ERIE INDEMNITY CO
Form 10-Q/A
November 03, 2005

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q/A
QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarter ended September 30, 2005
Commission file number 0-24000
ERIE INDEMNITY COMPANY
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-0466020
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Erie Insurance Place, Erie, Pennsylvania	16530
(Address of principal executive offices)	(Zip Code)

(814) 870-2000
Registrant s telephone number, including area code
Not applicable
Former name, former address and former fiscal year, if changed since last report

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 þ No o

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

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

The number of shares outstanding of Class A Common Stock, with no par value and a stated value of $.0292 per share was 61,851,203 at October 24, 2005.

The number of shares outstanding of Class B Common Stock with no par value and a stated value of $70 per share was 2,843 at October 24, 2005.

The common stock is the only class of stock the Registrant is presently authorized to issue.

EXPLANATORY NOTE

This Amendment to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005 that was originally filed with the Securities and Exchange Commission on November 2, 2005 is being filed to amend Part I Item 2. Item 2 has been amended to correct the average price per share of stock repurchases during the quarter. As a result of this Amendment, the Company is also filing as exhibits to this Amendment No. 1 to Form 10-Q the certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Because no financial statements are contained in this Amendment No. 1 to Form 10-Q, the Company is not including the certifications, pursuant to Section 906 Sarbanes-Oxley Act of 2002.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following information should be read in conjunction with the historical financial information and the notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in the Annual Report on Form 10-K for the year ended December 31, 2004 as filed with the Securities and Exchange Commission on February 24, 2005. Preceding the discussion of financial results is an introduction discussing the relationships between the member companies of the Erie Insurance Group. The following discussion of financial results focuses on the Erie Indemnity Company s (Company) three primary segments: management operations, insurance underwriting operations and investment operations consistent with the presentation in Note 13 in the Notes to Consolidated Financial Statements. That presentation, which management uses internally to monitor and evaluate results, is an alternative presentation of the Company s Consolidated Statements of Operations.

NATURE OF ORGANIZATION

The following organizational chart depicts the organization of the various entities of the Erie Insurance Group:

Erie Indemnity Company has served since 1925 as the attorney-in-fact for the policyholders of the Erie Insurance Exchange (Exchange). The Company is a public registrant that operates predominantly as a provider of certain management services to the Exchange. The Company also owns subsidiaries that are property and casualty insurers. Each applicant for insurance to a reciprocal insurance exchange signs a subscriber s agreement, which contains a power-of-attorney appointing an attorney-in-fact. Under the Company s attorney-in-fact arrangement with subscribers to the Exchange, the Company is required to perform services relating to the sales, underwriting and issuance of policies on behalf of the Exchange.

The Exchange and its property/casualty subsidiary, Flagship City Insurance Company (Flagship), and the Company s three property/casualty subsidiaries, Erie Insurance Company (EIC), Erie Insurance Company of New York (EINY) and Erie Insurance Property & Casualty Company (EIPC), (collectively,

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

the Property and Casualty Group) write personal and commercial lines property and casualty coverage exclusively through more than 1,700 independent agencies comprising over 7,700 licensed independent agents and pool their underwriting results. The financial position or results of operations of the Exchange are not consolidated with those of the Company. The Company, together with the Property and Casualty Group and EFL, operate collectively as the Erie Insurance Group.

The financial information presented herein reflects the Company s management operations from serving as attorney-in-fact for the Exchange, its insurance underwriting results from its wholly-owned subsidiaries (EIC, EINY and EIPC) and the Company s investment operations.

Results of Operations

	Three Months Ended September 30		Nine Months Ended September 30	
(dollars in thousands, except per share data)	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Income from management operations	$ 52,165	$ 63,774	$ 171,257	$ 188,629
Underwriting income (loss)	1,698	2,895	12,857	(3,455)
Net revenue from investment operations	25,112	21,153	95,271	62,101
Income before income taxes	78,975	87,822	279,385	247,275
Provision for income taxes	25,970	29,256	92,441	82,182
Net income	$ 53,005	$ 58,566	$ 186,944	$ 165,093
Net income per share diluted	$ .76	$ .83	$ 2.69	$ 2.34

Consolidated net income for the third quarter of 2005 was $53.0 million compared to $58.6 million during the same period in 2004, a decrease of 9.5%. Management fee revenues decreased in the third quarter of 2005 as a result of lower direct written premiums of the Property and Casualty Group, on which the management fee is based as well as the lower management fee rate in the third quarter of 2005. The cost of management operations increased in the third quarter 2005 primarily due to higher personnel costs which included contract labor for information technology projects. Income from insurance underwriting operations was lower in the third quarter of 2005 than the third quarter of 2004 driven by an increases in claims reserves for certain pre-1986 automobile catastrophic injury claims made during the third quarter 2005 loss reserve evaluation. The Company s underwriting loss resulting from these reserve actions were $2.7 million. The Property and Casualty Group and Company recorded no underwriting losses as a result of Hurricanes Katrina or Rita during the third quarter of 2005 or Wilma during October 2005. Revenue from investment operations increased in the third quarter of 2005 compared to the same period in 2004 primarily due to improved earnings of limited partnerships and realized gains.

Consolidated net income for the nine months ended September 30, 2005 increased 13.2% to $186.9 million. Income from management operations decreased 9.2% during the first nine months of 2005 compared to the first nine months of 2004. The gross margin from management operations decreased to 23.1% from 25.5% for the nine months ended September 30, 2005 and 2004, respectively, due to slower growth in management fee revenue relative to increases in the cost of management operations. Insurance underwriting operations generated income of $12.9 million for the nine months ended September 30, 2005, compared to underwriting losses of $3.5 million for the nine months ended September 30, 2004. The improvement in underwriting results in 2005 compared to 2004 is a result of the initiatives implemented to focus on underwriting profitability in combination with very low catastrophe losses in 2005 and favorable development of prior accident year losses. Revenue from investment operations increased to $95.3 million for the nine months ended September 30, 2005 from $62.1 million in the same period in 2004 due to a recognition of

limited partnership valuation adjustment recorded in the second quarter of 2005 which increased realized earnings from limited partnerships, as well as improvement in realized gains due to sales of common stock.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

OVERVIEW OF OPERATING SEGMENTS

Management Operations

	Three Months Ended September 30		Nine Months Ended September 30	
(dollars in thousands)	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Management fee revenue net	$ 241,639	$ 246,388	$ 726,429	$ 724,379
Service agreement revenue	5,294	5,384	15,440	16,207
Total revenue from management operations	246,933	251,772	741,869	740,586
Cost of management operations	194,768	187,998	570,612	551,957
Income from management operations	$ 52,165	$ 63,774	$ 171,257	$ 188,629
Gross margin percentage	21.1%	25.3%	23.1%	25.5%
Management fee rate	23.75%	24.0%	23.75%	23.7%*

