

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

FORM 10-Q

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

For the quarterly period ended September 30, 2005

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-14697

**HARLEYSVILLE GROUP INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**51-0241172**

(I.R.S. Employer  
Identification No.)

**355 Maple Avenue, Harleysville, PA 19438-2297**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(215) 256-5000**

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No .

Indicate by check mark whether Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No .

At October 31, 2005, 30,512,001 shares of common stock of Harleysville Group Inc. were outstanding.

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## Item 1. Financial Statements

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share data)

	<u>September 30,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
	(Unaudited)	
<b>Assets</b>		
Investments:		
Fixed maturities:		
Held to maturity, at amortized cost (fair value \$481,054 and \$517,434)	\$ 473,532	\$ 499,487
Available for sale, at fair value (cost \$1,182,955 and \$1,028,457)	1,200,140	1,067,504
Equity securities, at fair value (cost \$138,513 and \$110,495)	177,085	150,249
Short-term investments, at cost, which approximates fair value	64,945	113,822
Fixed maturity securities on loan:		
Held to maturity, at amortized cost (fair value \$5,029 and \$1,966)	4,958	1,835
Available for sale, at fair value (amortized cost \$110,329 and \$128,183)	112,726	134,020
Total investments	<u>2,033,386</u>	<u>1,966,917</u>
Cash	3,671	328
Receivables:		
Premiums	143,476	141,601
Reinsurance (affiliate \$314 and \$390)	229,448	193,209
Accrued investment income	22,376	23,236
Total receivables	<u>395,300</u>	<u>358,046</u>
Deferred policy acquisition costs	106,603	100,755
Prepaid reinsurance premiums	34,884	32,675
Property and equipment, net	17,981	20,891
Deferred income taxes	63,130	53,137
Securities lending collateral	121,393	139,486
Due from affiliate	15,885	
Other assets	45,416	45,828
Total assets	<u>\$ 2,837,649</u>	<u>\$ 2,718,063</u>
<b>Liabilities and Shareholders' Equity</b>		
Liabilities:		
Unpaid losses and loss settlement expenses (affiliate \$183,314 and \$187,172)	\$ 1,448,538	\$ 1,317,735
Unearned premiums (affiliate \$50,239 and \$47,038)	455,645	441,697
Accounts payable and accrued expenses	89,328	99,098
Securities lending obligation	121,393	139,486
Debt (affiliate \$18,500 and \$18,500)	119,060	119,625
Due to affiliate		12,498
Total liabilities	<u>2,233,964</u>	<u>2,130,139</u>
Shareholders' equity:		
Preferred stock, \$1 par value, authorized 1,000,000 shares; none issued		
Common stock, \$1 par value, authorized 80,000,000 shares; issued 31,909,360 and 31,589,474 shares; outstanding 30,511,451 and 30,191,565 shares	31,909	31,589
Additional paid-in capital	167,704	161,689
Accumulated other comprehensive income	24,837	42,051
Retained earnings	404,582	377,282
Deferred compensation	(860)	(200)
Treasury stock, at cost, 1,397,909 shares	(24,487)	(24,487)
Total shareholders' equity	<u>603,685</u>	<u>587,924</u>
Total liabilities and shareholders' equity	<u>\$ 2,837,649</u>	<u>\$ 2,718,063</u>

See accompanying notes to consolidated financial statements.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

**For the three months ended September 30, 2005 and 2004**  
(dollars in thousands, except per share data)

	2005	2004
Revenues:		
Premiums earned from affiliate, (ceded to affiliate, \$188,750 and \$188,868)	\$ 212,327	\$ 212,641
Investment income, net of investment expense	23,064	21,499
Realized investment gains (losses), net	(1)	104
Other income (affiliate \$1,719 and \$1,755)	3,811	4,024
Total revenues	239,201	238,268
Losses and expenses:		
Losses and loss settlement expenses from affiliate (ceded to affiliate, \$120,513 and \$129,248)	139,078	153,944
Amortization of deferred policy acquisition costs	53,163	52,150
Other underwriting expenses	22,851	18,154
Interest expense (affiliate \$177 and \$100)	1,660	1,587
Other expenses	1,036	2,764
Total expenses	217,788	228,599
Income before income taxes	21,413	9,669
Income taxes	4,972	789
Net income	\$ 16,441	\$ 8,880
Per common share:		
Basic earnings	\$ .54	\$ .30
Diluted earnings	\$ .54	\$ .29
Cash dividend	\$ .175	\$ .17

See accompanying notes to consolidated financial statements.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

**For the nine months ended September 30, 2005 and 2004**  
(dollars in thousands, except per share data)

	<u>2005</u>	<u>2004</u>
Revenues:		
Premiums earned from affiliate, (ceded to affiliate, \$559,191 and \$553,663)	\$ 628,872	\$ 627,241
Investment income, net of investment expense	67,403	64,578
Realized investment gains, net	67	12,651
Other income (affiliate \$5,220 and \$5,210)	<u>12,252</u>	<u>12,259</u>
Total revenues	<u>708,594</u>	<u>716,729</u>
Losses and expenses:		
Losses and loss settlement expenses from affiliate (ceded to affiliate, \$377,018 and \$391,030)	430,943	453,765
Amortization of deferred policy acquisition costs	156,124	153,536
Other underwriting expenses	57,984	57,518
Interest expense (affiliate \$485 and \$268)	4,945	4,730
Other expenses	<u>4,306</u>	<u>5,449</u>
Total expenses	<u>654,302</u>	<u>674,998</u>
Income before income taxes	54,292	41,731
Income taxes	<u>11,342</u>	<u>6,630</u>
Net income	<u>\$ 42,950</u>	<u>\$ 35,101</u>
Per common share:		
Basic earnings	<u>\$ 1.42</u>	<u>\$ 1.17</u>
Diluted earnings	<u>\$ 1.41</u>	<u>\$ 1.17</u>
Cash dividend	<u>\$ .515</u>	<u>\$ .51</u>

