

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K**

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

For the fiscal year ended December 31, 2005

OR

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

Commission File Number 0-24000

ERIE INDEMNITY COMPANY

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction
of incorporation or organization)

25-0466020
(I.R.S. Employer
Identification No.)

100 Erie Insurance Place, Erie, Pennsylvania
(Address of principal executive offices)

16530
(Zip code)

Registrant's telephone number, including area code (814) 870-2000

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Class A Common Stock, stated value \$.0292 per share
Class B Common Stock, stated value \$70 per share
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act
Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Aggregate market value of voting stock of non-affiliates: There is no active market for the Class B voting stock and no Class B voting stock has been sold in the last year upon which a price could be established.

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

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date: 60,419,835 shares of Class A Common Stock and 2,833 shares of Class B Common Stock outstanding on February 16, 2006.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Registrant's Annual Report to Shareholders for the fiscal year ended December 31, 2005 (the "Annual Report") are incorporated by reference into Parts I, II and III of this Form 10-K Report.
2. Portions of the Registrant's Proxy Statement relating to the Annual Meeting of Shareholders to be held April 18, 2006 are incorporated by reference into Parts I and III of this Form 10-K Report.

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PART I

Item 1. Business

Erie Indemnity Company ("Company"), a Pennsylvania corporation, operates predominantly as the management services company that provides sales, underwriting and policy issuance services to the policyholders of Erie Insurance Exchange ("Exchange"). The Company has served as the attorney-in-fact for the policyholders of the Exchange since 1925. The Company also operates as a property/casualty insurer through its wholly-owned subsidiaries, Erie Insurance Company, Erie Insurance Property and Casualty Company and Erie Insurance Company of New York. The Exchange and its property/casualty insurance subsidiary, Flagship City Insurance Company, along with the Company's three insurance subsidiaries (collectively, the "Property and Casualty Group") write a broad line of personal and commercial lines property and casualty coverages and pool their underwriting results. The financial results of the Exchange are not consolidated with the Company's.

For its services as attorney-in-fact, the Company charges the Exchange a management fee calculated as a percentage, limited to 25%, of the direct written premiums of the Exchange and the direct written premiums of the other members of the Property and Casualty Group, all of which are assumed by the Exchange under the intercompany pooling arrangement. Management fees accounted for approximately 72% of the Company's revenues in 2005 and approximately 74% in both 2004 and 2003.

Because the Company's earnings are largely generated from fees based on the direct written premium of the Exchange and other members of the Property and Casualty Group, the Company has an interest in the growth and financial condition of the Exchange. The Property and Casualty Group underwrites a broad range of insurance. In 2005, personal lines comprised 70% of direct written premium revenue of the Property and Casualty Group while commercial lines constituted the remaining 30%. The core products in personal lines are private passenger automobile (49%) and homeowners (19%) while the core commercial lines consist principally of multi-peril (11%), workers' compensation (9%) and automobile (8%). The Property and Casualty Group operates primarily in the Midwest, mid-Atlantic and southeast regions of the United States exclusively through 7,800 independent agents. While sales, underwriting and policy issuance services are centralized at the Company's home office, the Property and Casualty Group maintains 23 field offices throughout the 11 contiguous states where the Property and Casualty Group does business to provide claims services and marketing support for the independent agents. Historically, due to policy renewal and sales patterns, the Property and Casualty Group's direct written premiums are greater in the second and third quarters of the calendar year. While loss and loss adjustment expenses are not entirely predictable, historically such costs have been greater during the third and fourth quarters, influenced by the weather in the geographic regions, including the Midwest, mid-Atlantic and southeast regions in which the Property and Casualty Group operates.

The Company's property/casualty insurance subsidiaries participate in the underwriting results of the Exchange through the intercompany pooling arrangement. Under the arrangement, the Exchange assumes 94.5% of the underwriting results of the Property and Casualty Group while the Company's insurance subsidiaries assume 5.5%.

The Company also owns 21.6% of the common stock of Erie Family Life Insurance Company ("EFL"), an affiliated life insurance company of which the Exchange owns 53.5%. Together with the Exchange, the Company and its subsidiaries and affiliates operate collectively as the "Erie Insurance Group".

Operating Segments

Financial information about these segments is set forth in and referenced to Note 20 of the "Notes to Consolidated Financial Statements" included in the Annual Report. Further discussion of financial results by operating segment is provided in and referenced to "Management's Discussion and Analysis" also included in the 2005 Annual Report.

Competition

The markets in which the Property and Casualty Group operates are highly competitive. The Property and Casualty Group ranked as the 15th largest automobile insurer in the United States based on 2004 direct written premiums and as the 23rd largest property/casualty insurer in the United States based on 2004 total lines net premium written according to A.M. Best Company, Inc. Property and casualty insurers generally compete on the basis of customer service, price, brand recognition, coverages offered, claim handling ability, financial stability and geographic coverage. Vigorous competition is provided by large, well-capitalized national companies, some of which have broad distribution networks of employed or captive agents, and by smaller regional insurers. In addition, because the insurance products of the Property and Casualty Group are marketed exclusively through independent insurance agents, the Property and Casualty Group, faces competition within its appointed agencies based on ease of doing business, product, price and service relationships.

Market competition bears directly on the price charged for insurance products and services subject to regulatory limitations. Growth is driven by a company's ability to provide insurance services at a price that is reasonable and acceptable to the customer. In addition, the marketplace is affected by available capacity of the insurance industry. Industry surplus expands and contracts primarily in conjunction with profit levels generated by the industry. Growth is a product of a company's ability to retain existing customers and to attract new customers, as well as movement in the average premium per policy charged by the Property and Casualty Group.

