

Erie Indemnity Company
Annual Shareholders' Meeting
May 5, 2009
Speaker: Terrence W. Cavanaugh
President and Chief Executive Officer

Thank you, Tom, and good morning everyone. I'm pleased that you could join us today.

Last year brought significant change to ERIE. As you know, I joined the company in late July, just before the turmoil erupted in our economy and we all began to feel the full impact of the financial crisis.

Some might say I picked an interesting time to become a CEO. I can't say I disagree with them.

But even so, today, as I look back on our journey over the last twelve months, I can tell you that I'm more convinced than ever that I made the right choice to become a part of the ERIE team.

I knew coming in that Erie Insurance had some clear advantages over its competition. But once on board, I quickly discovered the biggest advantage -- the people who make this company real -- ERIE Employees and Agents.

The commitment of ERIE Employees to this Company is pretty phenomenal. People here are engaged, motivated and willing to accept the new and different.

When you couple that with the intense loyalty and skill of ERIE's independent agency force, you have the fundamental ingredients for success.

And ERIE is a successful company. That's what I joined -- a successful company. But as any coach who takes over a winning team will tell you, it is often more difficult to lead success than it is to improve failure.

Why? Because with success, we often find complacency, resistance to change and a lack of urgency. And with success, the new leader sometimes tries to drive change for the sake of change even where change isn't needed.

It takes a careful balance – equilibrium -- between preserving what's right about an operation and motivating change where it's needed.

That's what we're focusing on at ERIE.

Customers are dynamic, technology is ever changing, our economy is always in flux...we need to recognize and anticipate changes that result in such an environment and be prepared to respond in kind.

This understanding is echoed in a book I read last year and have shared with many people here at ERIE. It's the business bestseller, *Our Iceberg is Melting*. Many of you may be familiar with it as well ...

It's a fable told through the experience of a group of penguins.

The iceberg they live on – their source of food, shelter and security -- is melting. And their story illustrates the courage it takes to acknowledge the need to move forward and to change in order to continue to thrive through challenging and unexpected conditions.

So within that context I'd like to give you an idea about what the iceberg looks like from *our* perspective – About how we at Erie Insurance are responding to today's challenges and opportunities.

I want to talk about the opportunities we see ahead – because we firmly believe that out of turmoil comes opportunity for those who are perceptive enough and prepared to recognize and act.

Let's start by acknowledging what's happening in the marketplace and in the broader environment in which we operate.

Today's operating environment presents significant challenges for the entire property and casualty insurance industry – economic challenges, yes -- but other challenges have emerged out of the current unrest, which also affect our industry and the way we do business. The competitive landscape is changing and regulatory reform has moved from the sidelines to the center.

These three environmental factors – economic, competitive and regulatory – have merged and are giving rise to a new playing field.

First, the economic factors: The upheaval in the financial industry and the severe downturn in the economy are potentially cycle-firming events for the industry.

- The recession is suppressing opportunities for insurers to grow investment returns.
- This is driving greater underwriting discipline and capital conservation.
- The credit market freeze is limiting access to fresh capital, which is constricting economic expansion and affecting top-line growth.
- And inflation in medical costs and hospital services are driving up loss severity.

Secondly, on the competitive front, these factors are contributing to pricing momentum:

- In personal lines competitors are taking moderate rate increases.
- In commercial, we continue to see price reductions, but there is evidence that the rate of reductions is slowing.

In both markets – personal and commercial – underlying premium exposures are declining as demand for products and services is limited and people and businesses are looking for ways to reduce expenses through coverage reductions -- again affecting top-line growth.

- By contrast, while indications point to an upward turn in the cycle, some insurers continue to follow geographic and policy growth strategies that are indicative of a soft cycle.

Finally, the crisis in the financial industry has accelerated the longstanding debate over a national regulator and the introduction of an optional federal charter for insurance companies.

While the jury is out on the implications this could bring, we will be examining the potential that exists within this system for a strongly capitalized regional insurer like ERIE.

But beyond these three environmental factors, the biggest threat by far to most companies today – including ERIE -- is thinking that time is on our side.

The time to act is before the iceberg starts to melt. A major challenge is convincing people to act before they have measurable proof that the iceberg is indeed shrinking.

Part of being an effective organization is a sense of urgency about making results happen. That's precisely my message to our Employees and Agents – we must have a sense of urgency about making results happen – about responding effectively to our customers – about being “Above All in SERVICE.”

That's a primary reason why – early on – working with our executive team, I took the opportunity to realign our operations.

This refined structure positions ERIE for greater success. It clarifies reporting relationships and better aligns functions and accountability throughout the organization.

Additionally, it provides opportunities for people to step out of traditional roles and broaden their skills and experiences.

It puts the right talent in the right positions at the right time – and it prepares the ERIE workforce to meet the needs of the future.

We're already beginning to realize the benefits of a more effectively aligned structure coupled with ERIE's steadfast commitment to its core disciplines. We're moving quickly, making sure we continue to generate added value for new and existing customers.

Let's move now to ERIE's story in 2008.

As a result of being well-capitalized, ERIE's in a remarkably strong position and we're weathering the economic storm better than most.

Our balance sheet is evidence of strong underwriting capitalization, a solid reserving position, effective pricing and good asset management.

In fact, our balance sheet is one of the organization's key strengths.

Let's look at some underlying metrics – underwriting performance, policy in force growth, retention, premium, and expense management.

ERIE's Property & Casualty Group, and the Indemnity Company alone, ended the year with combined ratios that outperformed the year-end industry result, putting us in a stronger position moving into 2009.