See accompanying notes to consolidated financial statements.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**(Unaudited)**

**For the nine months ended September 30, 2005**

(dollars in thousands)

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Retained Earnings</u>	<u>Deferred Compensation</u>	<u>Treasury Stock</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>						
Balance at December 31, 2004	31,589,474	\$31,589	\$161,689	\$42,051	\$377,282	\$(200)	\$(24,487)	<u>\$587,924</u>
Net income					42,950			42,950
Other comprehensive income, net of tax:								
Unrealized investment losses, net of reclassification adjustment				(17,214)				<u>(17,214)</u>
Comprehensive income								25,736
Issuance of common stock	319,886	320	5,715					6,035
Tax benefit from stock options exercised			300					300
Deferred compensation						(660)		(660)
Cash dividend paid					(15,650)			<u>(15,650)</u>
Balance at September 30, 2005	<u>31,909,360</u>	<u>\$31,909</u>	<u>\$167,704</u>	<u>\$24,837</u>	<u>\$404,582</u>	<u>\$(860)</u>	<u>\$(24,487)</u>	<u>\$603,685</u>

See accompanying notes to consolidated financial statements.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

**For the nine months ended September 30, 2005 and 2004**  
(in thousands)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Net income	\$ 42,950	\$ 35,101
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in receivables, unearned premiums and prepaid reinsurance balances	(25,515)	(266)
Change in affiliate balance	(28,383)	(23,017)
Increase in unpaid losses and loss settlement expenses	130,803	60,843
Deferred income taxes	(724)	(1,518)
Increase in deferred policy acquisition costs	(5,848)	(4,343)
Amortization and depreciation	3,955	4,017
Gain on sale of investments	(67)	(12,651)
Other, net	(1,245)	12,029
Net cash provided by operating activities	<u>115,926</u>	<u>70,195</u>
Cash flows from investing activities:		
Fixed maturity investments:		
Purchases	(217,595)	(157,879)
Sales or maturities	90,343	151,491
Equity securities:		
Purchases	(55,873)	(25,447)
Sales	31,343	25,064
Net sales (purchases) of short-term investments	48,877	(62,801)
Sale (purchase) of property and equipment, net	1,357	(818)
Net cash used by investing activities	<u>(101,548)</u>	<u>(70,390)</u>
Cash flows from financing activities:		
Issuance of common stock	5,180	3,635
Repayment of debt obligations	(565)	(520)
Dividend paid (to affiliate, \$8,756 and \$8,671)	(15,650)	(15,313)
Net cash used by financing activities	<u>(11,035)</u>	<u>(12,198)</u>
Increase (decrease) in cash	3,343	(12,393)
Cash at beginning of period	328	13,430
Cash at end of period	<u>\$ 3,671</u>	<u>\$ 1,037</u>

See accompanying notes to consolidated financial statements.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**(Unaudited)**

**Notes To Consolidated Financial Statements**

1 - Basis of Presentation

The financial information for the interim periods included herein is unaudited; however, such information reflects all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary to a fair presentation of the financial position, results of operations, and cash flows for the interim periods. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

These financial statements should be read in conjunction with the financial statements and notes for the year ended December 31, 2004 included in the Company's 2004 Annual Report filed with the Securities and Exchange Commission on Form 10-K.

The affiliate transaction disclosures on the face of the financial statements are in regards to transactions with Harleysville Mutual Insurance Company (Mutual). Mutual owns approximately 56% of the outstanding common stock of Harleysville Group Inc. As used herein, "Harleysville Group" refers to Harleysville Group Inc. and its subsidiaries.

Policy Acquisition Costs

Policy acquisition costs, such as commissions, premium taxes and certain other underwriting and agency expenses that vary with and are primarily related to the production of business, are deferred and amortized over the effective period of the related insurance policies and in proportion to the premiums earned. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value. The estimation of net realizable value takes into account the premium to be earned, related investment income over the claim paying period, losses and loss settlement expenses, and certain other costs expected to be incurred as the premium is earned. Future changes in estimates, the most significant of which is expected losses and loss settlement expenses, may require adjustments to deferred policy acquisition costs. If the estimation of net realizable value indicates that the acquisition costs are unrecoverable, further analyses are completed to determine if a reserve is required to provide for losses that may exceed the related unearned premiums.

Stock-Based Compensation

Stock-based compensation plans are accounted for under the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, no compensation expense is recognized for fixed stock option grants and an employee stock purchase plan. Compensation expense would be recorded on the date of a stock option grant only if the current market price of the underlying stock exceeded the exercise price. The following table illustrates the effect on net income and earnings per share as if the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (as amended by SFAS No. 148), "Accounting for Stock-Based Compensation," had been applied for the three and nine months ended September 30, 2005 and 2004:

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**(Unaudited)**

**Notes To Consolidated Financial Statements**  
**(Continued)**

	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
	(in thousands, except per share data)			
Net income, as reported	\$ 16,441	\$ 8,880	\$ 42,950	\$ 35,101
Plus:				
Stock-based employee compensation expense included in reported net income, net of related tax effects	354	199	27	253
Less:				
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	<u>(760)</u>	<u>(764)</u>	<u>(1,607)</u>	<u>(2,216)</u>
Pro forma net income	<u>\$ 16,035</u>	<u>\$ 8,315</u>	<u>\$ 41,370</u>	<u>\$ 33,138</u>
Basic earnings per share:				
As reported	\$ .54	\$ .30	\$ 1.42	\$ 1.17
Pro forma	\$ .53	\$ .28	\$ 1.36	\$ 1.10
Diluted earnings per share:				
As reported	\$ .54	\$ .29	\$ 1.41	\$ 1.17
Pro forma	\$ .52	\$ .28	\$ 1.36	\$ 1.10