The Erie Insurance Group has followed several strategies that management believes will result in long-term underwriting performance which exceeds those of the property/casualty industry in general. First, the Erie Insurance Group employs an underwriting philosophy and product mix targeted to produce a Property and Casualty Group underwriting profit on a long-term basis through careful risk selection and rational pricing. The careful selection of risks allows for lower claims frequency and loss severity, thereby enabling insurance to be offered at favorable prices. With the recent introduction of insurance scoring into the underwriting and pricing processes, the Property and Casualty Group has continued to refine its risk measurement and price segmentations skills. Second, Erie Insurance Group's management focuses on consistently providing superior service to policyholders and agents. Third, the Erie Insurance Group's business model is designed to provide the advantages of localized marketing and claims servicing with the economies of scale from centralized accounting, administrative, underwriting, investment, information management and other support services.

Finally, the Company carefully selects the independent agencies that represent the Property and Casualty Group. The Property and Casualty Group seeks to be the lead insurer with its agents in order to enhance the agency relationship and the likelihood of receiving the most desirable underwriting opportunities from its agents. The Company has ongoing, direct communications with the agency force. Agents have access to a number of Company-sponsored venues designed to promote sharing of ideas, concerns and suggestions with the senior management of the Property and Casualty Group with the goal of improving communications and service. The Company continues to evaluate new ways to support its agents' efforts, from marketing programs to identifying potential customer leads, to grow the business of the Property and Casualty Group. These efforts have resulted in outstanding agency penetration and the ability to sustain long-term agency partnerships. The higher agency penetration and long term relationships allow for greater efficiency in providing agency support and training.

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[Employees](#)

The Company employed over 4,600 persons at December 31, 2005, of which approximately 2,300 provide claims specific services exclusively for the Property and Casualty Group and approximately 160 perform services exclusively for EFL. Both the Exchange and EFL reimburse the Company monthly for the cost of these services.

[Geographic areas](#)

The Property and Casualty Group is represented by an agency force of 7,800 agents in 11 Midwest, mid-Atlantic and southeast states including Illinois, Indiana, Maryland, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and Wisconsin, and the District of Columbia. See the table "Management fee revenue by line by state" for the Company included in and referenced to the Management's Discussion and Analysis in the 2005 Annual Report.

[Reserves for losses and loss adjustment expenses](#)

The following table illustrates the change over time of the loss and loss adjustment expense reserves established for the Company's property/casualty insurance subsidiaries at the end of the last ten calendar years. Conditions and trends that have affected development of the liability in the past may not necessarily occur in the future. Accordingly, it generally is not appropriate to extrapolate future redundancies or deficiencies based on this data.

**Property and Casualty Subsidiaries of Erie Indemnity Company
Reserves for Unpaid Losses and Loss Adjustment Expenses**

(amounts in millions)	At December 31,									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Gross liability for unpaid losses and loss adjustment expense ("LAE")	\$386.4	\$413.4	\$426.2	\$ 432.9	\$ 477.9	\$ 557.3	\$717.0	\$845.5	\$943.0	\$1,019.5
Gross liability re-estimated as of:										
One year later	397.4	410.8	431.2	477.0	516.2	622.6	727.2	832.2	927.5	
Two years later	400.9	411.5	448.7	487.2	567.1	635.1	736.3	843.3		
Three years later	400.4	422.5	453.3	518.6	567.2	649.1	755.5			
Four years later	404.6	420.5	471.9	518.5	588.7	669.9				
Five years later	402.1	435.6	472.2	541.1	619.0					
Six years later	412.5	438.3	492.3	568.9						
Seven years later	416.8	456.2	516.4							
Eight years later	433.7	480.1								
Nine years later	457.5									
Cumulative (deficiency) redundancy	<u>(71.1)</u>	<u>(66.7)</u>	<u>(90.2)</u>	<u>(136.0)</u>	<u>(141.1)</u>	<u>(112.6)</u>	<u>(38.5)</u>	<u>2.2</u>	<u>15.5</u>	
Gross liability for unpaid losses and LAE	\$386.4	\$413.4	\$426.2	\$ 432.9	\$ 477.9	\$ 557.3	\$717.0	\$845.5	\$943.0	\$1,019.5
Reinsurance recoverable on unpaid losses	<u>301.5</u>	<u>323.9</u>	<u>334.8</u>	<u>337.9</u>	<u>375.6</u>	<u>438.6</u>	<u>577.9</u>	<u>687.8</u>	<u>765.6</u>	<u>828.4</u>
Net liability for unpaid losses and LAE	<u>\$ 84.9</u>	<u>\$ 89.5</u>	<u>\$ 91.4</u>	<u>\$ 95.0</u>	<u>\$ 102.3</u>	<u>\$ 118.7</u>	<u>\$139.1</u>	<u>\$157.7</u>	<u>\$177.4</u>	<u>\$ 191.1</u>
Net re-estimated liability as of:										
One year later	\$ 87.3	\$ 88.9	\$ 92.5	\$ 104.7	\$ 109.8	\$ 126.6	\$140.9	\$162.6	\$181.2	
Two years later	88.1	89.1	96.2	106.2	116.0	127.0	144.6	171.9		
Three years later	88.0	91.5	97.2	110.6	116.2	131.9	155.7			
Four years later	88.9	91.0	101.2	110.8	120.9	143.6				
Five years later	88.3	94.3	101.3	115.3	132.5					
Six years later	90.6	94.9	105.6	124.8						
Seven years later	91.6	98.8	110.8							
Eight years later	95.3	103.9								
Nine years later	100.5									
Cumulative (deficiency) redundancy	<u>(15.6)</u>	<u>(14.4)</u>	<u>(19.4)</u>	<u>(29.8)</u>	<u>(30.2)</u>	<u>(24.9)</u>	<u>(16.6)</u>	<u>(14.2)</u>	<u>(3.8)</u>	

The development of loss and loss adjustment expenses are presented on a gross basis (gross of ceding transactions in the intercompany pool) and a net basis (the amount remaining as the Company's exposure after ceding amounts through the intercompany pool and the Company's insurance subsidiaries assuming their 5.5% of the pool, as well as transactions under the excess-of-loss reinsurance agreement with the Exchange).