* *Effective management fee rate represents 23.5% effective January through June 2004 and 24.0% from July to September 2004*

Management fee revenue

Net management fee revenue decreased 1.9% for the quarter ended September 30, 2005 compared to the quarter ended September 30, 2004. Management fees from the Exchange represented 73.2% and 75.0% of the Company s total revenues for the third quarters of 2005 and 2004, respectively. Management fee revenue is based on the management fee rate, established by the Board of Directors, and the direct written premiums of the Property and Casualty Group. The lower management fee rate in the third quarter of 2005 of 23.75%, compared to 24% in the third quarter of 2004, resulted in $2.6 million less in management fee revenue for the quarter ended September 30, 2005, or a decrease in diluted net income per share of $.02. Direct written premiums of the Property and Casualty Group decreased 2.1% in the third quarter of 2005 to $1.0 billion. While policies in force continued to grow modestly by about 1,300 policies in the third quarter of 2005, the average premium per policy declined in the third quarter of 2005 compared to the third quarter of 2004 resulting in lower direct written premiums for the third quarter 2005. The year over year average premium per policy still increased due to certain rate increases implemented in 2004, however the anticipated year over year decline in new policies resulted in lower direct written premiums for the nine months ended September 30, 2005 compared to 2004. Retention ratios improved slightly through the third quarter 2005 to 88.4 from 88.3 through the second quarter of 2005.

Management fees are returned to the Exchange when policies are cancelled mid-term and unearned premiums are refunded. The Company records an estimated allowance for management fees returned on mid-term policy cancellations. Management fee revenues were reduced by $1.6 million and $4.6 million in the third quarters of 2005

and 2004, respectively, due to changes in the allowance. The 2005 allowance adjustment reflects stabilizing of cancellation levels as compared to 2004. Policy retention ratios were 88.4% at September 30, 2005 and 88.3% at both June and March 2005. Cancellation levels have been stabilizing as a result of underwriting rate stabilization and price segmentation. The 2004 allowance adjustment was partially reflective of higher cancellations with the retention ratio declining to 88.7% at September 2004, compared to 89.2% at June 2004 and 89.8% at March 2004. The higher cancellation experience in 2004 was due to initiatives implemented to focus on underwriting profitability.

The Company periodically evaluates actual mid-term policy cancellations compared to the allowance and refines this estimate accordingly. During the third quarter of 2005, the Company began to utilize a greater number of historical periods to develop the cancellation rate, a refinement management believes more accurately reflects anticipated amounts of management fees to be returned. This revision yielded projected annual cancellations more comparable to actual cancellations in the developed periods. For the

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

nine months ended September 30, 2005 and 2004, changes in this allowance reduced management fee revenue $.9 million and $5.7 million, respectively.

Significant factors affecting management fee revenue are as follows:

New business premium production

Total new business premium of the Property and Casualty Group declined 2.9% to $100.7 million in the third quarter of 2005 from $103.6 million in the third quarter of 2004. Personal lines new business premium written of the Property and Casualty Group declined 5.4% to $70.6 million from $74.6 million for the third quarters of 2005 and 2004, respectively. Commercial lines new business premiums of the Property and Casualty Group increased 3.4% to $30.0 million in the third quarter of 2005 from $29.0 million in the third quarter of 2004. (see Note 13, Segment Information which contains policies in force and policy retention trends by line of business). The private passenger auto new business premium written of the Property and Casualty Group decreased to $42.0 million from $46.8 million for the third quarters of 2005 and 2004, respectively. During the third quarter of 2005, the Company continued refining its price segmentation model for the private passenger auto and homeowners lines of business to improve the Company s competitive position in those lines.

Premium rates and rate change impacts

The year over year average premium per policy increased 1.2% to $1,055 at September 30, 2005 from $1,042 at September 30, 2004. The year over year average premium per personal lines policy increased .6% while commercial lines year over year average premiums increased 1.9% at September 30, 2005. The private passenger auto year over year average premium per policy increased .4% to $1,179 at September 30, 2005 from $1,175 at September 30, 2004. In 2004 and 2003 substantial rate increases were filed by the Property and Casualty Group for certain lines of business in various states to offset growing loss costs. The Property and Casualty Group writes one-year policies. Rate increases take 24 months to be reflected fully in earned premiums. It takes 12 months to implement a rate increase to all policyholders and another 12 months to earn the increased premiums in full. Because of the time span for full recognition of premium rate increases, certain rate increases approved in 2004 are earned in 2005.

The improvement in underwriting experience afforded the Property and Casualty Group the ability to implement rate reductions to be more price competitive for potential new policyholders and improve retention of existing policyholders in 2005. Management continuously evaluates pricing actions and estimates that those approved, filed and contemplated for filing through September 30, 2005 will result in a net decrease in direct written premiums of $10.1 million in 2005. The most significant rate decreases are in the private passenger auto and homeowners lines of business in Pennsylvania.

Premium related initiatives

Personal Lines In August 2004, the Property and Casualty Group implemented insurance scoring for underwriting purposes for its private passenger auto and homeowners lines of business in most of its operating states in response to changing competitive market conditions. Insurance scoring has also been incorporated, along with other risk characteristics, into a rating plan with multiple pricing tiers. This segmented pricing provides the Property and Casualty Group greater flexibility in pricing policies with varying degrees of risk. This should result in more competitive rates being offered to customers with the most favorable loss characteristics. The rating plan with multiple pricing tiers was implemented in most

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

states on new business in March 2005, and on renewal business in April 2005. In 2006, the Company anticipates implementing additional pricing segmentations in auto and homeowners insurance.

Commercial Lines The Property and Casualty Group is implementing initiatives to provide more competitive rates for higher quality workers compensation risks. Rate changes and a more formalized process of evaluating accounts should allow a better alignment between rate and risk level similar to the pricing segmentation efforts in the personal lines. Rate changes will become effective in November 2005 in the state of Pennsylvania. Rate changes for workers compensation in all other states except Wisconsin are filed to be effective in January 2006.

Promotional incentive programs Two twelve-month promotional incentive programs started in the second quarter of 2005 to offer incentives for property/casualty, life and annuity sales. The total projected cost to the Company, after reimbursement from EFL, is estimated at $3.0 million. Through September 2005, the Company has incurred $.9 million for the programs.

