....	25



**State of New Jersey**  
**DEPARTMENT OF BANKING AND INSURANCE**  
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TRENTON, NJ 08625-0325

CHRIS CHRISTIE  
*Governor*

TEL (609) 292-5360

THOMAS B. CONSIDINE  
*Commissioner*

March 28, 2011

Honorable Thomas Considine  
Commissioner of Banking and Insurance  
State of New Jersey  
20 West State Street  
Trenton, New Jersey 08625

Commissioner:

In accordance with the authority vested in you by the Revised Statutes of New Jersey, an examination has been made of the assets and liabilities, method of conducting business and other affairs of the:

HARLEYSVILLE INSURANCE COMPANY OF NEW JERSEY  
MOUNT LAUREL, NEW JERSEY  
N.A.I.C. GROUP CODE 0253  
N.A.I.C. COMPANY CODE 42900

a domestic insurer duly authorized to transact the business of insurance in the State of New Jersey. Hereinafter, the Harleysville Insurance Company of New Jersey will be referred to in this report as the "Company" or "HICNJ".

## SCOPE OF THE EXAMINATION

This financial condition examination was called by the Commissioner of Banking and Insurance of the State of New Jersey pursuant to the authority granted by Section 17:23-22 of the New Jersey Statutes Annotated.

The examination took place concurrently with the other affiliated companies of the Harleysville Group which was lead by the Pennsylvania Insurance Department, being primary state of domicile of the parent company; Harleysville Mutual Insurance Company.

The examination was made as at December 31, 2009, and addressed the five-year period from December 31, 2004, the date of the last Financial Condition Examination. During this five-year period under examination, the Company's assets increased from \$626,936,747 to \$715,147,164. liabilities increased from \$494,309,474 to \$539,757,860 and its surplus to policyholders increased from \$132,627,273 to \$175,389,304.

This examination was conducted in accordance with the risk focus examination approach as adopted by the National Association of Insurance Commissioners (NAIC) and followed regulatory procedures prescribed or permitted by the New Jersey Department of Banking and Insurance (NJDOBI). The format of this report is consistent with the current practices of the NJDOBI and the examination format prescribed by the NAIC. It is limited to a description of the Company, a discussion of financial items that are of specific regulatory concern and a factual disclosure of other significant regulatory information.

The scope of this examination will focus on the direct business of Harleysville Insurance Company of New Jersey.

### Examination Goals

- Perform an examination that identifies significant deviations from statutory accounting practices that affect solvency.
- Perform an examination that identifies deviations from New Jersey Insurance Laws and New Jersey Regulations.
- Perform an examination in accordance with standards prescribed by the revised NAIC Financial Examiners Handbook, NAIC Accreditation Standards and New Jersey Department of Banking and Insurance Policy.
- Identify and report on significant operational and internal control deficiencies and access the Company's risk management practices.
- Assess the risks that the Company's surplus is materially misstated.
- Provide a foundation for a profile of the Company's operations, risks and results to be utilized by regulatory authority.

The specific asset and liability accounts comprising in part the various examination phases that are generally material, which were determined to require substantive procedures to be performed during the examination and which were material accounts specific to the Company, are the asset accounts bonds, common stocks and short-term investments.

Additional areas reviewed during this examination were as follows:

- History and Kind of Business
- Territory and Plan of Operation
- Corporate Records
- Management and Control
- Reinsurance and Retention
- Holding Company System
- Employees' Welfare and Pension Plans
- Policy on Conflict of Interest
- Fidelity Bond and Other Insurance Coverage
- Parent, Subsidiaries and Affiliates
- Intercompany Agreements
- Accounts and Records
- Advertising and Sales Material
- Treatment of Policyholders
- Continuity of Operations
- Policy Forms and Underwriting Practices

The examination report, contained herein, will address significant balance sheet accounts and, if necessary, comments on those accounts which involve departures from laws, regulations or rules, or which are deemed to require special explanation or description. All other accounts were either tested by analytical review or control procedures.

## COMPLIANCE WITH PRIOR EXAMINATION REPORT RECOMMENDATIONS

### Corporate Records

#### 2004 Examination Report Recommendation

It is recommended that the Company mention in future Board Minutes that the Board of Directors has reviewed the examination report.

#### Company Response and Examination Review:

The examination determined the Company complied with this recommendation.

## HISTORY AND KIND OF BUSINESS

The Company was incorporated under the laws of the State of New Jersey on April 11, 1983, and commenced operations on May 18, 1984. The Company is a wholly owned subsidiary of Harleysville Group, Inc. (HGI) which is 54 percent owned by the Harleysville Mutual Insurance Company (HMIC) and 46 percent owned by the public.

On August 1, 2008, the Company moved its principal office to 112 West Park Drive Mount Laurel, NJ 08054. The individual upon whom process may be served is National Registered Agents.

The Company's amended Certificate of Authority dated November 6, 2000 authorizes the Company to transact the kinds of insurance specified under paragraphs "a", "b", "d", "e", "f", "g", "j", "k", "l", "m", "n" and "o-1", and "o-3" of N.J.S.A. 17:17-1 et seq.

The Company is a part of Harleysville Mutual Holding Company System and its pool participant's rate is 21percent. The Company's Home Office in New Jersey handles commercial underwriting, field marketing, claims and policy service functions. Underwriting for personal lines is maintained at the Company's general administrative office in Harleysville, Pennsylvania.

The Company's main administrative office, which serves as the primary location for accounting books and records, is located at 355 Maple Avenue, Harleysville, PA 19438. This office provides administrative and support functions such as executive, financial systems, data processing, customer service, underwriting, equipment, supplies and human resources. The Company's parent is responsible for the maintenance of the Company's general ledger. The Company is also a party to the Pooling Agreement, Amended Consolidated and Restated Compensation Allocation Agreement, Accounts Receivables Agreement -Amended and Restated, Amended and Restated Financial Tax Sharing Agreement and Equipment and Supplies Allocation Agreement either with its parent Harleysville Group Inc. or with its ultimate parent Harleysville Mutual Insurance Company.

