

Erie Indemnity Company
Annual Shareholders' Meeting
May 5, 2009
Speaker: Marcia A. Dall, CPA
Executive Vice President & Chief Financial Officer

Thank you, Terry, and good morning.

Today, I'll review some key industry metrics and share some highlights of the results of The ERIE Property & Casualty Group and Erie Indemnity for 2008. I will also provide a brief summary of our first quarter 2009 results.

So, I'll start with a review of some of the key industry metrics.

Like other industries, the property & casualty insurance industry suffered from the impact of the financial market disruption and the economic downturn during 2008.

The challenging economic environment coupled with a continued soft market caused net premiums written to be essentially flat.

The industry's combined ratio also deteriorated nearly 10 points to almost 105 percent. This produced an underwriting loss for the industry of \$20 billion versus an underwriting gain of \$22 billion in 2007.

Catastrophic losses added approximately 3 points to the industry's combined ratio in 2008 – creating the fourth most expensive year in the industry's history. Catastrophic events cost the industry \$26 billion according to the Insurance Services Office. This was the highest level since 2005 - the year of Hurricane Katrina.

The industry's policyholders' surplus fell by 11 percent to \$465 billion – a record decline of nearly \$60 billion , reflecting the impact of investment losses and impairments.

I think it's important to note that despite the significant impact of the financial markets and the recession, the industry remains well capitalized by historical standards with a ratio of net premiums written to available surplus of 0.90 to 1 according to ISO.

Now, turning to the 2008 results for the ERIE Property and Casualty Group: You can see that we, too, were not immune to the financial and economic disruption that has occurred.

Direct premium written was slightly higher than 2007 - reflecting solid growth in policies in force of 3 percent to just over 4 million policies, while the average premium per policy declined 3 percent, reflecting the impact of pricing actions during the year.

New and renewal policies both grew by 3 percent and we ended the year with a very strong retention ratio of 90.6 percent.

The expense ratio increased 1 point to 33 percent primarily from increased loss adjustment expenses.

The reported statutory combined ratio was up nearly 6 points to 93 percent - albeit materially lower than the industry average. The increase in the combined ratio was driven primarily by slightly higher catastrophic losses and less favorable prior year loss development.

And finally, the policyholders' surplus declined by nearly 15 percent to \$4.3 billion. This decline was primarily a result of higher levels of investment losses.

Despite the decline, ERIE's Property & Casualty Group continues to be well capitalized with a strong premium to surplus ratio of 0.89 to 1.

With that context in mind, let's look at the results for the three segments of the Erie Indemnity Company.

First, let me discuss our management operations. As you know, the Company's fees for managing Erie Insurance Exchange represent a large portion of the revenues of Erie Indemnity. These fees are based on a management fee rate applied to the direct written premiums of the Property & Casualty Group.

The Company's management fee revenue was relatively flat based on the flat direct written premiums for the Property & Casualty Group and a management fee rate of 25 percent – consistent with 2007.

The cost of management operations increased a little over 1 percent primarily due to increases in non-commission expenses related to higher information technology investments.

This increase in costs with relatively flat fee revenue resulted in a slight decline in our gross margins.

Our insurance underwriting operations produced a GAAP combined ratio of 94 percent, up 6 points from 2007. This increase primarily reflects the impact of slightly higher catastrophic losses and less favorable development of prior accident year loss reserves when compared to 2007 results.

Turning to our investment operations, net losses from investment operations totaled \$78 million compared to net gains of \$110 million in 2007.

The primary drivers of this decline were increased net realized losses, lower levels of equity in earnings from limited partnership investments and a loss related to our equity in Erie Family Life.

The Company had net realized losses of \$113 million compared to \$5 million in 2007.

- The majority of these relate to impairment charges on bonds and preferred stock investments. Most of these securities continue to meet interest and dividend obligations – however their market values are depressed due to current market conditions.
- The Company also realized losses of \$39 million related to common stock.

Our equity in earnings from limited partnerships decreased to \$6 million compared to \$60 million in 2007 - reflecting fair value declines across all categories.

And finally, equity in losses related to Erie Family Life was \$15 million compared to earnings of \$3 million in 2007.

So, as a result of the performance of these three segments - net income decreased to \$69 million or \$1.19 per share on a diluted basis.

And finally, from a capital perspective, Erie Indemnity Company's balance sheet remains strong.

Shareholder equity declined \$259 million to \$792 million primarily as a result of dividends to our shareholders, repurchase of Company shares, a charge related to our pension program and unrealized losses on our investments.

We generated strong operating cash flow of \$151 million in 2008 -- all of which we've returned to shareholders in the form of increased dividends and share repurchases. Even in these difficult times, we've increased our dividends by more than 2 percent.

In 2008, we repurchased 2.1 million Class A common shares at a total cost of \$102 million.

Last Friday, we held our first quarter earnings call. Many of you listened to the call and are familiar with our results.

For the first quarter 2009, net income decreased to \$11 million compared to \$30 million in the first quarter 2008.

The earnings decrease was primarily a result of losses from limited partnership investments, realized investment losses, and losses in insurance underwriting operations.

The Company's management fee revenue was essentially flat for the first quarter compared to a year ago. This was a result of policy growth offset by declines in average premium per policy. Policies in force grew 3 percent or more than 124,000 policies year-over-year, while the average premium per policy dropped 3 percent.

We anticipate average premium per policy to begin increasing due to rating actions we began to take in late 2008.

Losses in our insurance underwriting segment produced a GAAP combined ratio of 111 percent compared to 92 percent in the first quarter of 2008.

This was driven by three factors:

- First, losses from catastrophic events contributed 8 points to the combined ratio;
- Second, the loss and loss adjustment expense ratio related to the current accident year, excluding catastrophes was 3 points higher than the first quarter 2008.
- And third, the Company experienced 4 points of adverse development on prior accident year loss reserves.

The Company also recorded losses from its investment operations of \$26 million compared to losses of \$5 million in the first quarter of 2008 driven by losses in our limited partnership investments.

There is no doubt, given the recession and the continued volatility in the financial markets, that the industry will continue to have challenges in 2009.

In his remarks earlier, Terry talked about a focus on our core disciplines – distribution, underwriting, pricing and service. ERIE excels in these areas.

The ERIE is a fundamentally strong, well-capitalized organization.

As for me, personally, I am proud to be a part of this great team of professionals. Terry described the engagement level of Employees here as phenomenal, and I can honestly say that I've found that to be true. The people here are very focused on sustaining and growing ERIE's success.

They've welcomed me and are open and receptive to helping me learn the organization.

In my brief time here, I've also had the opportunity to meet with some ERIE Agents – both new and longstanding – and have been equally impressed. I already have a sense of why ERIE Agents are lauded as some of the best in the business.

And the customers I've met since coming on board - ERIE policyholders – are real life testimonials to the value created from the philosophy of – “as near perfect protection, as near perfect service as humanly possible.”

I'd also like to say how welcoming the entire Erie community has been. I believe this will be a smooth transition for me and my family.

Thank you for your attention. I look forward to meeting with you very soon.

Mr. Chairman...