The Company's 5.5% share of the loss and loss reserves of the Property and Casualty Group are shown in the net presentation and are more representative of the actual development of the property/casualty insurance losses accruing to the subsidiaries of the Company. The gross presentation is shown to be consistent with the balance sheet presentation of reinsurance transactions which requires direct and ceded amounts to be presented gross of one another, per FAS 113, "Accounting and Reporting for Reinsurance of Short Duration and Long Duration Contracts", i.e. the gross liability for unpaid losses and LAE of \$1,019.5 million agrees to the gross balance sheet amount, however, factoring in the gross reinsurance recoverables of \$828.4 million presented in the balance sheet results in the net obligation to the Company of \$191.1 million. The development on a gross basis is not necessarily indicative of the Company's property/casualty insurance subsidiaries loss reserve development as the remaining transactions (ceded) are not reflected in the amounts.

Reserves for Unpaid Losses and Loss Adjustment Expenses (Continued)

(amounts in millions)	1996	1997	1998	1999	At December 31		2002	2003	2004	2005
					2000	2001				
Cumulative amount of gross liability paid through:										
One year later	\$141.3	\$136.9	\$145.4	\$158.9	\$174.4	\$194.3	\$217.0	\$259.1	\$271.4	
Two years later	212.2	211.5	228.2	244.9	270.9	302.1	351.0	410.6		
Three years later	250.0	256.8	274.9	297.6	326.1	372.5	434.7			
Four years later	271.6	280.5	300.9	326.9	361.3	418.9				
Five years later	285.9	295.9	315.8	347.0	384.8					
Six years later	295.0	306.0	325.9	362.9						
Seven years later	302.3	313.1	336.6							
Eight years later	308.2	321.9								
Nine years later	315.7									
Cumulative amount of net liability paid through:										
One year later	\$ 32.6	\$ 31.3	\$ 33.6	\$ 38.9	\$ 41.2	\$ 47.3	\$ 50.5	\$ 58.5	\$ 54.5	
Two years later	48.7	48.3	52.4	59.2	64.9	72.9	80.9	86.7		
Three years later	57.8	59.2	63.9	73.5	78.5	91.0	95.5			
Four years later	63.5	65.5	71.3	80.8	88.3	97.8				
Five years later	67.4	70.0	74.9	86.7	91.7					
Six years later	70.1	72.1	78.4	90.6						
Seven years later	70.2	74.5	81.4							
Eight years later	73.2	76.8								
Nine years later	75.2									

The Property and Casualty Group does not discount reserves except for workers' compensation reserves which are discounted on a nontabular basis. The workers' compensation reserves are discounted at a 2.5% interest rate as prescribed by the Insurance Department of the Commonwealth of Pennsylvania. The discount is based upon the Property and Casualty Group's historical workers' compensation payout pattern. The Company's unpaid losses and loss adjustment expenses reserve was reduced by \$4.6 million and \$4.1 million at December 31, 2005 and 2004, respectively, as a result of this discounting.

The Company's share of the Property and Casualty Group's positive development on losses for prior accident years was \$3.2 million in 2005 which includes the effects of the Company's share of an increase in the automobile catastrophe liability reserve of \$2.6 million. The positive development on losses of prior accident years in 2005 was experienced primarily in the commercial multi-peril and the private passenger auto uninsured motorists lines of business. The increase in the automobile catastrophe liability reserve was the result of higher cost expectations of future attendant care services as a result of the settlement of class action litigation involving attendant care liabilities. See "Insurance Underwriting Operations" and "Financial Condition" in the Management's Discussion and Analysis contained in the 2005 Annual Report.

A reconciliation of claims reserves of the Company's property/casualty insurance subsidiaries can be found at Note 12 of the "Notes to Consolidated Financial Statements" contained in the 2005 Annual Report. Additional discussion of reserve activity can be found in and is referenced to the "Financial Condition" section of the Management's Discussion and Analysis in the 2005 Annual Report.

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Government Regulation

The Property and Casualty Group is subject to supervision and regulation in the states in which it transacts business. The primary purpose of such supervision and regulation is the protection of policyholders. The extent of such regulation varies, but generally derives from state statutes that delegate regulatory, supervisory and administrative authority to state insurance departments. Accordingly, the authority of the state insurance departments includes the establishment of standards of solvency that must be met and maintained by insurers, the licensing to do business of insurers and agents, the nature of the limitations on investments, the approval of premium rates for property/casualty insurance, the provisions that insurers must make for current losses and future liabilities, the deposit of securities for the benefit of policyholders, the approval of policy forms, notice requirements for the cancellation of policies and the approval of certain changes in control. In addition, many states have enacted variations of competitive rate-making laws that allow insurers to set certain premium rates for certain classes of insurance without having to obtain the prior approval of the state insurance department. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to the financial condition of insurance companies.

The Property and Casualty Group is also required to participate in various involuntary insurance programs for automobile insurance, as well as other property/casualty lines, in states in which such companies operate. These involuntary programs provide various insurance coverages to individuals or other entities that otherwise are unable to purchase such coverage in the voluntary market. These programs include joint underwriting associations, assigned risk plans, fair access to insurance requirements ("FAIR") plans, reinsurance facilities and windstorm plans. Legislation establishing these programs generally provides for participation in proportion to voluntary writings of related lines of business in that state. Generally, state law requires participation in such programs as a condition to doing business in that state. The loss ratio on insurance written under involuntary programs has traditionally been greater than the loss ratio on insurance in the voluntary market. Involuntary programs generated underwriting losses for the Property and Casualty Group of \$12.5 million and \$26.7 million in 2005 and 2004, compared to an underwriting profit of \$30.2 million in 2003. The Company's share of underwriting losses related to involuntary programs was \$.7 million and \$1.5 million in 2005 and 2004, respectively.