#### STATUTORY DEPOSIT

The Company maintains a \$100,000 United States Treasury Note with the Commissioner of Banking and Insurance of the State of New Jersey for the benefit and security of the policyholders of Harleysville Insurance Company of New Jersey. This security is being held by Commerce Bank as required by State of New Jersey regulations.

The Company is also required to maintain a \$100,000 United States Treasury Note with the State of Massachusetts and \$300,000 with the State of Michigan for the benefit and security of the policyholders of Harleysville Insurance Company of New Jersey. These securities are being held by Citibank and JP Morgan Chase respectively.

#### TERRITORY AND PLAN OF OPERATION

A review of the Company's Schedule T indicated the Company is licensed and authorized to write business in the states of: Pennsylvania, Michigan and New Jersey. The Company wrote the majority of the business in New Jersey with the balance in Pennsylvania. The Company is licensed in the states of Maryland, Massachusetts, and Virginia as a qualified reinsurer as of December 31, 2009.

The Company writes the bulk of its business in commercial lines with an emphasis on commercial multiple peril, commercial automobile liability and workers' compensation through " a long standing independent agency force". The Company does not utilize Third Party Administrators (TPA) or Managing General Agents (MGA).

Harleysville-Garden State Insurance Company, a New Jersey Company, discontinued operations effective May 1, 2004 and entered into an assumption reinsurance agreement and asset and liability transfer agreement with its ultimate Parent.

The Company markets its products exclusively through approximately 1,300 independent agents.

A summary of net premiums written over the past five years is summarized below:

<u>Year</u>	<u>Net Premiums Written</u>
2005	\$221,414,300
2006	\$221,354,572
2007	\$221,137,116
2008	\$248,837,704
2009	\$223,549,332

Net premiums written in 2009 is allocated among the following lines of business:

<u>Line of Business</u>	<u>Net Premiums Written</u>
Fire	\$2,005,908
Allied Lines	3,167,101
Farmowners Multi-Peril	(60)
Homeowners Multi-Peril	21,011,630
Commercial Multiple Peril	85,638,592
Inland Marine	6,694,235
Earthquake	374,622
Workers' Compensation	21,127,124
Other Liability -Occurrence	12,718,111
Other Liability - Claims made	77,675
Products Liability - Occurrence	333,880
Private Passenger Auto Liability	13,497,485
Commercial Auto Liability	39,313,519
Auto Physical Damage	17,371,959
Surety	14,237
Burglary and theft	203,314

### CORPORATE RECORDS

The Company's bylaws stipulate that the annual meeting of shareholders will be held on the fourth Thursday of April of each year at the Company's principal office, at 112 West Park Drive, Mount Laurel NJ 08054, or at such other place as the Board of Directors may designate. Special meetings of the shareholders may be held whenever called by the Chief Executive Officer or by the Board of Directors, or by a shareholder of not less than 25 percent of the shares. A notice of each annual meeting of the shareholders and each special meeting of shareholders shall be given at least 30 days written notice.

The number of Directors shall be not less than five or more than sixteen. Each Director shall file a written acceptance of trust with the Secretary of the Corporation. The Directors shall be elected at each annual meeting by the shareholders entitled to vote and shall hold office for one year until their successors have been duly elected and qualified. Meeting of the Board will be held at the place of and immediately succeeding the annual meeting of shareholders. Majority of the members of the Board of Directors shall constitute a quorum.

Review of the Company's minutes from the Board meeting indicated the approval of significant company transactions.

## MANAGEMENT AND CONTROL

### Board of Directors

The management, conduct and affairs of the Company have been vested in the Board of Directors (herein after Board) who are elected and vested with the authority by the shareholders of the Company. A listing of the Board serving at December 31, 2009, with their principal occupation, is as follows:

<u>Name</u>	<u>Principal Occupation</u>
Michael L. Browne 355 Maple Ave. Harleysville, PA 19438	President and Chief Executive Officer Harleysville Mutual Insurance Company
Arthur E. Chandler 355 Maple Ave. Harleysville, Pa 19438	Senior Vice President and Chief Financial Officer Harleysville Mutual Insurance Company
Thomas E. Clark 355 Maple Ave. Harleysville, PA 19438	Senior Vice President -Field Operations Harleysville Mutual Insurance Company
Mark R. Cummins 355 Maple Ave Harleysville, PA 19438	Executive Vice President, Chief Investment Officer & Treasurer Harleysville Mutual Insurance Company
Kevin M. Toth 355 Maple Ave. Harleysville, PA 19438	Senior Vice President - Chief Underwriting Officer Harleysville Mutual Insurance Company

The Board of Directors at their annual meeting may elect a Chairman of the Board and shall elect a President, one or more Vice Presidents, a Secretary, a Treasurer and such Assistant Secretaries, Assistant Treasurers, and any other officers that the Board deems necessary. The same person may hold any two or more offices except that the President shall not also serve as Secretary, Assistant Secretary, Treasurer or Assistant Treasurer. All elected officers shall serve until the next annual meeting of the Board and until their respective successors shall have been elected and qualified.

The Chairman of the Board shall preside at each meeting of the Board and shall have and perform such duties as may be assigned to him in accordance with the authority of the Board. These powers and duties as may be assigned to him in accordance with the Authority of the Board. These powers and duties may include those usually vested in the Chief Executive Officer of the Company.