Cost of management operations

The cost of management operations increased 3.6% for the third quarter of 2005 to $194.8 million from $188.0 million during the third quarter of 2004, primarily due to increases in personnel costs and insurance scoring costs. For the nine months ended September 30, 2005, the cost of management operations grew by 3.4% to $570.6 million compared to $552.0 million for the same period a year ago.

Commissions to independent agents, which are the largest component of the cost of management operations, include scheduled commissions earned by independent agents on premiums written, accelerated commissions and agent bonuses.

	Three Months Ended September 30		Percent	Nine Months Ended September 30		Percent
(dollars in thousands)	2005	2004	Change	2005	2004	Change
	(unaudited)			(unaudited)		
Scheduled and accelerated rate commissions	$ 121,598	$ 128,714	(5.5)%	$ 361,099	$ 379,915	(5.0)%
Agent bonuses	19,412	13,807	40.6	50,479	32,260	56.5
Allowance for mid-term policy cancellations	(700)	(2,300)	N/A	(100)	(2,900)	N/A
Total commissions	$ 140,310	$ 140,221	0.1%	$ 411,478	$ 409,275	0.5%

Scheduled rate commissions were impacted by a 2.1% decrease in the direct written premiums of the Property and Casualty Group in the third quarter of 2005 and the reduction in certain commercial commission rates. Commercial commission rate reductions became effective on premiums collected after December 31, 2004 and resulted in a $4.9 million reduction in scheduled rate commissions in the third quarter of 2005 and a $15.8 million reduction for the nine months ended September 30, 2005.

Accelerated rate commissions are offered to some newly recruited agents for their initial three years. Accelerated commissions were lower in the first nine months of 2005 as there were fewer new agency appointments in 2004 and existing accelerated commission contracts expired. New agency appointments resumed in 2005, with 41 appointments in the first nine months. As new agent appointments continue, accelerated rate commissions will reflect a corresponding increase.

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Agent bonuses are based on an individual agency s property/casualty underwriting profitability and also include a component for growth in agency current and prior two year property/casualty premiums if the agencies are profitable. The estimate for the bonus is modeled on a monthly basis using the two prior years actual underwriting data by agency combined with the current year-to-date actual data. Company estimates use projected underwriting data for the remainder of the current year in order to model the 36-month underwriting results by agency. The increase in agent bonuses in the third quarter of 2005 reflects the impact of the improved underwriting profitability in 2004. The agent bonus award is estimated at $66.4 million for 2005. The bonus estimate at the third quarter of 2004 was lower given the less favorable underwriting results in 2003 and 2002.

The cost of management operations excluding commission costs, increased 14.0% for the third quarter of 2005 to $54.5 million from $47.8 million recorded in the third quarter of 2004. Personnel related costs are the second largest component in cost of management operations. The Company s personnel costs totaled $33.6 million in the third quarter of 2005, compared to $29.4 million in the third quarter of 2004, an increase of 14.4%. Contributing to this increase was an 11.9% increase in salaries and wages which includes, in addition to base pay rate increases, an increase in staffing levels and increases in contract labor of 5.0%. Costs incurred related to external contract labor primarily related to information technology projects, increased $1.1 million to $1.7 million in the third quarter of 2005 and there was an increase in expense of $1.0 million in the long term incentive plan for executives.

Also contributing to the increase in the cost of management operations were the cost of obtaining insurance scores on applications of $.7 million during the third quarter of 2005 and $3.1 million during the first nine months of 2005. The Company began using insurance scoring in August 2004 and had only incurred $.1 million in the three and nine months ended September 30, 2004 for insurance scores.

Insurance Underwriting Operations

	Three Months Ended September 30		Nine Months Ended September 30	
(dollars in thousands)	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Premiums earned	$ 53,908	$ 52,862	$ 161,721	$ 154,576
Losses and loss adjustment expenses incurred	36,995	34,602	103,457	112,642
Policy acquisition and other underwriting expenses	15,215	15,365	45,407	45,389
Total losses and expenses	$ 52,210	$ 49,967	$ 148,864	$ 158,031
Underwriting income (loss)	$ 1,698	$ 2,895	$ 12,857	($ 3,455)

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The following table reconciles the underwriting results of the Property and Casualty Group on a statutory accounting basis (SAP) to the underwriting results of the Company on a GAAP basis.

Reconciliation of Property and Casualty (P&C) Group Underwriting Results to the Company Underwriting Results

	Three Months Ended September 30		Nine Months Ended September 30	
(dollars in thousands)	2005	2004	2005	2004
Property and Casualty Group Insurance Underwriting Operations (SAP Basis)				
Direct underwriting results:				
Direct written premium	$ 1,024,165	$ 1,045,785	$ 3,062,437	$ 3,084,470
Premium earned	1,005,571	998,231	3,009,496	2,900,590
Loss and loss adjustment expenses incurred	686,611	604,944	1,865,169	1,911,122
Policy acquisition and other underwriting expenses	280,968	289,371	845,087	841,688
Total losses and expenses	967,579	894,315	2,710,256	2,752,810
Direct underwriting income	37,992	103,916	299,240	147,780
Nonaffiliated reinsurance underwriting results net	48,724	(7,986)	25,428	(29,373)
Net underwriting gain (SAP Basis)	$ 86,716	$ 95,930	$ 324,668	$ 118,407
Erie Indemnity Company Insurance Underwriting Operations (SAP to GAAP Basis)				
Percent of pool assumed by Company	5.5%	5.5%	5.5%	5.5%
Company preliminary underwriting income (loss):				
Direct	$ 2,090	$ 5,715	$ 16,458	$ 8,128
Nonaffiliated reinsurance	2,679	(439)	1,399	(1,616)
Net underwriting gain (SAP Basis)	4,769	5,276	17,857	6,512
Excess-of-loss premiums ceded to the Exchange	(844)	(842)	(2,531)	(2,524)
Excess-of-loss changes to recoveries under the agreement*	(2,166)	(1,159)	(2,341)	(6,088)
SAP to GAAP adjustments	(61)	(380)	(128)	(1,355)
Company underwriting income (loss) before tax (GAAP Basis)	$ 1,698	$ 2,895	$ 12,857	($3,455)

* *The change in the recoverable under the excess-of-loss agreement is an offset to the prior accident year loss development included in the loss and loss adjustment expenses reflected in the table.*