Most states have enacted legislation that regulates insurance holding company systems. Each insurance company in the holding company system is required to register with the insurance supervisory authority of its state of domicile and furnish information regarding the operations of companies within the holding company system that may materially affect the operations, management or financial condition of the insurers within the system. Pursuant to these laws, the respective insurance departments may examine the Company and the Property and Casualty Group at any time, require disclosure of material transactions with the insurers and the Company as an insurance holding company and require prior approval of certain transactions between the Company and the Property and Casualty Group.

All transactions within the holding company system affecting the insurers the Company manages are filed with the applicable insurance departments and must be fair and reasonable. Approval of the applicable insurance commissioner is required prior to the consummation of transactions affecting the control of an insurer. In some states, the acquisition of 10% or more of the outstanding common stock of an insurer or its holding company is presumed to be a change in control.

Internet access

The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports are available free of charge on the Company's website at www.erieinsurance.com as soon as reasonably practicable after such material is filed electronically with the SEC. The Company's Code of Conduct is available on the Company's website and in printed form upon request. Also copies of the Company's annual report will be made available, free of charge, upon written request.

Item 1A. Risk Factors

The Company's business involves various risks and uncertainties, including, but not limited to those discussed in this section. This information should be considered carefully together with the other information contained in this report including the consolidated financial statements and the related notes. If any of the following events described in the risk factors below actually occur, the Company's business, financial condition and results of operations could be adversely affected.

Risk factors related to the Company's business and relationships with third parties

If the management fee rate paid by the Exchange is reduced, if there is a significant decrease in the amount of premiums written by the Exchange, or if the costs of providing services to the Exchange are not controlled, revenues and profitability could be materially adversely affected.

The Company is dependent upon management fees paid by the Exchange, which represent the Company's principal source of revenue. The management fee rate is determined by the board of directors and may not exceed 25% of the direct written premiums of the Property and Casualty Group. The board of directors sets the management fee rate each December for the following year. However, at their discretion, the rate can be changed at any time. The factors considered by the board in setting the management fee rate include the Company's financial position in relation to the Exchange and the long-term needs of the Exchange for capital and surplus to support its continued growth and competitiveness. If the board of directors determines that the management fee rate should be reduced, the Company's revenues and profitability could be materially adversely affected.

Management fee revenue from the Exchange is calculated by multiplying the management fee rate by the direct premiums written by the Exchange and the direct premiums written by the other members of the Property and Casualty Group, which are assumed by the Exchange under an intercompany pooling arrangement. Accordingly, any reduction in direct premiums written by the Property and Casualty Group would have a proportional negative effect on the Company's revenues and net income.

Pursuant to the attorney-in-fact agreements with the policyholders of the Exchange, the Company is appointed to perform certain services, regardless of the cost to the Company of providing those services. These services relate to the sales, underwriting and issuance of policies on behalf of the Exchange. The Company would lose money or be less profitable if the cost of providing those services increases significantly.

The Company is subject to credit risk from the Exchange because the management fees from the Exchange are not paid immediately when earned. The Company's property/casualty insurance subsidiaries are subject to credit risk from the Exchange because the Exchange assumes a higher insurance risk under an intercompany pooling arrangement than is proportional to its direct business contribution to the pool.

The Company recognizes management fees due from the Exchange as income when the premiums are written because at that time the Company has performed substantially all of services it is required to perform, including sales, underwriting and policy issuance activities. However, such fees are not paid to the Company by the Exchange until the Exchange collects the premiums from policyholders. As a result, the Company holds receivables for management fees earned and due the Company.

The Company also holds receivables from the Exchange for costs the Company pays on the Exchange's behalf and for reinsurance under the intercompany pooling arrangement. The Company's total receivable

from the Exchange, including the management fee, reimbursable costs the Company paid on behalf of the Exchange and total amounts recoverable from the intercompany pool, totaled \$1.2 billion or 37.2% of the Company's total assets at December 31, 2005.

Two of the Company's wholly-owned property/casualty insurance subsidiaries, Erie Insurance Company and Erie Insurance Company of New York are parties to the intercompany pooling arrangement with the Exchange. Under this pooling arrangement, the Company's insurance subsidiaries cede 100% of their property/casualty underwriting business to the Exchange, which retrocedes 5% of the pooled business to Erie Insurance Company and .5% to Erie Insurance Company of New York. In 2005, approximately 83% of the pooled direct property/casualty business was originally generated by the Exchange and its subsidiary, while 94.5% of the pooled business is retroceded to the Exchange under the intercompany pooling arrangement. Accordingly, the Exchange assumes a higher insurance risk than is proportional to the insurance business it contributes to the pool. In 2005, the Company's insurance subsidiaries wrote 17% of the direct premiums, while assuming only 5.5% of the risk. This poses a credit risk to the Company's property/casualty subsidiaries participating in the pool as they retain the responsibility to their direct policyholders if the Exchange is unable to meet its reinsurance obligations.

The financial condition of the Company may suffer because of declines in the value of the securities held in the Company's investment portfolio that constitute a significant portion of the Company's assets.

The Company's fixed income securities investments, which totaled \$972 million at December 31, 2005 and comprised 31% of total assets, are exposed to price risk and to risk from changes in interest rates as well as credit risk related to the issuer. The Company does not hedge its exposure to interest rate risk as the Company has the ability to hold fixed income securities to maturity. The Company's investment strategy achieves a balanced maturity schedule in order to moderate investment income in the event of interest rate declines in a year in which a large amount of securities could be redeemed or mature.