The Company's Board is comprised of officers of its ultimate parent. N.J.S.A.17:27A-4d(5) states that paragraphs 3 and 4 of subsection d shall not apply to a domestic insurer if the person controlling the insurer is an entity having a Board and committees thereof that meet the requirements of those paragraphs. The controlling entity Harleysville Mutual Insurance Company (hereinafter HMIC) has eight outside directors serving on its nine member Board. This meets the requirement of NJSA 17:27a-4d(3) that one third of the Board be comprised of outside directors.

HMIC has an audit committee that meets the requirements of NJSA 17:27A-4d(4). The audit committee is composed of Directors who are neither officers or employees of HMIC. HMIC's and Harleysville Group Inc.'s audit committee members are as follows:

Harleysville Group Inc.

G. Lawrence Buhl, Chairman  
Retired from Ernst & Young

Barbara Austell  
JP Morgan and Co.  
Managing Director of  
Investment Banking

W. Thacher Brown  
President of MBIA Asset  
Management, LLC; Director of  
MBIA Insurance Company

William E. Storts  
Manager Partner in the Global  
Financial Services Market Unit

Harleysville Mutual Insurance Company

G. Lawrence Buhl, Chairman

W. Thacher Brown

William E. Storts

The following is the Company's listing of officers serving as of December 31, 2009:

Michael L. Browne	President and Chief Executive Officer
Robert A. Kauffman	Secretary
Mark R. Cummins	Treasurer
Allan R. Becker	Vice President and Chief Actuary
David K. Bond	Vice President
Theodore A. Majewski	Vice President

#### REINSURANCE AND RETENTION

Harleysville Group Inc. had reinsurance agreements and treaties in force at December 31, 2009 providing excess, catastrophe, pro-rata and facultative reinsurance for various lines of business written. The various reinsurance treaties and contracts in effect, along with the maximum limits of reinsurance, are summarized as follows:

#### Assumed Reinsurance Coverages as of December 31, 2009

The Company reported its assumed reinsurance in Schedule F-Part 1 of its 2009 annual statement. The bulk of the Company's assumed business is through an inter-company pooling agreement it participates in with its ultimate parent, Harleysville Mutual Insurance Company and its affiliates. The Company assumes 21 percent of the net business generated by the group, which is pooled together net of reinsurance ceded. This assumed business accounted for \$223,550,000 in assumed premiums, \$136,168,000 in reinsurance on known case losses and LAE, contingent commissions payable of \$3,372,000 and unearned premiums in the amount of \$114,501,000. The \$223,550,000 in assumed premiums accounted for 99.92 percent of the Company's total assumed business of \$223,718,000. The remaining assumed business for 2009 is from mandatory pools, such as the NJ Fair Plan and the Pennsylvania Fair Plan.

The following is a summary of the Company's ceded reinsurance program:

Ceded Reinsurance Coverages as of December 31, 2009

Workers' Compensation

Ceded	Reinsurance Type	Policy Limits	Company Retention	Reinsurer Limit Per Occurrence	Reinsurer Aggregate Limit
	Excess of Loss	Statutory	\$2,000,000		
First Excess	Excess of Loss	Statutory		\$3,000,000	\$18,000,000
Second Excess	Excess of Loss	Statutory		\$5,000,000	\$20,000,000
Casualty Clash Excess (WC Coverage inures to the benefit of the Casualty Clash Excess Contract)	Excess of Loss	Statutory	\$500,000	\$2,500,000 \$5,000,000	Unlimited \$35,000,000
Workers' Compensation (Per Person Excess)	Excess of Loss	Statutory	\$18,000,000	\$10,000,000	\$30,000,000

Auto Liability

Ceded	Reinsurance Type	Policy limits	Company Retention	Reinsurer Limit Per Occurrence	Reinsurer Aggregate Limit
	Excess of Loss	\$2M Primary (CL) \$10M Umbrella (CL) \$1M Primary (PL) \$5M Umbrella (PL)	\$2,500,000(CL) \$1,500,000(PL)		
First Excess	Excess of Loss			\$2,500,000(CL) \$3,500,000(PL)	Unlimited
Second Excess	Excess of Loss			\$5,000,000	\$35,000,000
Third Excess	Excess of Loss			\$10,000,000	\$30,000,000
Fourth Excess	Excess of Loss			\$20,000,000	\$40,000,000
Fifth Excess	Excess of Loss			\$10,000,000	\$20,000,000

\*CL Commercial Lines Business

\* PL - Personal Lines Business

Other Liability (Casualty XOL)

WCMAOL=\$10,000,000

Ceded	Reins. Type	Policy Limits	Company Retention	Reinsurer Limit Per Occurrence	Reinsurer Aggregate Limit
	Excess of Loss	\$2M Primary (CL) \$10M Umbrella (CL) \$1M Primary (PL) \$5M Umbrella (PL)	\$2,500,000(CL) \$1,500,000(PL)		
First Excess	Excess of Loss			\$2,500,000(CL) \$3,500,000(PL)	Unlimited
Second Excess	Excess of Loss			\$5,000,000	\$35,000,000
Third Excess	Excess of Loss			\$10,000,000	\$30,000,000
Fourth Excess	Excess of Loss			\$20,000,000	\$40,000,000
Fifth Excess	Excess of loss			\$10,000,000	\$20,000,000

\*CL - Commercial Lines business

\*PL - Personal Lines business

Property Per Risk

Ceded	Reinsurance Type	Policy limits	Company Retention	Reinsurer Limit per Occurrence	Reinsurer Aggregate Limit
	Excess of Loss	\$25,000,000(CL) \$2,000,000 (PL)	\$2,000,000 (CL) \$1,500,000 (PL)	1.5 Million Retention for Personal lines	
First Excess	Excess of Loss			\$3,000,000(CL) \$3,500,000(PL)	Unlimited
Second Excess	Excess of Loss			\$5,000,000	\$20,000,000
Third Excess	Excess of Loss			\$15,000,000	\$30,000,000