COMBINED RATIO SAP AND GAAP

	Three Months Ended September 30		Nine Months Ended September 30	
	2005	2004	2005	2004
Company GAAP combined ratio	96.9%	94.5%	92.1%	102.2%
P&C Group statutory combined ratio	90.5	88.6	88.4	93.9
P&C Group statutory combined ratio, excluding catastrophes	90.0	85.0	87.9	91.7
P&C Group adjusted statutory combined ratio	85.9	83.0	83.3	88.3
P&C Group adjusted statutory combined ratio, excluding catastrophes	85.4	79.4	82.8	86.1
Loss ratio points from prior accident year reserve development- (redundancy) efficiency	(1.8)	(2.3)	(3.3)	(2.5)
Loss ratio point from salvage and subrogation recoveries collected	(0.8)	(0.9)	(1.7)	(1.8)
Total loss ratio points from prior accident years	(2.6)	(3.2)	(5.0)	(4.3)

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Summary

The GAAP combined ratio represents the ratio of losses, loss adjustment, acquisition and other underwriting expenses incurred to premiums earned. The GAAP combined ratios of the Company are different than the results of the Property and Casualty Group due to certain GAAP adjustments and the effects of the excess-of-loss reinsurance agreement between the Company s property/casualty insurance subsidiaries and the Exchange. The statutory combined ratio as reported and the adjusted statutory combined ratio which removes the profit component paid to the Company are also presented above for the Property and Casualty Group. There was no impact on the Property and Casualty Group or the Company s underwriting results from either Hurricane Katrina or Hurricane Rita during the third quarter 2005 or Hurricane Wilma in October 2005. For the nine months ended 2004, the less favorable GAAP combined ratio, as compared to the statutory combined ratio, was driven by $6.1 million of charges recorded by the Company s property/casualty insurance subsidiaries under the intercompany excess-of-loss reinsurance agreement, resulting in a variance of 3.9 GAAP combined ratio points.

The Property and Casualty Group direct business statutory combined ratio increased in the third quarter of 2005 as a result of increased pre-1986 automobile catastrophe injury liability reserves as well as seasonal fluctuations. Favorable prior year development of the direct business other than the pre-1986 automobile catastrophe injury liability reserves reduced the statutory combined ratio and catastrophe losses had a minimal impact. The assumed loss and loss adjustment expense reserves related to the September 11th 2001 attack were reduced in the third quarter of 2005 improving the Property and Casualty Group s statutory combined ratio. See discussion of property/casualty loss reserves on page 38. While the Company s GAAP combined ratio was impacted by these reserve adjustments, the reduction in the World Trade Center assumed loss and loss adjustment expense reserves triggered a reduction in previously recorded recoveries under the intercompany aggregate excess-of-loss reinsurance arrangement for accident year 2001 which offset the reduction in assumed reserves.

Direct Underwriting Results

	Three Months Ended September 30		Nine Months Ended September 30	
(dollars in thousands)	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Property and Casualty Group direct underwriting income	$ 37,992	$ 103,916	$ 299,240	$ 147,780
Percent of pool assumed by Company	5.5%	5.5%	5.5%	5.5%
Company direct underwriting income, before adjustments	$ 2,090	$ 5,715	$ 16,458	$ 8,128

While underwriting results on direct business in 2005 continue to reflect the impact of underwriting profitability initiatives implemented in 2003 and 2004 to help offset severity increases and manage exposure growth, the third quarter of 2005 reflects an increase to reserves for certain pre-1986 automobile catastrophe injury liability reserves. The Property and Casualty Group increased reserves for automobile catastrophe injury liability reserves by $47 million (net of ceded recoveries) during the third quarter reserve evaluation. The reserve re-estimates on these claims during the quarter took into account updated trends with respect to ongoing attendant care costs for claimants. This reserve increase was responsible for adding 4.7 points to the third quarter 2005 Property and Casualty Group statutory combined ratio. Also in the third quarter of 2005, seasonal increases in claim volume, which are recognized in reserves in the quarter they occurred, contributed 6.1 points to the Property and Casualty Group s statutory combined ratio. The impact of seasonal fluctuations was offset by positive

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

development of prior accident year losses, which improved the Property and Casualty Group s statutory combined ratio by 1.8 points in the third quarter of 2005. Catastrophe losses incurred by the Property and Casualty Group have not been significant in 2005. During the third quarter of 2004, the Property and Casualty Group recorded approximately $21 million related to Hurricane Ivan. The positive development of prior accident years and minimal catastrophe losses, coupled with improved current accident year underwriting experience, resulted in Property and Casualty Group losses that were lower by $46 million for the nine months ended September 30, 2005 compared to September 30, 2004.

Underwriting profitability initiatives

The Property and Casualty Group continues to maintain its focus on enhancing quality growth while maintaining underwriting profitability. Recent underwriting results have strengthened the Property and Casualty Group s ability to compete for profitable business. Underwriting practices affect the number of new policyholders eligible for coverage with the Property and Casualty Group as well as the number eligible to renew and the terms of renewal. The acceptability of risks written by the Property and Casualty Group is an important element of underwriting profitability. In the latter part of 2004 and into 2005, the Property and Casualty Group implemented insurance scoring for private passenger auto and homeowners to aid in underwriting risk selection and to provide greater flexibility in pricing policies with varying degrees of risk. In November 2005, the Property and Casualty Group will be implementing a tiered pricing program for workers compensation in the state of Pennsylvania to provide more competitive rates to more desirable risks. This price segmentation, along with a new underwriting process of evaluating workers compensation risks factors, should allow a better alignment between rate and risk level. These rate changes and new commercial underwriting process are expected to be implemented in all other states except Wisconsin in January 2006.

Catastrophe losses

Catastrophes are an inherent risk of the property/casualty insurance business and can have a material impact on the Company s insurance underwriting results. In addressing this risk, the Company employs what it believes are reasonable underwriting standards and monitors its exposure by geographic region. The Property and Casualty Group maintains catastrophe reinsurance coverage from unaffiliated insurers. The 2005 agreement is a property catastrophe reinsurance treaty that provides coverage of up to 95.0% of a loss of $400 million in excess of the Property and Casualty Group s loss retention of $200 million per occurrence. No loss recoverables were recorded under this treaty at September 30, 2005 as the Property and Casualty Group had no significant catastrophe losses in 2005. Additionally, the Company s property/casualty insurance subsidiaries aggregate excess-of-loss reinsurance agreement with the Exchange can mitigate the effect of catastrophe losses on the Company s financial position. During the third quarters of 2005 and 2004, the Company s share of catastrophe losses, as defined by the Property and Casualty Group, amounted to $.3 million and $2.0 million, respectively and contributed .5 points and 3.6 points to the GAAP combined ratio.