At December 31, 2005, the Company had investments in marketable securities of approximately \$266 million and investments in limited partnerships of approximately \$153 million, or 8.6% and 5.0% of total assets, respectively. In addition, the Company is obligated to invest up to an additional \$243 million in limited partnerships, including in partnerships for U.S. and foreign private equity, real estate and fixed income investments. All of the Company's marketable security investments are subject to market volatility. The Company's marketable securities have exposure to price risk and the volatility of the equity markets and general economic conditions.

To the extent that future market volatility negatively impacts our investments, our financial condition will be negatively impacted.

The Company reviews the investment portfolio on a continuous basis to evaluate positions that might have incurred other-than-temporary declines in value. The primary factors considered in the Company's review of investment valuation include the extent and duration to which fair value is less than cost, historical operating performance and financial condition of the issuer, near term prospects of the issuer and its industry, specific events that occurred affecting the issuer and the Company's ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value. If the Company's policy for determining the recognition of impaired positions were different, the Company's Consolidated Statements of Financial Position and Statements of Operations could be significantly impacted. See also Note 3 of the "Notes to Consolidated Financial Statements" contained in the 2005 Annual Report.

The threat of terrorism and other actions may adversely affect the Company's investment portfolio and as a result the Company's net income and shareholder's equity.

The threat of terrorism, both within the United States and abroad, and heightened security measures in response to these types of threats, may cause significant volatility and declines in the debt and equity markets in the United States and around the world. In addition, some of the assets in the Company's investment portfolio may be adversely affected by declines in the equity markets and economic activity caused by the continued threat of terrorism, ongoing military and other actions and heightened security measures. The Company cannot predict whether and the extent to which industry sectors in which the Company maintains investments may suffer losses as a result of potential decreased commercial and economic activity.

The Company can offer no assurances that the threats of future terrorist-like events in the United States and abroad will not have a material adverse effect on the Company's business, financial condition or results of operations.

Risk factors relating to the business of the Property and Casualty Group

The Property and Casualty Group faces significant competition from other regional and national insurance companies which may result in lower revenues.

The Property and Casualty Group competes with regional and national property/casualty insurers including direct writers of insurance coverage. Many of these competitors are larger and many have greater financial, technical and operating resources. In addition, there is competition within each insurance agency that represents other carriers as well as the Property and Casualty Group.

As discussed previously, the property/casualty insurance industry is highly competitive on the basis of product, price and service. If competitors offer property/casualty products with more coverage and/or better service, or offer lower premiums, the Property and Casualty Group's ability to grow and renew its business may be adversely impacted.

The internet has also emerged as a growing method of distribution, both from existing competitors using their brand to write business and from new competitors. If the Property and Casualty Group's method of distribution does not include advancements in technology that meet consumer preferences, its ability to grow and renew its business may be adversely impacted.

If the Erie Insurance Group is unable to keep pace with the rapidly developing technological advancements in the insurance industry or to replace its legacy policy administration systems, the ability of the Property & Casualty Group to compete effectively could be impaired.

Technological development is necessary to reduce the cost of operating the Company and the Property & Casualty Group and to facilitate agents' and policyholder's ability to do business with the Property & Casualty Group. If the Erie Insurance Group is unable to keep pace with advancements being made in technology, its ability to compete with other insurance companies who have advanced technological capabilities will be negatively affected. Further, if the Erie Insurance Group is unable to update or replace its legacy policy administration systems as they become obsolete or as emerging technology renders them competitively inefficient, the Property and Casualty Group's competitive position would be adversely affected.

Premium rates and reserves must be established for members of the Property and Casualty Group from forecasts of the ultimate costs expected to arise from risks underwritten during the policy period. The Company's underwriting profitability could be adversely affected to the extent such premium rates or reserves are too low.

One of the distinguishing features of the property and casualty insurance industry in general is that its products are priced before its costs are known, as premium rates are generally determined before losses are reported. Accordingly, premium rates must be established from forecasts of the ultimate costs expected to arise from risks underwritten during the policy period and may not prove to be adequate. Further, property and casualty insurers establish reserves for losses and loss adjustment expenses based upon estimates, and it is possible that the ultimate liability will exceed these estimates because of the future development of known losses, the existence of losses that have occurred but are currently unreported and larger than historical settlements on pending and unreported claims. The process of estimating reserves is inherently judgmental and can be influenced by factors that are subject to variation.

If pricing or reserves established by a member of the Property and Casualty Group are not sufficient, the Company's underwriting profitability may be adversely impacted.

The financial performance of members of the Property and Casualty Group could be adversely affected by severe weather conditions or other catastrophic losses, including terrorism.

The Property and Casualty Group conducts business in only 11 states and the District of Columbia, primarily in the mid-Atlantic, midwestern and southeastern portions of the United States. A substantial portion of this business is private passenger and commercial automobile, homeowners and workers' compensation insurance in Ohio, Maryland, Virginia and particularly, Pennsylvania. As a result, a single catastrophe occurrence, destructive weather pattern, general economic trend, terrorist attack, regulatory development or other condition disproportionately affecting one or more of the states in which the Property and Casualty Group conducts substantial business could adversely affect the results of operations of members of the Property and Casualty Group.

Common natural catastrophe events include hurricanes, earthquakes, tornadoes, hail storms and severe winter weather. The frequency and severity of these catastrophes is inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposures in the area affected by the event and the severity of the event.

Actual terrorist attacks could cause losses from insurance claims related to the property/casualty insurance operations, as well as a decrease in the Company's shareholders' equity, net income or revenue. The Terrorism Risk Insurance Act of 2005 requires that some coverage for terrorist loss be offered by primary commercial property insurers and provides Federal assistance for recovery of claims through 2007. While the Property and Casualty Group is exposed to terrorism losses in commercial lines and workers' compensation, these lines are afforded a limited backstop above insurer deductibles for foreign acts of terrorism under this federal program. The Property and Casualty Group has no personal lines terrorist coverage in place. The Property and Casualty Group could incur large net losses if future terrorism attacks occur.