\*CL - Commercial Lines business

\* PL \_ Personal Lines

## Property Catastrophe

Ceded	Reinsurance Type	Policy Limits	Company Retention	Reinsurer Limit Per Occurrence	Reinsurer Aggregate Limits
	Excess of Loss		\$50,000,000		
First Excess	Excess of Loss			\$40,000,000	\$80,000,000
Second Excess	Excess of Loss			\$110,000,000	\$220,000,000
Third Excess	Excess of Loss			\$225,000,000	\$450,000,000

In accordance with N.J.S.A.17:18-9 (Risk Limitations), "No insurance company transacting business in this State shall expose itself to any one loss on any one risk or hazard in an amount exceeding ten per centum (10 percent) of its net assets as of December 31 next preceding..., Except that for the business specified in subsection "e"of NJSA 17:17-1, the exposure shall not exceed five per centum (5 percent) the insurer's net assets as of December 31 next preceding. HICNJ is in compliance with N.J.S.A. 17:18-9 on Risk Limitations.

The Company maintains reinsurance intermediaries-brokers Towers Perrin and Guy Carpenter as liaisons between the Company and its Reinsurers. The reinsurance intermediaries are authorized to transact business in the state of New Jersey under N.J.S.A.17:22E-2(b). The Company maintains agreements with Towers Perrin conforming to the reinsurance intermediary contract requirements as stipulated in and in accordance with N.J.S.A. 17:22E-6. The agreement with Guy Carpenter did not meet N.J.S.A. 17:22E-6. However, the Company revised the agreement to be in compliance with N.J.S.A.17:22E-6.

## Automatic Property Facultative Agreement

All members of the group are covered under this agreement. It provides reinsurance coverage, on a facultative basis and subject to terms in the agreement, for Property business written by the Company and classified as Fire, Allied Lines, Inland Marine, Commercial Multi-Peril (property coverages), Homeowners Multiple Peril (property coverages) or Auto Physical Damage excluding collision, to the extent of the amount of the net loss sustained by the Company in excess of the Company's retention but not exceeding the limit of liability as set forth in the agreement. The Company's retention level is based on the Total Insured Value (TIV) of the business property and is available up to \$25,000,000 for TIV up to \$50,000,000. The premium paid in respect to each risk is in accordance with the Arch Re Facultative Program Portal between the Company and the reinsurer. Builder's risks are subject to a minimum ground up rate as specified in the agreement. All other risks are subject to a minimum premium that is the greater of \$500 or a minimum excess rate of \$250 net per million. Business is written directly with Arch Reinsurance Company of the Arch Capital Group LTD.

#### Employment Practices Liability Quota Share:

Business ceded under this treaty is 100 percent reinsured with General Reinsurance Corporation. This contract provides coverage under two Exhibits. Exhibit A covers insurance classified by the Company as Employment Practices Liability written as part of a business owners policy. The limit of insurance applicable to Exhibit A is \$250,000. Exhibit B covers business written by the Company on its Employment Practices Liability Insurance Policy. The maximum limit of insurance applicable to Exhibit B is \$1,000,000.

Exhibit A provides coverage for 75 percent of net loss, each claim. Exhibit B provides coverage for 50 percent of the first \$100,000 of net loss, each claim and 75 percent of the next \$900,000 of net loss, each claim in excess of the first \$100,000 of loss. Such insurance is written on a claims-made basis with respects to insureds domiciled in the USA.