There was no impact on the Property and Casualty Group s underwriting results from either Hurricane Katrina or Hurricane Rita during the third quarter 2005 or Wilma during October 2005. The third quarter 2004 catastrophe losses included the effects of Hurricane Ivan on North Carolina, West Virginia, Virginia, Pennsylvania and the District of Columbia. Catastrophe losses of the Company were $.8 million and $3.6 million for the first nine months of 2005 and 2004, respectively.

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Reinsurance Underwriting Results

	Three Months Ended September 30		Nine Months Ended September 30	
(dollars in thousands)	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Erie Indemnity Company Insurance Underwriting Operations:				
Nonaffiliated reinsurance	$ 2,679	($ 439)	$ 1,399	($ 1,616)
Affiliated reinsurance				
Premiums ceded to Exchange	(844)	(842)	(2,531)	(2,524)
Change to recoveries under the excess-of-loss agreement	(2,166)	(1,159)	(2,341)	(6,088)
	($ 3,010)	($ 2,001)	($ 4,872)	($ 8,612)

In the third quarter of 2005, the estimate of assumed loss and loss adjustment expense reserves related to the September 11th, 2001 event was reevaluated based on potential exposure. This review resulted in a reduction of the Property and Casualty Group s reserves by $42 million, of which the Company s share was $2.3 million (See Financial Condition for further discussion). This reserve change triggered a $2.2 million reduction in recoveries during the third quarter of 2005 to the Company under the aggregate excess-of-loss reinsurance agreement for the 2001 accident year which was recorded in the third quarter of 2005. The net effect of this World Trade Center reserve activity to the Company was a $.1 million reduction in expense to the Company in the third quarter of 2005.

Investment Operations

	Three Months Ended September 30		Nine Months Ended September 30	
(dollars in thousands)	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Net investment income	$ 14,755	$ 14,795	$ 45,158	$ 45,086
Net realized gains on investments	1,765	859	16,457	6,743
Equity in earnings of limited partnerships	8,032	3,845	30,788	5,727
Equity in earnings of EFL	560	1,654	2,868	4,545
Net revenue from investment operations	$ 25,112	$ 21,153	$ 95,271	$ 62,101

Net revenues from investment operations increased in the third quarter of 2005 primarily due to a $4.2 million increase in earnings from limited partnerships. During the third quarter of 2005, the Company recorded earnings from one partnership of $4.4 million in the form of a distribution. In the second quarter of 2005, the

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Company corrected its accounting for limited partnerships to recognize in earnings market valuation adjustments to equity in earnings of limited partnerships. Included in the third quarter 2005 limited partnership earnings are $.3 million of unrealized gains.

Net realized gains improved $.9 million due to sales of common equity securities that were offset by impairment charges of $.3 million on equity investments and $.6 million on fixed maturities. The equity in earnings of EFL for the third quarter of 2005 was negatively impacted by a one time change in estimate recorded by EFL for implementing a new actuarial valuation system for its traditional products. The Company s share of this reduction to earnings of EFL approximated $.5 million in the third quarter.

The $33.2 million increase in net revenue from investment operations for the nine months ended September 30, 2005 included the second quarter 2005 $14.2 million limited partnership market valuation adjustment. Total unrealized gains included in limited partnership earnings were $14.5 million for the nine months ended September 30, 2005. Additionally, the limited partnership portfolio included investments in 81 partnerships at September 2005 compared to 70 partnerships in September 2004. Net realized gains on investments for the nine months ended September 30, 2005 was driven by sales of common equity securities. Impairment charges recorded in the nine months ended September 30, 2005 were $1.4 million on equity securities and $2.1 million on fixed maturities. There were no impairment charges on equity securities or fixed maturities in the nine months ended September 30, 2004.

The Company s performance of its fixed maturities and preferred stock portfolios compared to selected market indices is presented below. Annualized returns are shown pre-tax and include investment income, realized and unrealized gains and losses.

	Pre-tax annualized total returns
	Two year period ended September 30, 2005
Erie Indemnity Company Indices:	
Fixed maturities corporate	4.01%
Fixed maturities municipal	3.05
Preferred stock	5.87
Common stock	10.72(1)
Market indices:	
Lehman Brothers U.S. Aggregate	3.24%
S&P 500 Composite Index	13.03

(1) Return is gross of fees to external managers.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

FINANCIAL CONDITION

Investments

The Company s investment strategy takes a long-term perspective emphasizing investment quality, diversification and superior investment returns. Investments are managed on a total return approach that focuses on current income and capital appreciation. The Company s investment strategy also provides for liquidity to meet the short- and long-term commitments of the Company. At September 30, 2005, the Company s investment portfolio of investment-grade bonds and preferred stock, common stock and cash and cash equivalents represents $1.2 billion, or 39.8%, of total assets. These investments provide the liquidity the Company requires to meet the demands on its funds.

The Company continually reviews the investment portfolio to evaluate positions that might incur other-than-temporary declines in value. For all investment holdings, general economic conditions and/or conditions specifically affecting the underlying issuer or its industry, including downgrades by the major rating agencies, are considered in evaluating impairment in value. In addition to specific factors, other factors considered in the Company s review of investment valuation are the length of time the market value is below cost and the amount the market value is below cost.

There is a presumption of impairment for common equity securities when the decline is, in management s opinion significant and of an extended duration. The Company considers market conditions, industry characteristics and the fundamental operating results of the issuer to determine if sufficient objective evidence exists to refute the presumption of impairment. When the presumption of impairment is confirmed, the Company will recognize an impairment charge to operations. Common stock impairments are included in realized losses in the Consolidated Statements of Operations.

For fixed maturity and preferred stock investments, the Company individually analyzes all positions with emphasis on those that have, in management s opinion, declined significantly below cost. The Company considers market conditions, industry characteristics and the fundamental operating results of the issuer to determine if the decline is due to changes in interest rates, changes relating to a decline in credit quality, or other issues affecting the investment. A charge is recorded in the Consolidated Statements of Operations for positions that have experienced other-than-temporary impairments due to credit quality or other factors, or for which it is not the intent or ability of the Company to hold the position until recovery has occurred. (See Analysis of Investment Operations section).

If the Company s policy for determining the recognition of impaired positions were different, the Company s Consolidated Statements of Operations could be significantly impacted. Management believes its investment valuation philosophy and accounting practices result in appropriate and timely measurement of value and recognition of impairment.