The Property and Casualty Group maintains a property catastrophe reinsurance treaty that was renewed effective January 1, 2006 that provides coverage of 95% of a loss up to \$400 million in excess of the Property and Casualty Group's loss retention of \$300 million per occurrence. This treaty excludes losses from acts of terrorism. Nevertheless, catastrophe reinsurance may prove inadequate if a major catastrophic loss exceeds the reinsurance limit which could adversely effect the Company's underwriting profitability. The Company is particularly exposed to an Atlantic hurricane in its homeowners lines of insurance in the states of North Carolina, Virginia, Maryland and Pennsylvania.

The Property and Casualty Group depends on independent insurance agents, which exposes the Property and Casualty Group to risks not applicable to companies with dedicated agents.

The Property and Casualty Group markets and sells its insurance products through independent, non-exclusive agencies. These agencies are not obligated to sell only the Property and Casualty Group's insurance products, and generally they also sell competitor's insurance products. As a result, the Property and Casualty Group's business depends in part on the marketing and sales efforts of these agencies. To the extent these agencies' marketing efforts cannot be maintained at their current levels of volume or they bind the Property and Casualty Group to unacceptable insurance risks, fail to comply with established underwriting guidelines or otherwise improperly market the Property and Casualty Group's products, the results of operations and business of the Property and Casualty Group could be adversely affected.

To the extent that business migrates to a delivery system other than independent agencies because of changing consumer preferences, the business of the Property and Casualty Group could be adversely affected. Also, to the extent the agencies choose to place significant or all of their business with

competing insurance companies, the results of operations and business of the Property and Casualty Group could be adversely affected.

If there were a failure to maintain a commercially acceptable financial strength rating, the Property and Casualty Group's competitive position in the insurance industry would be adversely affected.

Financial strength ratings are an important factor in establishing the competitive position of insurance companies and may be expected to have an effect on an insurance company's sales. Higher ratings generally indicate greater financial stability and a stronger ability to meet ongoing obligations to policyholders. Ratings are assigned by rating agencies to insurers based upon factors that they believe are relevant to policyholders. Currently the Property and Casualty Group's pooled A.M. Best rating is an A+ ("superior"). A significant future downgrade in this or other ratings would reduce the competitive position of the Property and Casualty Group making it more difficult to attract profitable business in the highly competitive property/casualty insurance market.

Changes in applicable insurance laws, regulations or changes in the way regulators administer those laws or regulations could adversely change the Property and Casualty Group's operating environment and increase its exposure to loss or put it at a competitive disadvantage.

Property and casualty insurers are subject to extensive supervision in the states in which they do business. This regulatory oversight includes, by way of example, matters relating to licensing and examination, rate setting, market conduct, policy forms, limitations on the nature and amount of certain investments, claims practices, mandated participation in involuntary markets and guaranty funds, reserve adequacy, insurer solvency, transactions between affiliates, the amount of dividends that may be paid and restrictions on underwriting standards. Such regulation and supervision are primarily for the benefit and protection of policyholders and not for the benefit of shareholders. For instance, members of the Property and Casualty Group are subject to involuntary participation in specified markets in various states in which it operates, and the rate levels the Property and Casualty Group is permitted to charge do not always correspond with the underlying costs associated with the coverage issued. Although the federal government does not directly regulate the insurance industry, federal initiatives, such as federal terrorism backstop legislation, from time to time, also can impact the insurance industry.

The ability of the Company to attract, develop and retain talented employees, managers and executives is critical to the Company's success.

The Company's success depends on its ability to attract, develop and retain talented employees, including executives and other key management. The company's loss of certain key officers and employees or the failure to attract and develop talented new executives and management could have an adverse effect on the Company's business.

"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 expressions. These 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.

Item 1B. Unresolved SEC Comments

None.

Item 2. Properties

The member companies of the Erie Insurance Group (the Company and its subsidiaries, the Exchange and its subsidiary and EFL) share a corporate home office complex in Erie, Pennsylvania, which is comprised of 496,160 square feet. The home office complex is owned by the Exchange. The Company is charged rent expense for the related square footage it occupies.

The Company also operates 23 field offices, including the Erie branch office, in 11 states. Eighteen of these offices provide both agency support and claims services and are referred to as "Branch Offices", while the remaining five provide only claims services and are considered "Claims Offices". The Company owns three of its field offices. Three other field offices are owned by the Exchange and leased to the Company. The rent expense incurred by the Company for both the home office complex and the field offices leased from the Exchange totaled \$10.3 million in 2005.

One field office is owned by EFL and leased to the Company. The rent expense for the field office leased from EFL was \$.3 million in 2005.

The remaining 16 field offices are leased from various unaffiliated parties. In addition to these field offices, the Company leases a warehouse facility from an unaffiliated party. During 2003, the Company entered into a lease for a building in the vicinity of the home office complex. This additional space is used to house certain home office employees. During 2005, the Company entered into a lease for office space for its corporate financial personnel. Total lease payments to external parties amounted to \$2.8 million in 2005. Lease commitments for these properties expire periodically through 2011.

The total operating expense, including rent expense, for all office space occupied by the Company in 2005 was \$20.1 million. This amount was reduced by allocations to the Property and Casualty Group of \$13.9 million for claims operations. The net amount after allocations is reflected in the Company's cost of management operations.

Item 3. Legal Proceedings

Information concerning the legal proceedings of the Company is incorporated by reference to the section "Legal Proceedings" in the Company's definitive Proxy Statement with respect to the Company's Annual Meeting of Shareholders to be held on April 18, 2006 to be filed with the SEC within 120 days of December 31, 2005 (the "Proxy Statement").

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of 2005.