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123(R), "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS 123(R) requires that the compensation cost related to share-based payment transactions be recognized in financial statements. The compensation cost will be measured based on the fair value of the equity or liability instruments issued. The Statement is effective as of the beginning of the first fiscal year beginning after June 15, 2005. The impact of adopting SFAS No. 123(R) is currently being evaluated. The impact that any future share-based payment transactions will have on our financial position or results of operations is not yet known.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**(Unaudited)**

**Notes To Consolidated Financial Statements**  
**(Continued)**

2 - Earnings Per Share

The computation of basic and diluted earnings per share is as follows:

	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	(in thousands, except per share data)			
Numerator for basic and diluted earnings per share:				
Net income	\$ 16,441	\$ 8,880	\$ 42,950	\$ 35,101
Denominator for basic earnings per share -- weighted average shares outstanding	30,428	30,063	30,330	29,995
Effect of stock incentive plans	161	90	156	96
Denominator for diluted earnings per share	30,589	30,153	30,486	30,091
Basic earnings per share	\$ .54	\$ .30	\$ 1.42	\$ 1.17
Diluted earnings per share	\$ .54	\$ .29	\$ 1.41	\$ 1.17

The following options to purchase shares of common stock were not included in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price:

	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	(in thousands)			
Number of options	1,184	1,608	1,184	1,608

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**(Unaudited)**

**Notes To Consolidated Financial Statements**  
**(Continued)**

3 – Reinsurance

Premiums earned are net of amounts ceded of \$24,711,000 and \$70,538,000 for the three and nine months ended September 30, 2005, respectively, and \$22,051,000 and \$66,108,000 for the three and nine months ended September 30, 2004, respectively. Losses and loss settlement expenses are net of amounts ceded of \$71,856,000 and \$83,052,000 for the three and nine months ended September 30, 2005, respectively, and \$13,592,000 and \$53,308,000 for the three and nine months ended September 30, 2004, respectively. Losses and loss settlement expenses ceded for the three and nine months ended September 30, 2005 include \$67,566,000 and \$74,866,000 of losses ceded to the federal government's National Flood Insurance Program (NFIP), primarily related to flood losses from Hurricane Katrina. Reinsurance receivables include \$65,869,000 and \$22,389,000 at September 30, 2005 and December 31, 2004, respectively, for flood losses recoverable from the NFIP. Since such flood losses are entirely ceded to the NFIP they did not impact results of operations. Such amounts ceded do not include the reinsurance transactions with Mutual under the pooling arrangement (described below) which are reflected on the face of the income statements, but do include reinsurance with unaffiliated reinsurers and the reinsurance described in the following paragraph.

Harleysville Group has a reinsurance agreement with Mutual whereby Mutual reinsures accumulated catastrophe losses in a quarter up to \$14,400,000 in excess of \$3,600,000 in return for a reinsurance premium. The agreement excludes catastrophe losses resulting from earthquakes, terrorism or hurricanes, and supplements the existing external catastrophe reinsurance program. Harleysville Group ceded to Mutual premiums earned of \$2,196,000 and \$2,164,000 and losses incurred of \$(24,000) and \$(440,000), for the three months ended September 30, 2005 and 2004, respectively. Harleysville Group ceded to Mutual premiums earned of \$6,607,000 and \$6,424,000 and losses incurred of \$(114,000) and \$544,000 for the nine months ended September 30, 2005 and 2004, respectively. Harleysville Group and Mutual have agreed to terminate this agreement on December 31, 2005.

Pursuant to the terms of a reinsurance pooling agreement with Mutual, each of the insurance subsidiaries of Harleysville Group Inc. cedes premiums, losses and expenses on all of their respective business to Mutual which, in turn, retrocedes to such subsidiaries a specified portion of premiums, losses and expenses of Mutual and such subsidiaries. Because this agreement does not relieve Harleysville Group Inc.'s insurance subsidiaries of primary liability as originating insurers, there is a concentration of credit risk arising from business ceded to Mutual. However, the reinsurance pooling agreement provides for the right of offset. Mutual has an A. M. Best rating of "A-" (Excellent).

4 - Cash Flows

Net cash tax payments (refunds) of \$8,600,000 and \$(13,709,000) were made (received) in the first nine months of 2005 and 2004, respectively. Cash interest payments of \$6,245,000 and \$6,043,000 were made in the first nine months of 2005 and 2004, respectively.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**(Unaudited)**

**Notes To Consolidated Financial Statements**  
**(Continued)**

5 - Segment Information

The performance of the personal lines and commercial lines is evaluated based upon underwriting results as determined under statutory accounting practices (SAP).