The Company s investments are subject to certain risks, including interest rate and price risk. The Company s exposure to interest rates is concentrated in the fixed maturities portfolio. The fixed maturities portfolio comprises 71.3% and 74.2% of invested assets at September 30, 2005 and December 31, 2004, respectively. The Company calculates the duration and convexity of fixed maturities portfolio each month to measure the price sensitivity of the portfolio to interest rate changes. Duration measures the relative sensitivity of the fair value of an investment to changes in interest rates. Convexity measures the rate of change of duration with respect to changes in interest rates. These factors are analyzed monthly to ensure that both the duration and convexity remain in the targeted ranges established by management.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The Company s portfolio of marketable equity securities, which is carried on the Consolidated Statements of Financial Position at estimated fair value, has exposure to price risk, the risk of potential loss in estimated fair value resulting from an adverse change in prices. The Company has been diversified its common stock portfolio through transitioning the portfolio to external equity managers. The Company does not hedge its exposure to equity price risk inherent in its equity investments. The Company s objective is to earn competitive relative returns by investing in a diverse portfolio of high-quality, liquid securities. Portfolio holdings are diversified across industries and among exchange traded mid- to large-cap stocks. The Company measures risk by comparing the performance of the marketable equity portfolio to benchmark returns such as the S&P 500.

The Company s portfolio of limited partnership investments has exposure to market risks, primarily relating to the financial performance of the various entities in which the partnerships are invested. The limited partnership portfolio comprised 9.5% and 9.9% of invested assets at September 30, 2005 and December 31, 2004, respectively. These investments consist primarily of equity investments in small and medium-sized companies and in real estate. The Company achieves diversification within the limited partnership portfolio by investing in approximately 81 partnerships that have approximately 1,568 distinct investments. The Company reviews at least quarterly the limited partnership investments by sector, geography and vintage year. These limited partnership investments are diversified to avoid concentration in a particular industry. The Company performs extensive research prior to investment in these partnerships.

Property/casualty loss reserves

Loss reserves are established to account for the estimated ultimate costs of loss and loss adjustment expenses for claims that have been reported but not yet settled and claims that have been incurred but not reported.

Most reserve estimates are reviewed on a quarterly basis. Reserves that are reviewed semi-annually include all catastrophic injury no fault and asbestos and environmental liability reserves. Multiple actuarial methods are used in estimating unpaid loss and loss adjustment expense liabilities. Each methodology utilizes unique assumptions and variables. A range of reasonable estimates is developed utilizing these methods for each product line or product coverage analyzed. The presence or absence and magnitude of underlying variables, their interaction, and their recognition in estimation methods will cause the width of the range to vary for different product segments and over time for the same product segment. The final estimate recorded by management is a function of detailed analyses of historical trends adjusted as new emerging data indicates and represents management s best estimate of ultimate claim costs.

The factors which may potentially cause the greatest variation between current reserve estimates and the actual future paid amounts are: unforeseen changes in statutory or case law altering the amounts to be paid on existing claim obligations, new medical procedures and/or drugs for which costs are significantly different from that experienced in the past, and claims patterns on current business that differ significantly from historical claims patterns.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Loss and loss adjustment expense reserves are presented on the Company s Statements of Financial Position on a gross basis for EIC, ENY, and EPC, the property/casualty insurance subsidiaries of the Company that wrote about 17% of the direct property/casualty premiums of the Property and Casualty Group for the nine months ended September 30, 2005. Under the terms of the Property and Casualty Group s quota share and intercompany pooling arrangement, a significant portion of these reserve liabilities are recoverable. Recoverable amounts are reflected as an asset on the Company s Statements of Financial Position. The direct and assumed loss and loss adjustment expense reserves by major line of business and the related amount recoverable under the intercompany pooling arrangement and excess-of-loss reinsurance agreement are presented below:

Loss and Loss Adjustment Expense Reserve:

	As of	
(in thousands)	September 30, 2005	December 31, 2004
Gross reserve liability		
Personal:		
Private passenger auto	$ 406,894	$ 400,609
Catastrophic injury	104,895	86,239
Homeowners	23,229	22,798
Other personal	7,528	6,322
Commercial:		
Workers compensation	222,405	216,808
Commercial auto	84,143	78,646
Commercial multi-peril	66,178	63,118
Catastrophic injury	390	454
Other commercial	16,164	15,288
Reinsurance	54,010	52,752
Gross reserves	985,836	943,034
Reinsurance recoverables	779,174	765,563
Net reserve liability	$ 186,662	$ 177,471

As discussed previously, loss and loss adjustment expense reserves are developed using multiple estimation methods that result in a range of estimates for each product coverage group. The estimate recorded is a function of detailed analysis of historical trends and management expectations of future events and trends. The product coverage that has the greatest potential for variation is the pre-1986 automobile catastrophic injury liability reserve. The range of reasonable estimates for the pre-1986 automobile catastrophic injury liability reserve, net of reinsurance recoverables, for both personal and commercial is from $183 million to $400 million for the Property and Casualty Group. The reserve carried by the Property and Casualty Group, which is management s best estimate of liability at this time, increased to $249 million at September 30, 2005 which is net of $109 million of anticipated reinsurance recoverables. The Property and Casualty Group s net pre-1986 automobile catastrophic injury liability reserve increased from $200 million at June 2005. The increase was the result of higher cost expectations of future attendant care services as a result of the settlement of litigation involving attendant care liabilities. The Company s property/casualty subsidiaries share of the net automobile catastrophic injury liability reserve is $13.7 million at September 30, 2005.

The potential variability in these reserves can be primarily attributed to automobile no-fault claims incurred prior to 1986. The automobile no-fault law in Pennsylvania at that time provided for unlimited medical benefits. There are

currently 392 claimants requiring lifetime medical care of which 77 involve catastrophic injuries. The estimation of ultimate liabilities for these claims is subject to significant judgment due to variations in claimant health over time.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

It is anticipated that these automobile no-fault claims will require payments over approximately the next 40 years. The impact of medical cost inflation in future years is a significant variable in estimating this liability over 40 years. A 100-basis point change in the medical cost inflation assumption would result in a change in net liability for the Company of $2.2 million. Claimants future life expectancy is another significant variable. The life expectancy assumption underlying the estimate reflects experience to date. Actual experience, different than that assumed, could have a significant impact on the reserve estimate. The Company will continue to closely monitor these reserve estimates.