We were clearly able to attract and retain customers in 2008, surpassing a milestone of 4 million total policies in force. That momentum continues in 2009 as consumers look for greater value for their insurance dollar. They're finding ERIE's value proposition very appealing.

Our customer loyalty is also stronger – with retention continuing to expand.

Policy growth is outpacing the decline in average premium per policy. We ended 2008 in positive territory with total direct written premium up slightly. Again, we outperformed the industry, which according to A.M. Best ended down for the year.

Regarding Erie Family Life – EFL remains an integral component of our product offerings to both our Agents and our customers. In the past year we refreshed a number of life products and improved our service. 2009 should bring renewed vigor to this important division.

We're also being vigilant about where we're spending our money, with most of that invested into information technology for Agents, Employees and customers.

Of course, the state of the economy may impact revenue growth given the anticipated declines in exposure growth.

We have plans in place to offset that.

We have a sound investment philosophy that matches underwriting risk with the Company's reserves and capital. We're strengthening our liquidity position to manage through further economic challenges and underwriting cycles.

Furthermore, we're continuing that intense focus on core disciplines –

How we market --

How we underwrite and price --

How we settle claims.

We're focusing more on execution, getting the job done, satisfying the customer. And given the disruption in the financial markets, our competitors, too, are going back to basics – ERIE thrives in this environment.

Let's talk about how we market ERIE.

Our independent agency force is ERIE's sole distribution channel and we believe strongly that this is the way we should do business.

We have more than 9,000 licensed Agents in more than 2,000 locations throughout 11 states and the District of Columbia. And in 2009, we're looking to grow the agency force by appointing another 127 new agencies.

These are quality businessmen and women with strong insurance knowledge who share ERIE's values and uphold our "Above All in SERVICE" reputation.

We have loyal relationships with our Agents. We work hard to earn their business -- their trust -- and become the lead carrier in each agency. That's a position we've earned in more than 75 percent of our agencies.

As you know, our Agents do business in a very competitive environment. In personal insurance -- home and auto -- our Agents face stiff competition from other distribution models -- such as insurance sold direct to the consumer on the Internet or affinity insurance models such as AARP.

To combat this, we're looking to enhance our sales support to Agents and improve execution in new product and service development.

In the area of sales support, we think a robust online capability with access to local insurance experts is a winning proposition.

For example, we're developing a greater Internet presence for our Agents -- an initiative we call ERIE Agents Online -- that leverages ERIE's online features and functionality in a format customized to the Agent.

It's another way to reach customers and prospects while sharing our knowledge and technology with our Agent partners.

Sales are also an intense focus for ERIE. Instead of expanding into new states right now, we're looking to strengthen our market share in the areas where we already do business with existing agency partners. The potential to secure new business in our current markets is significant.

Today -- in this economy and marketplace -- we don't need the distraction of taking ERIE into a new state. We want to grow geographically, but right now isn't the right time.

So we're working with our top agencies to grow and expand their businesses and open new store fronts.

We've also enhanced our agency co-op marketing program – expanding funds and providing new creative materials.

Attracting new customers is only half the story. Retaining our current customers in this marketplace is absolutely critical to revenue growth. Our Agents play a huge role in our customer retention, which continues at a desirable level.

ERIE's stellar claims and customer service capability also share in this accomplishment.

Time and time again, ERIE places highly in J.D. Power and Associates' insurance studies of customer satisfaction.

In 2008, we earned the top recognition from J.D. Power in the Auto Insurance Purchase Experience. What that means is that the ERIE fared better than all our competitors in satisfying customers looking for auto insurance.

That study told us that the personal service of our Agents and Employees was a distinct advantage. It's helped the ERIE to generate and maintain very high levels of customer loyalty.

What we learn from those third-party acknowledgements and our own customer research helps us meet the evolving needs and expectations of our customers. This research helps us develop new product and service enhancements that differentiate ERIE in the marketplace.

For instance -- we recently equipped our claims adjusters with emergency cash cards that they can distribute to customers -- so if there's a house fire, for example, the family can get shelter or food or clothing right away using this cash advance.

We want to get them on the road to recovery from that loss as quickly as possible. And with feedback from our customers, we're exploring how to extend that claims experience even further.

The safety and well-being of our customers is of the utmost importance to us. It also promotes the economic health and well-being of the communities in which they live and work.

That's one of the reasons we recently provided support for the development of a research facility for the Institute for Business and Home Safety.

This national organization is to homes and businesses what the Insurance Institute for Highway Safety is to vehicles.

The research facility will develop ways to build homes and business structures that are safer and stronger places to work and live.

We've brought the knowledge of the institute here to Erie as well. Our partnership with Habitat for Humanity has resulted in the first "fortified for safer living" home in Pennsylvania.

The construction of the home incorporated special materials to strengthen the structure against severe weather.

ERIE's partnership with IBHS and with Habitat for Humanity is an example of our commitment to the community – as an employer and a neighbor – and it's a recognition of our obligation to help with the economic and social health of northwestern Pennsylvania.

What's next for us?

As the economic situation turns upward and financial markets respond accordingly, it's our vision that Erie Insurance will emerge an even stronger regional competitor.

The Company has been around since 1925. So we've been through tough times before – The Great Depression, World War and international conflict, the global oil crisis of the '70s.

We have been successful in both difficult and more benign market environments.

But we never take our success for granted. We understand the lesson of the melting iceberg.

These are unprecedented times. The smartest minds in the world can't agree on what's next – and I'm okay with that.

That's because I know that out of turmoil, winners emerge. They always do.

The winners are the ones who stay aware -- the organizations and individuals who listen to the subtle sound of ice cracking, who look beyond where they are today and, with a sense of urgency, get done what they need to do.

Thank you.