Financial data by segment is as follows:

	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
	(in thousands)			
Revenues:				
Premiums earned:				
Commercial lines	\$ 173,948	\$ 169,680	\$ 512,119	\$ 495,791
Personal lines	38,379	42,961	116,753	131,450
Total premiums earned	<u>212,327</u>	<u>212,641</u>	<u>628,872</u>	<u>627,241</u>
Net investment income	23,064	21,499	67,403	64,578
Realized investment gains (losses)	(1)	104	67	12,651
Other	<u>3,811</u>	<u>4,024</u>	<u>12,252</u>	<u>12,259</u>
Total revenues	<u>\$ 239,201</u>	<u>\$ 238,268</u>	<u>\$ 708,594</u>	<u>\$ 716,729</u>
Income before income taxes:				
Underwriting gain (loss):				
Commercial lines	\$ (5,742)	\$ (13,517)	\$ (25,740)	\$ (39,523)
Personal lines	2,497	344	4,028	(4,506)
SAP underwriting loss	<u>(3,245)</u>	<u>(13,173)</u>	<u>(21,712)</u>	<u>(44,029)</u>
GAAP adjustments	480	1,566	5,533	6,451
GAAP underwriting loss	<u>(2,765)</u>	<u>(11,607)</u>	<u>(16,179)</u>	<u>(37,578)</u>
Net investment income	23,064	21,499	67,403	64,578
Realized investment gains (losses)	(1)	104	67	12,651
Other	<u>1,115</u>	<u>(327)</u>	<u>3,001</u>	<u>2,080</u>
Income before income taxes	<u>\$ 21,413</u>	<u>\$ 9,669</u>	<u>\$ 54,292</u>	<u>\$ 41,731</u>

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**(Unaudited)**

**Notes To Consolidated Financial Statements**  
**(Continued)**

6 - Comprehensive Income

Comprehensive income for the three and nine months ended September 30, 2005 and 2004 consisted of the following (all amounts are net of taxes):

	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
	(in thousands)			
Net income	\$ 16,441	\$ 8,880	\$ 42,950	\$ 35,101
Other comprehensive income (loss):				
Unrealized investment holding gains (losses) arising during period	(11,363)	8,152	(17,170)	(6,449)
Less:				
Reclassification adjustment for gains included in net income		(65)	(44)	(8,196)
Net unrealized investment gains (losses)	<u>(11,363)</u>	<u>8,087</u>	<u>(17,214)</u>	<u>(14,645)</u>
Comprehensive income	<u>\$ 5,078</u>	<u>\$ 16,967</u>	<u>\$ 25,736</u>	<u>\$ 20,456</u>

7 - Pension

Harleysville Group Inc. has a pension plan that covers substantially all full-time employees. The net periodic pension cost for the plan including Mutual consists of the following components:

	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
	(in thousands)			
Components of net periodic pension cost:				
Service cost	\$ 2,315	\$ 2,007	\$ 6,733	\$ 5,992
Interest cost	2,986	2,821	8,962	8,361
Expected return on plan assets	(3,018)	(3,101)	(8,598)	(9,141)
Recognized net actuarial loss	1,134	600	3,358	1,635
Amortization of prior service cost	52	52	156	157
Net transition amortization	<u>13</u>	<u>14</u>	<u>40</u>	<u>39</u>
Net periodic pension cost:				
Entire plan	<u>\$ 3,482</u>	<u>\$ 2,393</u>	<u>\$ 10,651</u>	<u>\$ 7,043</u>
Harleysville Group portion	<u>\$ 2,308</u>	<u>\$ 1,589</u>	<u>\$ 7,057</u>	<u>\$ 4,658</u>

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**  
**(Unaudited)**

**Notes To Consolidated Financial Statements**  
**(Continued)**

Harleysville Group's expected portion of the 2005 contribution to the pension plan is \$8,015,000. Contributions of \$5,963,000 were made in the nine months ended September 30, 2005.

**8 – Shareholders' Equity**

Various states have adopted the National Association of Insurance Commissioners (NAIC) risk-based capital (RBC) standards that require insurance companies to calculate and report statutory capital and surplus needs based on a formula measuring underwriting, investment and other business risks inherent in an individual company's operations. These RBC standards have not affected the operations of Harleysville Group since each of the Company's insurance subsidiaries has statutory capital and surplus in excess of RBC requirements.

These RBC standards require the calculation of a ratio of total adjusted capital to Authorized Control Level. Insurers with a ratio below 200% are subject to different levels of regulatory intervention and action. Based upon their 2004 statutory financial statements, the ratio of total adjusted capital to the Authorized Control Level for the Company's nine insurance subsidiaries at December 31, 2004 ranged from 498% to 609%.

## HARLEYSVILLE GROUP INC. AND SUBSIDIARIES

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Certain of the statements contained herein (other than statements of historical facts) are forward looking statements. Such forward looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and include estimates and assumptions related to economic, competitive and legislative developments. These forward looking statements are subject to change and uncertainty which are, in many instances, beyond the Company's control and have been made based upon management's expectations and beliefs concerning future developments and their potential effect on Harleysville Group. There can be no assurance that future developments will be in accordance with management's expectations so that the effect of future developments on Harleysville Group will be those anticipated by management. Actual financial results including premium growth and underwriting results could differ materially from those anticipated by Harleysville Group depending on the outcome of certain factors, which may include changes in property and casualty loss trends and reserves; catastrophe losses; competition in insurance product pricing; government regulation and changes therein which may impede the ability to charge adequate rates; performance of the financial markets; fluctuations in interest rates; availability and price of reinsurance; the Best's rating of Harleysville Group; and the status of labor markets in which the Company operates.

#### Overview

The Company's net income is primarily determined by three elements including the expenses related to these elements:

- net premium income
- investment income
- amounts paid or reserved to settle insured claims

A number of factors may affect the level of premium income, including:

- limitations on rates arising from the competitive market place or regulation
- limitation on available business arising from a need to maintain the quality of underwritten risks
- the Company's ability to maintain its A- ("excellent") rating by A.M. Best
- the ability of the Company to maintain a reputation for efficiency and fairness in claims administration

## HARLEYSVILLE GROUP INC. AND SUBSIDIARIES

### Management's Discussion and Analysis of Financial Condition and Results of Operations

(Continued)

A number of factors may affect the level of investment income, including:

- general interest rate levels
- specific adverse events affecting the issuers of debt obligations held by the Company
- changes in the prices of equity securities generally and those held by the Company specifically
- cash available for investing activities

Loss and loss settlement expenses are affected by a number of factors, including:

- the quality of the risks underwritten by the Company
- the nature and severity of catastrophe losses
- the availability, cost and terms of reinsurance
- underlying settlement costs, including medical and legal costs

The Company seeks to manage each of the foregoing to the extent within its control. Many of the foregoing factors are partially, or entirely, outside of the control of the Company.