#### Boiler & Machinery, Equipment, Portfolio, Referral Risks & Systems Breakdown:

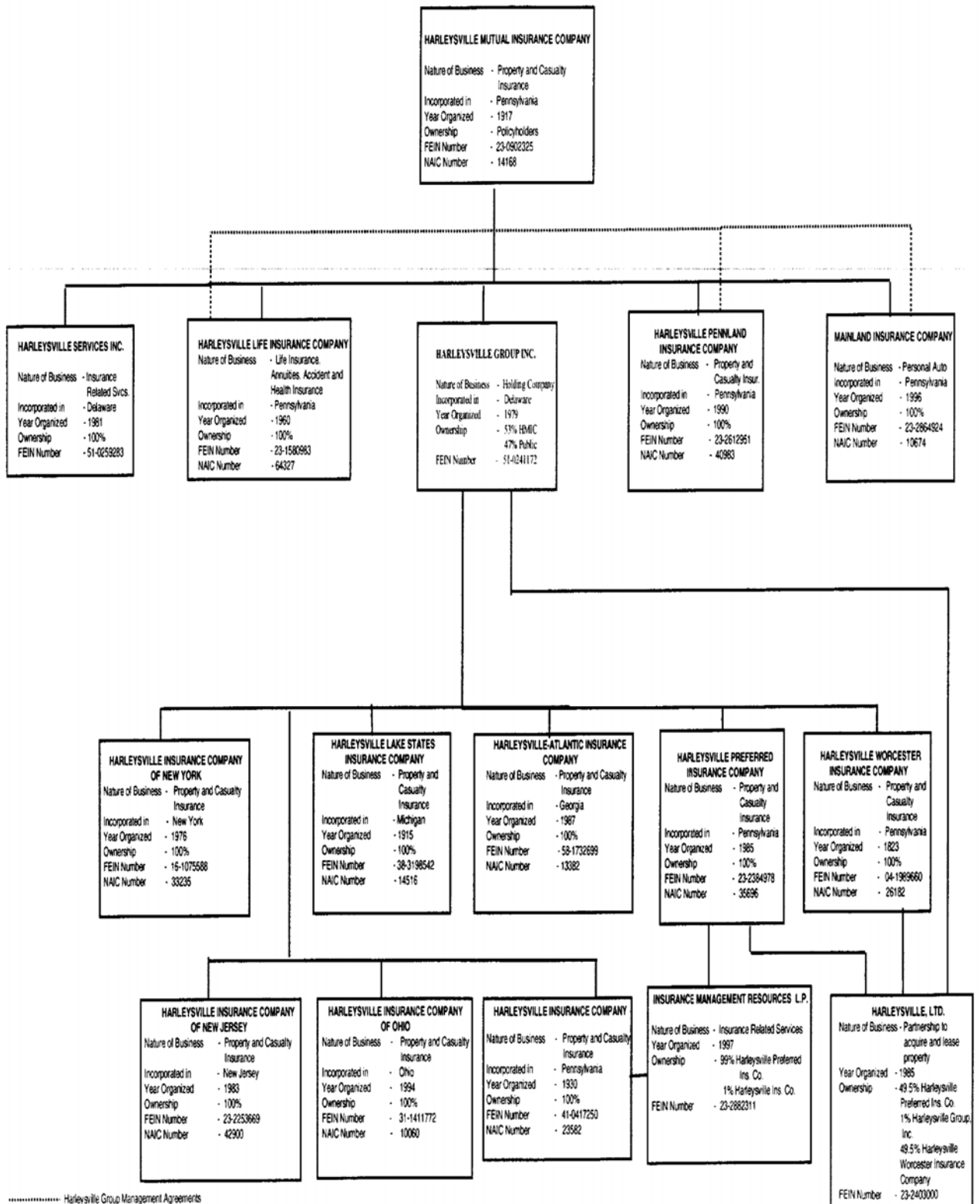
This treaty, reinsured 100 percent with The Hartford Steam Boiler Inspection and Insurance Company, provides automatic coverage for 100 percent of \$100,000,000 for any one accident as respects to business classified as Equipment Breakdown Liability, Portfolio Equipment Breakdown Liability (EBL), and EBL with a Systems Breakdown endorsement. This treaty also provides facultative coverage for risks with a TIV greater than \$50,000,000; any risk engaged in the generation of power; any risk which has a location in an occupancy of plastic, heavy manufacturing and metal manufacturing regardless of TIV; any risk that has a location in the occupancy of printing with a TIV greater than \$1,500,000 and any risk that has a location in an occupancy of light manufacturing with a TIV greater than \$3,000,000. The Company has no retention level under this treaty.

#### HOLDING COMPANY SYSTEM

The Company is a member of a holding company system as defined in N.J.S.A. 17:27A-1. The Company is a wholly owned subsidiary of Harleysville Group, Inc. (HGI) which is 54 percent owned by the Harleysville Mutual Insurance Company (HMIC) and 46 percent owned by the public.

The Company is a subsidiary of Harleysville Group Inc. within the holding company system as illustrated below:

# ORGANIZATIONAL CHART



## INTER COMPANY AGREEMENTS

### Amended and Restated Financial Tax Sharing Agreement

This agreement is between Harleysville Group Inc. and all its subsidiaries. Per the Agreement, a consolidated tax return is filed every year by Harleysville Group along with all its subsidiaries. A payment of tax liability by the subsidiary will be made to Parent and a refund to subsidiary will be made by Parent within 10 days of receiving notice. If the consolidated tax liability is adjusted, an account will be cleared within 30 days by either party. Each party is entitled to inspection of records. The agreement can be terminated with mutual consent. The agreement was signed on March 12, 1999 and superseded all prior agreements.

### Amended Consolidated and Restated Compensation Allocation Agreement

This agreement is made between Harleysville Group Inc. (HGI) and its affiliates.. Per the agreement, the termination of the agreement requires 60 days notice by any party. Under the provisions of the agreement, HICNJ shall reimburse HGI salary and employee benefits cost for the services performed by HGI. Reimbursements will be made each month. The basis of calculations is time allocations, premium volume, loss volume and level of investments. All parties will have a right to inspect the books. Any changes to the agreement will be in writing and the agreement will follow PA laws and will be submitted to the financial unit of the New Jersey Department of Banking and Insurance for approval. Any controversy or claim arising out of or relating to this contract or breach thereof shall be settled by arbitration. The agreement was signed May 11, 2009 and superseded all prior agreements.

### Accounts Receivables Agreement-Amended and Restated

This agreement is between Harleysville Mutual Insurance Company (HMIC) and HICNJ. Per Agreement, the Company shall transfer to HMIC all of its right, title and interest to receivables generated from insurance premium or agents' commissions in consideration for a payment from HMIC equal in amount to the receivable every month. If the receivables become uncollectible, HMIC will transfer the amount to the originating company. Each party will have the right to inspect the books of other party. Any changes to the agreement will be in writing. The agreement was signed on May 29, 1996 and superseded all prior agreements.

### Equipment & Supplies Allocation Agreement

This agreement is between HMIC and HICNJ. Per Agreement, HMIC will furnish all space required by HICNJ in the home office, any branch office and any other office mutually agreed upon by both parties. HMIC will also furnish all required equipment, office supplies, printing stationery, postage, photocopy and other similar supplies or equipment necessary. HIC-NJ will reimburse HMIC the cost of equipment, and supplies every month through inter company settlements. Each party will have the right to inspect the books of other party. Any changes to the agreement will be in writing. The agreement was signed on February 8, 1994 and superseded all prior agreements.

### Inter Company Pooling Agreement

This agreement, which has been amended eleven times, is between Harleysville Mutual Insurance Company and subsidiary companies and was originally made on April 7, 1986. The majority of the Company's assumed business is through the Inter Company Pooling Agreement. The Company assumes 21 percent of the net pooled business generated by the group, which is pooled together net of reinsurance ceded.