PART II**Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

Reference is made to "Market Price of and Dividends on Common Stock and Related Shareholder Matters" in the 2005 Annual Report, for information regarding the high and low sales prices for the Company's stock and additional information regarding such stock of the Company.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plan
October 1 – 31, 2005	367,552	\$ 52.68	365,178	
November 1 – 30, 2005	331,482	52.73	331,482	
December 1 – 31, 2005	288,696	52.97	288,696	
Total	<u>987,730</u>	\$ 52.78	<u>985,356</u>	<u>\$ 97,000,000</u>

The month of October 2005 includes shares that vested under the stock compensation plan for the Company's outside directors of 2,374. Included in this amount are the vesting of 2,216 of awards previously granted and 158 dividend equivalent shares that vest as they are granted (as dividends are declared by the Company).

Item 6. Selected Consolidated Financial Data

Reference is made to "Selected Consolidated Financial Data" in the 2005 Annual Report.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Reference is made to "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the 2005 Annual Report.

Item 7A. Quantitative and Qualitative Disclosure about Market Risk

Reference is made to "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the 2005 Annual Report.

Item 8. Financial Statements and Supplementary Data

Reference is made to the "Consolidated Financial Statements" and the "Quarterly Results of Operations" contained in the "Notes to Consolidated Financial Statements" in the 2005 Annual Report.

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosures

None.

Item 9A. Controls and Procedures

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control – Integrated Framework*, management concluded that our internal control over financial reporting was effective as of December 31, 2005.

Management's annual report on internal control over financial reporting and the attestation report of the Company's registered public accounting firm are included in Exhibit 13 under the headings "Report of Management on Internal Control Over Financial Reporting" and "Report of Independent Registered Public Accounting Firm," respectively, and incorporated herein by reference.

Item 9B. Other Information

There was no information required to be reported in a report of Form 8-K during the fourth quarter of 2005 that has not been reported.

PART III**Item 10. Directors and Executive Officers of the Registrant**

The information with respect to directors, audit committee, and audit committee financial experts of the Company and Section 16(a) beneficial ownership reporting compliance, is incorporated herein by reference to the Company's definitive Proxy Statement relating to the Company's Annual Meeting of Shareholders to be held on April 18, 2006 to be filed with the SEC within 120 days of December 31, 2005 in response to this item.

The Company has adopted a code of conduct that applies to all of its directors, officers (including its chief executive officer, chief financial officer, chief accounting officer and any person performing similar functions) and employees. The Company previously filed a copy of this Code of Conduct as Exhibit 14 to the Registrant's 2003 Form 10-K Annual Report as filed with the SEC on March 4, 2004. The Company has also made the Code of Conduct available on its website at <http://www.erieinsurance.com>.

Certain information as to the executive officers of the Company is as follows:

Name	Age as of 12/31/05	Principal Occupation for Past Five Years and Positions with Erie Insurance Group
President & Chief Executive Officer		
Jeffrey A. Ludrof	46	President and Chief Executive Officer of the Company, Erie Family Life Insurance Company (EFL), Erie Insurance Company, Flagship City Insurance Company (Flagship), Erie Insurance Company of New York (Erie NY), and Erie Insurance Property and Casualty Company (Erie P&C) since May 8, 2002. Executive Vice President—Insurance Operations of the Company, Erie Insurance Co., Flagship, Erie P&C, and Erie NY 1999–May 8, 2002; Senior Vice President of the Company 1994–1999.
Executive Vice Presidents		
Jan R. Van Gorder, Esq.	58	Senior Executive Vice President, Secretary and General Counsel of the Company, EFL and Erie Insurance Co. since 1990, and of Flagship and Erie P&C since 1992 and 1993, respectively, and of Erie NY since 1994; Senior Vice President, Secretary and General Counsel of the Company, EFL and Erie Insurance Co. for more than five years prior thereto; Director, Erie NY, Flagship and Erie P&C.
John J. Brinling, Jr.	58	Executive Vice President of Erie Family Life Insurance Company since December 1990. Division Officer 1984–Present; Director, Erie NY.

Name	Age as of 12/31/05	Principal Occupation for Past Five Years and Positions with Erie Insurance Group
Philip A. Garcia	49	Executive Vice President and Chief Financial Officer since 1997; Senior Vice President and Controller 1993–1997. Director, the Erie NY, Flagship and Erie P&C.
Michael J. Krahe	52	Executive Vice President–Human Development and Leadership since January 2003; Senior Vice President 1999–December 2002; Vice President 1994–1999. Director, the Erie NY, Flagship and Erie P&C.
Thomas B. Morgan	42	Executive Vice President–Insurance Operations since January 2003; Senior Vice President October 2000– December 2002; Assistant Vice President and Branch Manager 1997–October 2001; Director, Erie NY, Erie P&C and Flagship.
<u>Senior Vice President</u>		
Douglas F. Ziegler	55	Senior Vice President, Treasurer and Chief Investment Officer since 1993. Director, the Erie NY, Flagship and Erie P&C.

Item 11. Executive Compensation

The answer to this item is incorporated by reference to the Company's definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held on April 18, 2006, except for the Performance Graph, which has not been incorporated herein by reference, to be filed with the SEC within 120 days of December 31, 2005.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information with respect to security ownership of certain beneficial owners and management and securities authorized for issuance under equity compensation plans, is incorporated by reference to the Company's definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held on April 18, 2006 to be filed with the SEC within 120 days of December 31, 2005.

As of February 17, 2006, there were approximately 1,052 beneficial shareholders of record of the Company's Class A non-voting common stock and 20 beneficial shareholders of record of the Company's Class B voting common stock.

Item 13. Certain Relationships and Related Transactions

The Company's earnings are largely generated from fees based on the direct written premium of the Exchange in addition to the direct written premium of the other members of the Property and Casualty Group. Also, the Company's property and casualty insurance subsidiaries participate in the underwriting results of the Exchange via the pooling arrangement. As the Company's operations are interrelated with the operations of the Exchange, the Company's results of operations are largely dependent on the success of the Exchange. Reference is made to Note 15 of the "Notes to Consolidated Financial Statements" in the 2005 Annual Report, for a further discussion of the financial results of the Exchange.