#### Critical Accounting Policies and Estimates

The consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles, which require Harleysville Group to make estimates and assumptions (see Note 1 of the Notes to Consolidated Financial Statements for the year ended December 31, 2004 included in the Company's 2004 Annual Report filed with the Securities and Exchange Commission on Form 10-K). Harleysville Group believes that of its significant accounting policies, the following may involve a higher degree of judgment and estimation. The judgments, or the methodology on which the judgments are made, are reviewed quarterly with the Audit Committee.

**Liability for Losses and Loss Settlement Expenses.** The liability for losses and loss settlement expenses represents estimates of the ultimate unpaid cost of all losses incurred, including losses for claims which have not yet been reported to Harleysville Group. The amount of loss reserves for reported claims is based primarily upon a case-by-case evaluation of the type of risk involved, knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss. The amounts of loss reserves for unreported claims and loss

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition  
and Results of Operations**

(Continued)

settlement expense reserves are determined utilizing historical information by line of insurance as adjusted to current conditions. Inflation is implicitly provided for in the reserving function through analysis of costs, trends and reviews of historical reserving results. Reserves are closely monitored and are recomputed periodically using the most recent information on reported claims and a variety of statistical techniques. It is expected that such estimates will be more or less than the amounts ultimately paid when the claims are settled. Changes in these estimates are reflected in current operations.

Investments. Generally, unrealized investment gains or losses on investments carried at fair value, net of applicable income taxes, are reflected directly in shareholders' equity as a component of comprehensive income and, accordingly, have no effect on net income. However, if the fair value of an investment declines below its cost and that decline is deemed other than temporary, the amount of the decline below cost is charged to earnings. Harleysville Group monitors its investment portfolio and quarterly reviews investments that have experienced a decline in fair value below cost to evaluate whether the decline is other than temporary. Such evaluations consider, among other things, the magnitude and reasons for a decline and the prospects for the fair value to recover in the near term. Future adverse investment market conditions, or poor operating results of underlying investments, could result in an impairment charge in the future.

Harleysville Group has written down to fair value, any equity security that has declined below cost by more than 20% and maintained such decline for six months, or by 50% or more, in the quarter in which either such decline occurred. In some cases, securities that have declined by a lesser amount or for a shorter period of time are written down if the evaluation indicates the decline is other-than-temporary. Fair value of equity securities is based on the closing market value as reported by a national stock exchange or Nasdaq. Fair value of fixed maturities is based upon data supplied by an independent pricing service. It can be difficult to determine the fair value of non-traded securities but Harleysville Group does not own a material amount of non-traded securities.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition  
and Results of Operations**

(Continued)

**Policy Acquisition Costs.** Policy acquisition costs, such as commissions, premium taxes and certain other underwriting and agency expenses that vary with and are primarily related to the production of business, are deferred and amortized over the effective period of the related insurance policies and in proportion to the premiums earned. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value. The estimation of net realizable value takes into account the premium to be earned, related investment income over the claim paying period, losses and loss settlement expenses, and certain other costs expected to be incurred as the premium is earned. Future changes in estimates, the most significant of which is expected losses and loss settlement expenses, may require adjustments to deferred policy acquisition costs. If the estimation of net realizable value indicates that the acquisition costs are unrecoverable, further analyses are completed to determine if a reserve is required to provide for losses that may exceed the related unearned premiums.

**Contingencies.** Besides claims related to its insurance products, Harleysville Group is subject to proceedings, lawsuits and claims in the normal course of business. Harleysville Group assesses the likelihood of any adverse outcomes to these matters as well as potential ranges of probable losses. There can be no assurance that actual outcomes will not differ from those assessments.

The application of certain of these critical accounting policies to the periods ended September 30, 2005 and 2004 is discussed in greater detail below.

**Results of Operations**

Premiums earned decreased \$0.3 million during the three months ended September 30, 2005, and increased \$1.6 million during the nine months ended September 30, 2005, compared to the same prior year periods. The changes are primarily due to increases in premiums earned for commercial lines of \$4.3 million and \$16.3 million partially offset by decreases of \$4.6 million and \$14.7 million in personal lines premiums earned for the three and nine months ended September 30, 2005, respectively. The increases in premiums earned for commercial lines were 2.5% and 3.3% for the three and nine months ended September 30, 2005, respectively, primarily due to higher average premiums. The declines in premiums earned for personal lines were 10.7% and 11.2% for the three and nine months ended September 30, 2005, respectively, primarily due to fewer policy counts. The reduction in personal lines volume was driven primarily by a reduction of personal automobile business from the continued implementation of more stringent underwriting processes.

## HARLEYSVILLE GROUP INC. AND SUBSIDIARIES

### Management's Discussion and Analysis of Financial Condition and Results of Operations

(Continued)

Investment income increased \$1.6 million and \$2.8 million for the three and nine months ended September 30, 2005, respectively, compared to the same prior year periods, resulting from an increase in invested assets partially offset by a lower yield on the fixed maturity investment portfolio.

Realized investment gains decreased \$12.6 million for the nine months ended September 30, 2005, as compared to the same period in the prior year, and were essentially unchanged for the three months ended September 30, 2005. The nine-month decrease primarily resulted from gains on the sale of two equity securities in the first quarter of 2004.