### POLICY ON CONFLICT OF INTEREST

The Company, through its Parent, Harleysville Group Inc., (HGI) has a questionnaire regarding conflict of interest in which the officers and directors are informally required to disclose any possible conflict. This questionnaire is to be completed annually. HGI does have a formal policy to complete conflict of interest questionnaires. Upon review of the conflict of interest questionnaire for the year 2009, it was determined that the Company did not have any reported conflicts of interest.

### EMPLOYEE WELFARE AND PENSION PLANS

The Company has no employees of its own, but utilizes the employees of its Parent Company, Harleysville Group Inc. (HGI). These employees are provided the following benefits:

- Group Life Insurance
- Group Health Insurance
- Long Term Disability Program
- Dental Insurance
- Salary Continuation Plan
- Pension Plan
- Employee Stock Purchase Plan

HGI also offers their employees a flexible benefit program that consists of following plans:

- Medical Insurance
- Dental Insurance
- Vision Insurance
- Retiree Health Insurance
- Supplemental Benefits
- Flexible Spending Account

The Company's Parent, HGI, froze the Pension Plan effective from March 31, 2006 as the management of the Company switched to a Defined Contribution Plan.

## FIDELITY BOND AND OTHER INSURANCE COVERAGE

The Company maintains an insurance program on a consolidated basis with the Parent Company and all affiliates designed to protect their assets arising out of property and casualty risks.

Coverages include automobile, property, general liability, directors and officers, fiduciary liability, workers compensation, computer crime, extortion and kidnap, errors and omissions, cyber liability, umbrella-primary, excess liability and fidelity bond.

The Company maintains on a consolidated basis, fidelity coverage in the amount of \$30,000,000 aggregate limit, \$15,000,000 underlying limit with \$500,000 deductible that includes coverage for dishonesty, loss of property on premises or in transit and forgery on deposits and securities. The amount of fidelity bond coverage as measured by the NAIC's formula and exposure index was deemed adequate.

## POLICY FORMS AND UNDERWRITING PRACTICES

Harleysville Insurance Company of New Jersey's direct written business is within the State of New Jersey and Pennsylvania only. The Company's total direct written premiums for 2009 included 27 percent for commercial multiple peril, 20 percent commercial auto liability, 17 percent workers' compensation and 36 percent for remaining lines of business.

During the examination period, the Company's new policy forms were filed and approved by the New Jersey Department of Banking and Insurance.

## ACCOUNTS AND RECORDS

Financial information needed in conjunction with the verification of assets and determination of liabilities was made available in detail and summary form. The general ledger system was tested and reconciled to the annual statement.

The Company's accounting books and records are maintained at its main administrative office located at 355 Maple Avenue, Harleysville, PA 19438-2297.

The Company records losses through the use of its in-house computerized system. Losses are received and paid by the Company's ultimate Parent, Harleysville Mutual Insurance Company, and settled through inter-company accounts.

The Company has a direct billing system for the premiums. The vast majority of premium receipts are processed through a Lock Box with First Niagara Bank N.A. (formerly Harleysville National Bank). Checks are deposited daily into the Harleysville Mutual Insurance Company Operating Account at First Niagara. Like losses, the premium payables/receivables are settled through inter-company accounts.

The commissions are paid on a percentage basis based on the premium volume and paid bi-monthly.

The Harleysville Insurance Company of New Jersey pays dividends to eligible workers' compensation policyholders under the Variable Dividend System and under the Risk Retention System. The dividends are authorized by the Board of Directors and are paid out accordingly.

The recording of any of the above type items affecting HMIC and its subsidiary involves a comparable journal entry, that is, the item is booked to the proper subsidiary and a reciprocal entry is automatically booked to HMIC. This activity is reflected in the inter company accounts that are settled monthly through the Custodial Accounts at Bank of New York Mellon.

Each subsidiary owns and controls its funds via their respective custodial accounts at Bank of New York Mellon. Balances in these accounts reflect monthly inter company settlements between HMIC and its subsidiaries.

#### ADVERTISING AND SALES MATERIAL

The Company's advertising and sales materials are in compliance with N.J.S.A. 17:18-10.

#### TREATMENT OF POLICYHOLDERS

The company maintains a written record of complaints. The Company has the information recorded in writing based on the the complaints written sheet and the written complaints transmittal. The Company is in compliance with N.J.S.A. 17:29B-4(10) which states: "This record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of these complaints, and the time it took to process each complaint".

#### CONTINUITY OF OPERATIONS

The Company has made provisions for the succession of officers in its By-laws. The Company has created a formal, comprehensive Business Continuity Plan (BCP), which includes a Disaster Recovery Plan.

The Disaster Recovery portion of the Business Continuity Plan (BCP) was tested with no exceptions noted.

FINANCIAL STATEMENTS AND OTHER EXHIBITS

Exhibit A Balance Sheet as of December 31, 2009

Exhibit B Summary of Operations for the Five-Year Period Ending  
December 31, 2009

Exhibit C Capital and Surplus Account for the Five-Year Period  
Ended December 31, 2009