During the third quarter of 2005, the Property and Casualty Group reevaluated its estimate of assumed loss and loss adjustment expense reserves estimated for the September 11th 2001 event. Based on that assessment the Property and Casualty Group reduced its World Trade Center reserves by $42 million as of September 30, 2005. The original $150 million estimated total loss and loss adjustment expense estimate was based on uncertainties including cedant reserve estimates, the potential of retrocessional spirals, undeveloped claims and the uncertainty of legal actions. As a result of this reserve re-estimate the Property and Casualty Group s total loss and loss adjustment expense estimate for the World Trade Center claims are estimated at $107 million. At September 2005, four years subsequent to the date of the event, most of the reported claims have been property losses which are short-tailed and have developed since 2001 providing more known data. Only one claim was identified as being exposed to a retrocessional spiral, which results when there are multiple levels of reinsurers and has the potential to increase the Company s obligation. Factoring in this loss experience data supported the reduction in the World Trade Center reserve. At September 2005, the Property and Casualty Group s estimated total loss exposure related to the events of September 11th of $107 million, includes paid claims and case reserves on reported claims of $78.2 million. The remaining $29 million recorded relates to the coverage disputes with respect to the number of events. The most critical factor in the estimation of these losses is whether the destruction of the World Trade Center Towers will be considered a single event or two separate events. The Company believes the current reserves should be sufficient to absorb the potential development that may occur should the destruction of the World Trade Center Towers be considered two separate events. No losses were recognized by the Company s property/casualty insurance subsidiaries in 2005 and 2004 related to the World Trade Center attack.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measure of an entity s ability to secure enough cash to meet its contractual obligations and operating needs. The Company s major sources of funds from operations are the net cash flow generated from the Company s management operations, the net cash flow from EIC s and EINY s 5.5% participation in the underwriting results of the reinsurance pool with the Exchange, and investment income from affiliated and non-affiliated investments. With respect to the management fee, funds are generally received from the Exchange on a premiums collected basis. The Company has a receivable from the Exchange and affiliates related to the management fee receivable from premiums written, but not yet collected, as well as the management fee receivable on premiums collected in the current month. The Company pays nearly all general and administrative expenses on behalf of the Exchange and other affiliated companies. The Exchange generally reimburses the Company for these expenses on a paid basis each month. Management fee and other cash settlements due from the Exchange were $208.6 million at September 30, 2005, and $207.2 million at December 31, 2004. A receivable from EFL for cash settlements totaled $2.5 million at September 30, 2005, compared to $4.3 million at

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

December 31, 2004. The receivable due from the Exchange for reinsurance recoverable from unpaid loss and loss adjustment expenses and unearned premium balances ceded to the intercompany reinsurance pool increased to $929.0 million at September 30, 2005 from $893.8 million at December 31, 2004. The changes are the result of corresponding changes in direct loss reserves, loss adjustment expense reserves and unearned premium reserves of the Company s property/casualty insurance subsidiaries that are ceded to the Exchange under the intercompany pooling agreement. The change in the property/casualty insurance subsidiaries reserves ceded to the Exchange is a result of a corresponding increase or decrease in direct premium written by the Company s property/casualty insurance subsidiaries. Direct written premium of the property/casualty insurance subsidiaries decreased 5.9% in the third quarter of 2005 compared to the third quarter of 2004.

Cash outflows are variable because settlement dates for claim payments vary and cannot be predicted with absolute certainty. While volatility in claims payments could be significant for the Property and Casualty Group, the effect on the Company of this volatility is mitigated by the intercompany reinsurance pooling arrangement. The exposure for large loss payments is also mitigated by the Company s excess-of-loss reinsurance agreement with the Exchange. The cash flow requirements for claims have not historically been significant to the Company s liquidity. Historically, about 50% of losses and loss adjustment expenses included in the reserve are paid out in the subsequent 12-month period and approximately 89% is paid out within a five year period. Such payments are reduced by recoveries under the intercompany reinsurance pooling agreement.

The Company has historically generated sufficient net positive cash flow from its operations to fund its commitments and build the investment portfolio. The Company also maintains a high degree of liquidity in its investment portfolio in the form of readily marketable fixed maturities, equity securities and short-term investments. Net cash flows provided by operating activities were $174.9 million and $178.2 million for the nine months ended September 30, 2005 and 2004, respectively.

There were no cash payments for agent bonuses in the third quarter of 2005. Agent bonuses of $46.7 million were paid in the first quarter of 2005. As $46.0 million was accrued for agent bonuses in 2004, the Company s income reflected the $.7 million change in the first nine months of 2005. There were no contributions to the employee pension plan in the nine months ended September 30, 2005 compared to a $7.6 million contribution in the nine months ended September 30, 2004. The Company has met its minimum pension funding requirements and no contribution will be made to the employee pension plan in 2005 in accordance with tax regulations.

The Company has liquidated certain of its internally managed equity securities to allow the external investment managers to manage the portfolio. As a result, proceeds from the sales of equity securities totaled $72.4 million and $29.4 million in the first nine months of 2005 and 2004, respectively. Purchases of equity securities were $128.7 million and $23.9 million in the first nine months of 2005 and 2004, respectively.

Dividends paid to shareholders for the nine months ended September 30, 2005 and 2004, totaled $61.6 million and $41.5 million, respectively. As part of its capital management activities in 2004, the Company increased its quarterly shareholder dividends for 2005 by 51% on both its Class A and Class B common stock. The annualized dividends will increase the Company s 2005 payout by approximately $28 million from the prior dividend level. There are no regulatory restrictions on the payment of dividends to the Company s shareholders, although there are state law restrictions on the payment of dividends from the Company s insurance subsidiaries to the Company.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

During the third quarter of 2005, the Company repurchased 395,445 shares of its outstanding Class A common stock in conjunction with the stock repurchase plan that was authorized in December 2003. The shares were purchased at a total cost of $20.8 million, or an average price per share of $52.54. (See table at Part II. Item 2., Issuer Repurchases of Equity Securities.) The plan allows the Company to repurchase up to $250 million of its outstanding Class A common stock through December 31, 2006. The Company has repurchased shares at a total cost of $101.0 million since the inception of the plan.

FACTORS THAT MAY AFFECT FUTURE RESULTS

Insurance Premium Rate Action

The premium growth attributable to rate increases of the Property and Casualty Group directly affects underwriting profitability of the Property and Casualty Group and the Exchange. In recent years, prices for commercial and personal lines insurance have increased considerably in the industry. The Property and Casualty Group also increased prices considerably during 2003 and into 2004. Pricing actions contemplated or taken by the Property and Casualty Group are subject to various regulatory requirements of the states in which these insurers operate. The pricing actions already implemented, or to be implemented through 2005, will also have an effect on the market competitiveness of the Property and Casualty Group s insurance products. Such pricing actions, and those of competitors, could affect the ability of the Company s agents to sell and/or renew business.