Harleysville Group holds securities with unrealized losses at September 30, 2005 as follows:

	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Length of Unrealized Loss</u>	
			<u>Less Than 12 Months</u>	<u>Over 12 Months</u>
		(in thousands)		
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 151,823	\$ 1,708	\$ 1,050	\$ 658
Obligations of states and political subdivisions	161,013	2,976	1,373	1,603
Corporate securities	238,094	5,850	3,078	2,772
Mortgage-backed securities	<u>83,496</u>	<u>846</u>	<u>754</u>	<u>92</u>
Total fixed maturities	<u>\$ 634,426</u>	<u>\$ 11,380</u>	<u>\$ 6,255</u>	<u>\$ 5,125</u>
Equity securities	<u>\$ 20,627</u>	<u>\$ 756</u>	<u>\$ 756</u>	<u>\$ -</u>

There are 20 positions that comprise the unrealized loss in equity investments at September 30, 2005. All have had volatile price movements and have not been significantly below cost for significant continuous amounts of time. Harleysville Group has been monitoring these securities and it is possible that some may be written down in the income statement in the future.

Of the total fixed maturity securities with an unrealized loss at September 30, 2005, securities with a fair value of \$498.4 million and an unrealized loss of \$8.6 million are classified as available for sale and are carried at fair value on the balance sheet while securities with a fair value of \$136.0 million and an unrealized loss of \$2.8 million are classified as held to maturity on the balance sheet and are carried at amortized cost.

## HARLEYSVILLE GROUP INC. AND SUBSIDIARIES

### Management's Discussion and Analysis of Financial Condition and Results of Operations

(Continued)

The fixed maturity investments with continuous unrealized losses for less than twelve months were primarily due to the impact of the higher market interest rates rather than a decline in credit quality. There are \$139.5 million in fixed maturity securities, at fair value, that at September 30, 2005, had been below amortized cost for over twelve months. Of the \$5.1 million of unrealized losses on such securities, \$3.5 million relates to securities which carry investment grade ratings and have declined in fair value roughly in line with market interest rate changes. The remaining \$1.6 million of unrealized losses are comprised of airline enhanced equipment trust certificates (EETC) as follows:

	Cost	Fair Value <small>(in thousands)</small>	Maturity Dates
American Airlines	\$ 14,370	\$ 13,214	2011
United Airlines	6,925	6,578	2010-2012
Other airlines	2,000	1,935	2011
	\$ 23,295	\$ 21,727	

After the events of September 11, 2001, air travel and the value of these airlines' EETC securities declined. The EETCs are all "A tranche" holdings, which means they are in a senior credit position to the underlying airplane collateral value as compared to B and C tranche holders. At the time of issuance, the collateral was appraised at approximately twice the value of the A tranche EETCs. Recent estimates indicate that in a distressed sale scenario, the value of the collateral would be approximately the same as the EETCs' cost. Harleysville Group is participating in certain EETC creditor committees and is monitoring developments. It is possible that these EETCs may be written down in the income statement in the future, depending upon developments involving both the issuers and world events which impact the level of air travel.

Income before income taxes increased \$11.7 million for the three months ended September 30, 2005, compared to the same prior year period. The increase was primarily due to the increase in investment income and a lower underwriting loss. Income before income taxes increased \$12.6 million for the nine months ended September 30, 2005 compared to the same prior year period. The increase was primarily due to the increase in investment income and a lower underwriting loss, partially offset by lower realized investment gains. The lower underwriting losses were primarily due to lower catastrophe losses and lesser loss severity. Catastrophe losses were \$2.4 million and \$4.0 million for the three and nine months ended September 30, 2005, respectively, as compared to \$6.1 million and \$10.0 million for the three and nine months ended September 30, 2004, respectively.

## HARLEYSVILLE GROUP INC. AND SUBSIDIARIES

### Management's Discussion and Analysis of Financial Condition and Results of Operations

(Continued)

An insurance company's statutory combined ratio is a standard measure of underwriting profitability. This ratio is the sum of (1) the ratio of incurred losses and loss settlement expenses to net earned premium, (2) the ratio of expenses incurred for commissions, premium taxes, administrative and other underwriting expenses to net written premium, and (3) the ratio of dividends to policyholders to net earned premium. The combined ratio does not reflect investment income, federal income taxes or other non-operating income or expense. A ratio of less than 100 percent generally indicates underwriting profitability. Harleysville Group's statutory combined ratio decreased to 102.5% and 102.8% for the three and nine months ended September 30, 2005, respectively from 106.6% and 106.4% for the three and nine months ended September 30, 2004, respectively. Such decreases were due to improved underwriting results in both commercial lines and personal lines, primarily resulting from improved loss experience and lower catastrophe losses in the 2005 periods. The improved loss experience reflects lower claim severity in general and lower claim frequency in property coverages.

The statutory combined ratios by line of business for the three and nine months ended September 30, 2005, as compared to the three and nine months ended September 30, 2004, were as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Commercial:				
Automobile	104.5%	103.8%	100.8%	103.8%
Workers compensation	118.6%	131.2%	122.6%	125.4%
Commercial multi-peril	101.0%	105.8%	102.0%	105.4%
Other commercial	102.5%	103.4%	95.9%	93.5%
Total commercial	104.7%	108.6%	103.9%	106.7%
Personal:				
Automobile	98.1%	113.0%	102.8%	114.0%
Homeowners	88.8%	78.3%	94.5%	91.2%
Other personal	67.5%	88.0%	73.1%	103.8%
Total personal	92.8%	99.0%	97.9%	105.3%
Total personal and commercial	102.5%	106.6%	102.8%	106.4%

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES**

**Management's Discussion and Analysis of Financial Condition  
and Results of Operations**

(Continued)