HARLEYS VILLE INSURANCE COMPANY OF NEW JERSEY				
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS				
	DECEMBER	31, 2009		EXHIBIT A
	Current	Company	Examination	Note
	<u>Examination</u>	<u>As of 12/31/09</u>	<u>Change</u>	<u>Number</u>
<u>Assets</u>				
Bonds	\$603,480,053	\$603,480,053	\$0	1
Common stocks	52,757,751	52,757,751	0	1
Cash and Short-Term Investments	14,796,050	14,796,050	0	
Other Invested Assets	1,067,236	1,067,236	0	
Receivable for securities	10,629,317	10,629,317	0	
Investment income due and accrued	6,990,556	6,990,556	0	
Uncollected premiums and agents' balances in the course of collect	1,032,282	1,032,282	0	
Amounts recoverable from reinsurers	6,283,410	6,283,410	0	
Net deferred tax asset	16,112,180	16,112,180	0	
Guaranty funds receivable or deposit	1,889,459	1,889,459	0	
Equities & deposits in pools and associations	<u>108,870</u>	<u>108,870</u>	0	
<b>Total Admitted Assets</b>	<b><u>\$715,147,164</u></b>	<b><u>\$715,147,164</u></b>	<b><u>\$0</u></b>	
<u>Liabilities</u>				
Losses	\$324,398,773	\$324,398,773	\$0	2
Loss Adjustment Expenses	84,881,722	84,881,722	0	2
Contingent Commissions and Other Similar Charges	3,372,121	3,372,121	0	
Other Expenses	3,296,291	3,296,291	0	
Taxes, Licenses and Fees	3,906,162	3,906,162	0	
Current Federal and Foreign Income Taxes	95,184	95,184	0	
Unearned Premiums	114,501,478	114,501,478	0	
Dividends Declared and Unpaid: Policyholders	52,475	52,475	0	
Ceded Reinsurance Premiums Payable(Net of Ceding Commission)	(176,067)	(176,067)	0	
Funds Held by Company under Reinsurance Treaties	991,595	991,595	0	
Amounts Withheld or retained by Company for Account of Others	1,770,500	1,770,500	0	
Provision for Reinsurance	189,098	189,098	0	
Payable to parent, subsidiaries and affiliates	1,352,108	1,352,108	0	
Payable for Securities	1,126,420	1,126,420	0	
<b>Total Liabilities</b>	<b><u>\$539,757,860</u></b>	<b><u>\$539,757,860</u></b>	<b><u>\$0</u></b>	
<u>Surplus and Other Funds</u>				
Aggregate write-ins for Special Funds	\$2,389,373	\$2,389,373	\$0	
Common Capital Stock	9,000,000	9,000,000	0	
Gross Paid-in and Contributed Surplus	18,604,165	18,604,165	0	
Unassigned Funds (Surplus)	<u>145,395,766</u>	<u>145,395,766</u>	<u>0</u>	
Surplus as Regards Policyholders	<u>\$175,389,304</u>	<u>\$175,389,304</u>	<u>\$0</u>	3
<b>Total Liabilities, Surplus and Other Funds</b>	<b><u>\$715,147,164</u></b>	<b><u>\$715,147,164</u></b>	<b><u>\$0</u></b>	

**HARLEYSVILLE INSURANCE COMPANY OF NEW JERSEY**  
**SUMMARY OF OPERATIONS FOR THE**  
**FIVE YEAR PERIOD ENDING DECEMBER 31, 2009**

**EXHIBIT B**

<u>UNDERWRITING INCOME</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Premiums Earned	\$ 222,080,166	\$221,355,510	\$219,825,825	\$241,110,313	\$225,356,164
<b>Deductions:</b>					
Losses Incurred	\$ 121,395,802	\$112,571,283	\$109,829,953	\$131,424,508	\$118,038,667
Loss Expenses Incurred	28,215,390	29,672,571	28,114,012	28,839,941	26,801,662
Other Underwriting Expenses Incurred	<u>76,781,652</u>	<u>75,649,280</u>	<u>74,653,645</u>	<u>83,846,005</u>	<u>79,200,854</u>
<b>Total Underwriting Deductions</b>	<b>\$226,392,844</b>	<b>\$217,893,134</b>	<b>\$212,597,610</b>	<b>\$244,110,454</b>	<b>\$224,041,183</b>
<b>Net Underwriting Gain or (Loss)</b>	<b><u>(\$4,312,678)</u></b>	<b><u>\$3,462,376</u></b>	<b><u>\$7,228,215</u></b>	<b><u>(\$3,000,141)</u></b>	<b><u>\$1,314,981</u></b>
<u>INVESTMENT INCOME</u>					
Net Investment Income Earned	\$25,464,548	\$28,325,723	\$30,680,985	\$31,355,294	\$29,361,305
Net Realized Capital Gains or (-) Losses	<u>89,317</u>	<u>10,355,940</u>	<u>547,980</u>	<u>(16,498,689)</u>	<u>383,935</u>
<b>Net Investment Gain</b>	<b><u>\$25,553,865</u></b>	<b><u>\$38,681,663</u></b>	<b><u>\$31,228,965</u></b>	<b><u>\$14,856,605</u></b>	<b><u>\$29,745,240</u></b>
<u>OTHER INCOME</u>					
Net Gain or Loss (-) From Agents' Balances					
Charged Off	(\$149,785)	(\$128,809)	(\$156,248)	(\$259,721)	(\$317,625)
Finance or Service Charge not Included in Premium	488,679	468,588	467,898	462,385	437,852
Aggregate Write-ins for Miscellaneous Income	<u>(216,141)</u>	<u>0</u>	<u>53,043</u>	<u>18,371</u>	<u>86,740</u>
<b>Total Other Income</b>	<b><u>\$122,753</u></b>	<b><u>\$339,779</u></b>	<b><u>\$364,693</u></b>	<b><u>\$221,035</u></b>	<b><u>\$206,697</u></b>
<b>Net Income Before Dividends To Policyholders</b> <b>and Before Federal and Foreign Income Taxes</b>	<b>\$21,363,940</b>	<b>\$42,483,818</b>	<b>\$38,821,873</b>	<b>\$12,077,499</b>	<b>\$31,266,918</b>
<b>Dividends To Policyholders</b>	<b>403,117</b>	<b>390,888</b>	<b>339,728</b>	<b>360,889</b>	<b>315,978</b>
<b>Net Income, After Dividends to Policyholders</b> <b>but Before Federal and Foreign Income Taxes</b>	<b>\$20,960,823</b>	<b>\$42,092,930</b>	<b>\$38,482,145</b>	<b>\$11,716,610</b>	<b>\$30,950,940</b>
<b>Federal and Foreign Income Taxes Incurred</b>	<b><u>4,049,457</u></b>	<b><u>5,812,394</u></b>	<b><u>8,259,698</u></b>	<b><u>8,951,503</u></b>	<b><u>6,998,609</u></b>
<b>Net Income</b>	<b><u>\$16,911,366</u></b>	<b><u>\$36,280,536</u></b>	<b><u>\$30,222,447</u></b>	<b><u>\$2,765,107</u></b>	<b><u>\$23,952,331</u></b>