Rate increases filed by the Property and Casualty Group for certain lines of business in various states were taken to offset growing loss costs in those lines in 2003 and 2004. The financial results for the first nine months of 2005 included some of the impact of these rate changes being earned. In the first nine months of 2005, rating actions accounted for approximately $9 million in increased written premiums. Rate reductions are being sought by the Property and Casualty Group in 2005 to be more price competitive. The effects of rate increases implemented in 2004 offset by 2005 pricing actions approved, filed, awaiting approval or contemplated through September 30, 2005, are anticipated to result in a net decrease in written premiums of $10.1 million. The majority of the rate decreases stem from the private passenger auto and the homeowners lines of business in Pennsylvania. In the majority of states, an 8% rate reduction on certain coverages for new private passenger auto policyholders with no claims or violations was effective July 1, 2005. In Tennessee and West Virginia, this rate reduction for policyholders with no claims or violations was 6%. Pricing actions anticipated in 2005 are a result of the improvement in underwriting results. Pricing actions approved, contemplated or filing and awaiting approval through September 30, 2005, could reduce premium for the Property and Casualty Group by $87.4 million in 2006.

A return to more stable rates should allow the Property and Casualty Group to be price competitive with other insurers and is anticipated to increase the Property and Casualty Group s ability to attract new policyholders and to retain existing policyholders.

Policy Growth

Premium levels attributable to growth in policies in force of the Property and Casualty Group directly affects the underwriting profitability of the Property and Casualty Group and the management operations of the Company. The 2004 focus on underwriting discipline resulted in a reduction in policy production and policy retention ratios as expected. The continued growth of the business of the Property and Casualty Group is dependent upon its ability to retain existing and attract new policyholders. A lack of new policy growth or the inability to retain existing customers could have an adverse effect on the growth of premium levels for the Property and Casualty Group.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Insurance Scoring

The Property and Casualty Group continues developing its comprehensive rating plan for private passenger auto and homeowners lines of business. The new rating plan includes significantly more pricing segments than the former plan, providing the Company greater flexibility in pricing policies with varying degrees of risk. Insurance scoring is among the most significant risk factors the Company has recently incorporated into the rating plan. Expanded pricing segmentation, that incorporates insurance scoring, should enable the Company to provide more competitive rates to policyholders with varying risk characteristics as risks can be more accurately priced.

Implementing and refining insurance scoring could impact retention of existing policyholders and could affect the Property and Casualty Group s ability to attract new policyholders. Introduction of variables such as credit-worthiness could potentially disrupt the relationships with policyholders insured by the Property and Casualty Group. The long-term extent of this impact cannot be determined.

Service agreement revenue

The Company collects service charges from policyholders for providing multiple payment plans on policies written by the Property and Casualty Group. These premium service charges are currently $3 for each installment. Effective for policies renewing on or after January 1, 2006 paid in installments, the service charge will increase to $5 per installment. Also effective for policies renewing on or after January 1, 2006 paid using the direct debit payment method, the service charges will be eliminated. The financial impact this will have on the Company cannot be determined since the payment plan policyholders will choose cannot be predicted. However, if the number and mix of policyholders currently utilizing the installment plans and the direct debit program were to remain the same, premium service charges would increase by about $13 million on an annual basis once fully implemented, with approximately $7.5 million in 2006.

Reinsurance

During the fourth quarter of 2005, the Company conducted its annual review of the Property and Casualty Group s exposure to property catastrophe risk in preparation for the renewal of its property catastrophe reinsurance treaties in 2006. The Company intends to purchase property catastrophe reinsurance in 2006 for the Property and Casualty Group s property/casualty insurance business and is actively considering alternative structures and soliciting quotations relating to its property catastrophe reinsurance program.

The Company has also considered its renewal of the aggregate excess-of-loss reinsurance coverage with the Exchange for 2006. The aggregate excess-of-loss reinsurance coverage was first purchased by the Company in 1998 with the intent of dampening the effect on the Company s operating earnings of the volatility from the assumption of 5.5% of the Property Casualty Group s underwriting results. At that time, the Property Casualty Group was engaged in the assumed reinsurance business, which introduced added volatility to its insurance underwriting results and as a consequence the Company s. Additionally, at that time and until 2003, the Property Casualty Group did not carry ceded reinsurance coverage including property catastrophe reinsurance coverage and therefore was exposed to greater variability in insurance underwriting result.

For 2006, the Company does not expect to renew the aggregate excess-of-loss reinsurance arrangement with the Exchange. The Company believes this reinsurance arrangement with the Exchange should not be renewed as the Property Casualty Group plans to continue to purchase property catastrophe reinsurance coverage in 2006 and has completed its exit from the assumed reinsurance business. The Company also took into consideration the increased cost of this reinsurance in 2006.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Information Technology Costs

The comprehensive program of eCommerce initiatives being undertaken by the Erie Insurance Group began in 2001. Early in the program, substantial advancements in the organizations internal infrastructure were put in place, providing the enabling foundation for implementing advanced technology including operating environments and applications.

The Erie Insurance Group has spent $192.4 million on the eCommerce program through September 2005. Target delivery dates established in 2002 have generally not been met as management has devoted increased effort to quality assurance efforts to ensure that the rollout creates only minimal business disruption.

While functional as a personal lines rating and policy administration system, the agency interface component of Erie*Connection* has generally not met the Company s or agents expectations for ease of use. The Company has postponed further deployment of the system until such usability issues are resolved. Estimates of the costs to improve the agency interface for ease of use needed to facilitate future deployment and the timetable for deployment continue to be analyzed and developed.

During the third quarter of 2005, substantial progress was made in migrating all independent agencies to a common, stable Windows XP based agency interface platform. Previously, many agencies interfaced with the Company utilizing a DOS based platform that was commercially unsupportable, while some were on the Windows XP platform. While this more stable platform does not interface to Erie*Connection*, this migration enables the Company to more thoroughly research and plan for its future interface development and rollout strategy.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995: Certain forward-looking statements contained herein involve risks and uncertainties. These statements include certain discussions relating to management fee revenue, cost of management operations, underwriting, premium and investment income volume, business strategies, profitability and business relationships and the Company s other business activities during 2005 and beyond. In some cases, you can identify forward-looking statements by terms such as may, will, should, could, would, expect, plan, intend, anticipate, believe, estimate, project, predict, potential and similar ex forward-looking statements reflect the Company s current views about future events, are based on assumptions and are subject to known and unknown risks and uncertainties that may cause results to differ materially from those anticipated in those statements. Many of the factors that will determine future events or achievements are beyond our ability to control or predict.

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PART II. OTHER INFORMATION (Continued)
ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibit
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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.

Erie Indemnity Company
(Registrant)

Date: November 3, 2005

/s/ Jeffrey A. Ludrof
Jeffrey A. Ludrof, President & CEO

/s/ Philip A. Garcia
Philip A. Garcia, Executive Vice President & CFO

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