The following table presents the liability for unpaid losses and loss settlement expenses by major line of business:

	<u>September 30,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
	(in thousands)	
Commercial:		
Automobile	\$ 274,547	\$ 249,044
Workers compensation	306,137	298,994
Commercial multi-peril	423,390	371,247
Other commercial	<u>82,584</u>	<u>70,535</u>
Total commercial	<u>1,086,658</u>	<u>989,820</u>
Personal:		
Automobile	96,782	103,050
Homeowners	39,351	37,026
Other personal	<u>1,354</u>	<u>1,713</u>
Total personal	<u>137,487</u>	<u>141,789</u>
Total personal and commercial	1,224,145	1,131,609
Plus reinsurance recoverables	<u>224,393</u>	<u>186,126</u>
Total liability	<u>\$ 1,448,538</u>	<u>\$ 1,317,735</u>

The commercial lines statutory combined ratio decreased to 104.7% and 103.9% for the three and nine months ended September 30, 2005, respectively, from 108.6% and 106.7% for the three and nine months ended September 30, 2004, respectively. The decreases were primarily due to lower loss severity and lower property losses.

There was \$11.7 million of net favorable development in the provision for insured events in prior years for the nine months ended September 30, 2005 (\$2.9 million in the third quarter of 2005) of which \$5.6 million was in commercial lines and \$6.1 million was in personal lines. Approximately \$4.4 million of the \$11.7 million of favorable development related to the liability for unpaid loss settlement expenses. The remaining favorable development primarily related to the 2004 and 2003 accident years partially offset by adverse development in the prior accident years. There was \$9.1 million of net adverse development in the provision for insured events in prior years for the nine months ended September 30, 2004 (\$6.1 million in the third quarter of 2004).

## HARLEYSVILLE GROUP INC. AND SUBSIDIARIES

### Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

The following table presents workers compensation claim count information for the total pooled business in which Harleysville Group participates and payment amounts which are Harleysville Group's pooling share of the total pooled amounts:

	For the nine months ended September 30, 2005	For the year ended December 31, 2004
	(dollars in thousands)	
Number of claims pending, beginning of period	6,832	8,005
Number of claims reported	7,093	10,632
Number of claims settled or dismissed	<u>(7,531)</u>	<u>(11,805)</u>
Number of claims pending, end of period	<u>6,394</u>	<u>6,832</u>
Losses paid	\$ 49,718	\$ 73,548
Loss settlement expenses paid	\$ 10,771	\$ 15,831

Workers compensation losses primarily consist of indemnity and medical costs for injured workers. The reduction in claim counts reflects the impact of a reduction in workers compensation exposure as policy counts have declined.

Harleysville Group records the actuarial best estimate of the ultimate unpaid losses and loss settlement expenses incurred and does not determine an estimated possible range of loss. Actuarial loss reserving techniques and assumptions, which rely on historical information as adjusted to reflect current conditions, have been consistently applied during the periods presented. Changes in the estimate of the liability for unpaid losses and loss settlement expenses reflect actual payments and evaluations of new information and data since the last reporting date. These changes correlate with actuarial trends.

Because of the nature of insurance claims, there are uncertainties inherent in the estimates of ultimate losses. Reorganization of the claims operation in recent years has resulted in new people and processes involved in settling claims. As a result, more recent statistical data reflects different patterns than in the past and give rise to uncertainty as to the pattern of future loss settlements. Litigation on bodily injury liability cases is higher for the past three years while the rate of settlement is slower. These changed patterns give rise to greater uncertainty as to the pattern of future loss settlements on bodily injury liability claims. There are uncertainties regarding future loss cost trends particularly related to medical treatments and automobile repair. Court decisions, regulatory changes and economic conditions can affect the ultimate cost of claims that occurred in the past. Accordingly, the ultimate liability for unpaid losses and loss settlement expenses will likely differ from the amount recorded at September 30, 2005. For every 1% change in the aggregate estimate across all lines, the effect on pre-tax income would be \$12.2 million.

The property and casualty industry has had substantial aggregate loss experience from claims related to asbestos-related illnesses, environmental remediation, product liability, mold, and other uncertain exposures. Harleysville Group has not experienced significant losses from such claims.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition  
and Results of Operations**

(Continued)

The personal lines statutory combined ratio decreased to 92.8% and 97.9% for the three and nine months ended September 30, 2005 from 99.0% and 105.3% for the three and nine months ended September 30, 2004. The decreases primarily were due to generally lower loss severity.

Net catastrophe losses decreased \$3.7 million and \$5.9 million for the three and nine months ended September 30, 2005, respectively, primarily due to less severe catastrophes in the 2005 periods. The three months ended September 30, 2004 includes \$6.1 million of losses from weather related catastrophes, primarily four hurricanes.

The income tax expense for the three and nine months ended September 30, 2005 includes the tax benefit of \$2.5 million and \$7.7 million associated with tax-exempt income compared to \$2.6 million and \$8.0 million in the same prior year periods.

Other underwriting expenses increased \$4.7 million for the three months ended September 30, 2005 compared to the same prior year period. A severance charge of \$1.6 million was incurred during the three months ended September 30, 2005 related to ongoing expense-reduction initiatives. An estimated \$0.6 million severance charge is expected to be recorded in the fourth quarter of 2005 related to a further expense-reduction initiative begun in the fourth quarter. The remaining increase in other underwriting expenses related to higher incentive costs, primarily for agents.

Other expense decreased \$1.7 million for the three months ended September 30, 2005 primarily related to the write-off of capitalized costs for a software project during the three months ended September 30, 2004.