HARLEYSVILLE INSURANCE COMPANY OF NEW JERSEY  
 CAPITAL AND SURPLUS ACCOUNT FOR  
 THE FIVE YEAR PERIOD ENDED DECEMBER 31, 2009

EXHIBIT C

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Net Income	\$16,911,366	\$36,280,536	\$30,222,447	\$2,765,107	\$23,952,331
<b>OTHER SURPLUS GAINS OR (LOSSES)</b>					
Change in Net Unrealized Capital Gain or Losses	\$528,023	(\$6,331,654)	\$20,892	(\$2,619,679)	\$9,972,076
Change in Net Deferred Income Tax	102,518	(4,985,564)	(3,054,120)	4,047,264	(850,471)
Change in Non Admitted Assets	2,207,040	6,651,023	226,315	(2,023,964)	5,092,857
Change in Provision for Reinsurance	146,241	(125,917)	(305,127)	343,396	(86,098)
Dividends to Stock Holders	(8,200,000)	0	(25,924,000)	(29,600,000)	(14,990,000)
Aggregate-Write-ins for Gains and Losses in Surplus	0	0	0	0	2,389,373
Total Other Surplus Gains or (-) Losses	<u>(5,216,178)</u>	<u>(4,792,112)</u>	<u>(29,036,040)</u>	<u>(29,852,983)</u>	<u>1,527,737</u>
Change In Surplus as Regards Policyholders for the Year	\$11,695,188	\$31,488,424	\$1,186,227	(\$27,087,876)	\$25,480,068
Surplus as Regards Policyholders					
December 31, Previous Year	<u>\$132,627,273</u>	<u>\$144,322,461</u>	<u>\$175,810,885</u>	<u>\$176,997,112</u>	<u>\$149,909,236</u>
Surplus as Regards Policyholders					
December 31, Current Year	<u><u>\$144,322,461</u></u>	<u><u>\$175,810,885</u></u>	<u><u>\$176,997,112</u></u>	<u><u>\$149,909,236</u></u>	<u><u>\$175,389,304</u></u>

## NOTES TO THE FINANCIAL STATEMENTS

### (NOTE) 1: BONDS AND STOCKS

HICNJ reported admitted assets for bonds and common stocks of \$603,480,053 and \$52,757,751, respectively at December 31, 2009. These amounts will be accepted as stated by this examination.

### (NOTE 2) LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

HICNJ's loss and loss adjustment expense reserves as reported by the Company are \$324,398,773 and \$84,881,722 respectively for the period ending December 31, 2009.

The New Jersey Department of Banking and Insurance Managing Property and Casualty Actuary determined that HICNJ's reserves as of December 31, 2009 were reasonable and acceptable to meet future loss and loss adjustment expenses. This review was based on an actuarial analysis by the lead State of Pennsylvania.

### (NOTE 3) SURPLUS AS REGARDS POLICYHOLDERS

HICNJ's surplus as regards to policyholders as determined by this examination and reported in the Company's 2009 Annual Statement is \$175,389,304. This amount consisted of aggregate write-ins for special funds of \$2,389,373, common capital stock of \$9,000,000, gross paid-in and contributed surplus of \$18,604,165 and unassigned funds (surplus) of \$145,395,766.

STATEMENT OF NEW JERSEY DEPARTMENT OF BANKING AND INSURANCE  
PROPERTY AND CASUALTY ACTUARY

Harleysville Insurance Company of New Jersey

I, Boris Privman, Managing Property and Casualty Actuary for the New Jersey Department of Banking and Insurance, reviewed the actuarial analyses performed by the Pennsylvania Insurance Department actuary as of December 31, 2009 for the reported loss and loss adjustment expense reserves for the aforementioned insurer.

Actuarial results and findings contained within this examination report are the sole responsibility of the Actuarial Unit of Office of Solvency Regulation, New Jersey Department of Banking and Insurance.

/S/

Boris Privman - FCAS, MAAA

CONCLUSION

A regular statutory financial condition examination was conducted by the undersigned with the assistance of fellow examiners of the New Jersey Department of Banking and Insurance examination staff.

The examination and audit was conducted at the Harleysville Insurance Company of New Jersey office in Harleysville, Pennsylvania. The courteous assistance and cooperation of the Company's officers and employees is acknowledged.

Respectfully Submitted,

/S/

Ned E. Saaz,CFE  
Insurance Examiner 1  
NJ Department of Banking and Insurance,  
Office of Solvency Regulation

HARLEYSVILLE INSURANCE COMPANY OF NEW JERSEY

I, Ned E. Saaz, do solemnly swear that the foregoing report of examination is hereby represented to be a full and true statement of the condition and affairs of the subject insurer as of December 31, 2009 to the best of my information, knowledge and belief.

Respectfully Submitted,

/S/

Ned E. Saaz, CFE  
Insurance Examiner I  
New Jersey Department of Banking & Insurance  
Office of Solvency Regulation

State of New Jersey  
County of Mercer

Subscribed and sworn to before me, on this 2nd day of May 2011.

/S/

Sheila M. Tkacs  
Notary Public of New Jersey

My commission expires: July 2015