Harleysville Group and Mutual agreed on August 2, 2005 to terminate the reinsurance agreement whereby Mutual reinsures certain accumulated catastrophe losses as described in Note 3 of Notes to Consolidated Financial Statements. The agreement will terminate on December 31, 2005. The coverage will not be replaced as it is no longer needed based on our current catastrophe risk profile. Harleysville Group ceded to Mutual premiums earned of \$6.6 million and \$6.4 million and losses incurred of \$(0.1) million and \$0.5 million for the nine months ended September 30, 2005 and 2004, respectively.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition  
and Results of Operations  
(Continued)****Liquidity and Capital Resources**

Operating activities provided \$115.9 million and \$70.2 million of net cash for the nine months ended September 30, 2005 and 2004, respectively. The change primarily is from greater underwriting cash flow primarily due to lower paid losses.

Investing activities used \$101.5 million and \$70.4 million of net cash for the nine months ended September 30, 2005 and 2004, respectively. The increase is primarily due to an increase in net purchases of fixed maturity and equity investments partially offset by a decrease in the purchase of short-term investments.

Financing activities used \$11.0 million and \$12.2 million of net cash for the nine months ended September 30, 2005 and 2004, respectively. The change is primarily due to an increase in the issuance of common stock.

Harleysville Group participates in a securities lending program whereby certain fixed maturity securities from the investment portfolio are loaned to other institutions for a short period of time in return for a fee. At September 30, 2005, Harleysville Group held cash collateral of \$121.4 million related to securities on loan with a market value of \$117.8 million. Harleysville Group's policy is to require initial collateral of 102% of the market value of loaned securities plus accrued interest, which is required to be maintained daily by the borrower at no less than 100% of such market value plus accrued interest over the life of the loan. Acceptable collateral includes cash and money market instruments, government securities, A-rated corporate obligations, AAA-rated asset-backed securities or GIC's and Funding Agreements from issuers rated A or better. The securities on loan to others have been segregated from the other invested assets on the balance sheet. In addition, the assets and liabilities have been grossed up to reflect the collateral held under the securities lending program and the obligation to return this collateral upon the return of the loaned securities.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition  
and Results of Operations**

(Continued)

Harleysville Group Inc. maintained \$9.6 million of cash and marketable securities at September 30, 2005 which is available for general corporate purposes including dividends, debt service, capital contributions to subsidiaries, acquisitions and the repurchase of stock.

**RISK FACTORS**

The business, results of operations and financial condition, and therefore the value of Harleysville Group's securities, are subject to a number of risks. Some of those risks are set forth in the Company's annual report on Form 10-K for fiscal year 2004, filed with the Securities and Exchange Commission on March 14, 2005.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****Item 3. Quantitative and Qualitative Disclosure  
About Market Risk**

Harleysville Group's market risk generally represents the risk of gain or loss that may result from the potential change in the fair value of Harleysville Group's investment portfolio as a result of fluctuations in prices and interest rates. Harleysville Group attempts to manage its interest rate risk by maintaining an appropriate relationship between the average duration of the investment portfolio and the approximate duration of its liabilities.

Harleysville Group has maintained approximately the same duration of its investment portfolio to its liabilities from December 31, 2004 to September 30, 2005. In addition, the Company has maintained approximately the same investment mix during this period.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****Item 4. Controls and Procedures**

- (a) Evaluation of disclosure controls and procedures. Our management, under the supervision and with the participation of the chief executive officer and the chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2005, which is the end of the period covered by this quarterly report on Form 10-Q. Based on that evaluation, the chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures are effective and as such provide for a mechanism whereby (a) material information relating to us, including our consolidated subsidiaries, is made known to these officers by other employees of us and our consolidated subsidiaries, particularly material information related to the period for which this periodic report is being prepared; and (b) this information is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the rules and forms of the Securities and Exchange Commission.
  
- (b) Change in internal control over financial reporting. There was no change in the Company's internal control over financial reporting that occurred during the third quarter of 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****PART II. OTHER INFORMATION**

## ITEM 6. a. Exhibits

- 10.1 Settlement, Non-solicitation and Release Agreement with former executive officer.
- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Exchange Act.
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Exchange Act.
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**HARLEYSVILLE GROUP INC. AND SUBSIDIARIES****PART II. OTHER INFORMATION**

(Continued)

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Harleysville Group Inc.**

Date: November 2, 2005

By: /s/ ARTHUR E. CHANDLER

Arthur E. Chandler  
Senior Vice President and  
Chief Financial Officer  
(principal financial officer)

CERTIFICATION PURSUANT TO THE SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002

I, Michael L. Browne, certify that:

1. I have reviewed the quarterly report on Form 10-Q of Harleysville Group Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2005

/s/ MICHAEL L. BROWNE  
Michael L. Browne  
Chief Executive Officer and a Director

CERTIFICATION PURSUANT TO THE SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002

I, Arthur E. Chandler, certify that:

1. I have reviewed the quarterly report on Form 10-Q of Harleysville Group Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2005

/s/ ARTHUR E. CHANDLER  
Arthur E. Chandler  
Senior Vice President and  
Chief Financial Officer

## EXHIBIT (32.1)

HARLEYSVILLE GROUP INC.  
CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Harleystville Group Inc. (the "Company") on Form 10-Q for the period ended September 30, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael L. Browne, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that based on my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 2, 2005

/s/ MICHAEL L. BROWNE  
Michael L. Browne  
Chief Executive Officer and a Director

## EXHIBIT (32.2)

HARLEYSVILLE GROUP INC.  
CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Harleysville Group Inc. (the "Company") on Form 10-Q for the period ended September 30, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Arthur E. Chandler, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that based on my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 2, 2005

/s/ ARTHUR E. CHANDLER  
Arthur E. Chandler  
Senior Vice President and  
Chief Financial Officer