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Reference is also made to Note 13 of the "Notes to Consolidated Financial Statements" in the 2005 Annual Report, for a complete discussion of related party transactions.

Information with respect to certain relationships with Company directors is incorporated by reference to the Company's definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held on April 18, 2006 to be filed with the SEC within 120 days of December 31, 2005.

Item 14. Principal Accountant Fees and Services

The information required by this Item is incorporated by reference to the Company's definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held on April 18, 2006, to be filed with the SEC within 120 days of December 31, 2005.

Part IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Financial statements, financial statement schedules and exhibits filed:

(1) Consolidated Financial Statements

Erie Indemnity Company and Subsidiaries:

	<u>Page*</u>
Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements	56
Consolidated Statements of Operations for the three years ended December 31, 2005, 2004 and 2003	57
Consolidated Statements of Financial Position as of December 31, 2005 and 2004	58
Consolidated Statements of Cash Flows for the three years ended December 31, 2005, 2004 and 2003	59
Consolidated Statements of Shareholders' Equity for the three years Ended December 31, 2005, 2004 and 2003	60
Notes to Consolidated Financial Statements	61

(2) Financial Statement Schedules

Erie Indemnity Company and Subsidiaries:

Schedule I. Summary of Investments – Other than Investments in Related Parties	21
Schedule IV. Reinsurance	22
Schedule VI. Supplemental Information Concerning Property/Casualty Insurance Operations	23

All other schedules have been omitted since they are not required, not applicable or the information is included in the financial statements or notes thereto.

* Refers to the respective page of Erie Indemnity Company's 2005 Annual Report to Shareholders. The "Consolidated Financial Statements" and "Notes to Consolidated Financial Statements and Auditors' Report" thereon on pages 40 to 70 are incorporated by reference. With the exception of the portions of such Annual Report specifically incorporated by reference in this Item and Items 1, 5, 6, 7, 7a, 8 and 13, such Annual Report shall not be deemed filed as part of this Form 10-K Report or otherwise subject to the liabilities of Section 18 of the Securities Exchange Act of 1934.

(3) Exhibits – See Exhibit Index on page 25 hereof.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

February 22, 2006

ERIE INDEMNITY COMPANY
(Registrant)

/s/ Jeffrey A. Ludrof

Jeffrey A. Ludrof, President and CEO (principal executive officer)

/s/ Jan R. Van Gorder

Jan R. Van Gorder, Executive Vice President, Secretary & General Counsel

/s/ Philip A. Garcia

Philip A. Garcia, Executive Vice President & CFO (principal financial officer)

/s/ Timothy G. NeCastro

Timothy G. NeCastro, Senior Vice President & Controller (principal accounting officer)

Board of Directors

/s/ Kaj Ahlmann

Kaj Ahlmann

/s/ Susan Hirt Hagen

Susan Hirt Hagen

/s/ John T. Baily

John T. Baily

/s/ C. Scott Hartz

C. Scott Hartz

/s/ J. Ralph Borneman, Jr.

J. Ralph Borneman, Jr.

/s/ F. William Hirt

F. William Hirt

/s/ Wilson C. Cooney

Wilson C. Cooney

/s/ Claude C. Lilly, III

Claude C. Lilly, III

/s/ Patricia Garrison-Corbin

Patricia Garrison-Corbin

/s/ Jeffrey A. Ludrof

Jeffrey A. Ludrof

/s/ John R. Graham

John R. Graham

/s/ Robert C. Wilburn

Robert C. Wilburn

/s/ Jonathan Hagen

Jonathan Hagen

SCHEDULE I — SUMMARY OF INVESTMENTS OTHER THAN INVESTMENTS IN RELATED PARTIES

December 31, 2005

Type of Investment (In Thousands)	Cost or Amortized Cost	Fair Value	Amount at which Shown in the Consolidated Statements of Financial Position
Available-for-sale securities:			
Fixed maturities:			
U.S. treasuries & government agencies	\$ 9,583	\$ 9,735	\$ 9,735
States & political subdivisions	145,528	145,807	145,807
Special revenue	195,059	195,745	195,745
Public utilities	66,866	69,609	69,609
U.S. industrial & miscellaneous	353,843	355,719	355,719
Mortgage-backed securities	32,251	32,626	32,626
Asset-backed securities	22,117	21,717	21,717
Foreign	106,445	109,401	109,401
Redeemable preferred stock	30,628	31,851	31,851
Equity securities:			
Common stock:			
Public utilities	1,313	1,473	1,473
U.S. banks, trusts & insurance companies	10,783	12,025	12,025
U.S. industrial & miscellaneous	53,713	60,782	60,782
Foreign	18,950	21,281	21,281
Nonredeemable preferred stock:			
Public utilities	26,266	26,103	26,103
U.S. banks, trusts & insurance companies	64,632	66,836	66,836
U.S. industrial & miscellaneous	62,552	65,611	65,611
Foreign	11,231	12,223	12,223
Total fixed maturities and equity securities	<u>\$1,211,760</u>	<u>\$1,238,544</u>	<u>\$ 1,238,544</u>
Real estate mortgage loans	4,885	4,885	4,885
Limited partnerships	141,405	153,159	153,159
Total investments	<u>\$1,358,050</u>	<u>\$1,396,588</u>	<u>\$ 1,396,588</u>

SCHEDULE IV — REINSURANCE

(In Thousands)	Direct	Ceded to Other Companies	Assumed From Other Companies	Net Amount	Percentage of Amount Assumed to Net
December 31, 2005 Premiums for the year Property and Liability Insurance	\$704,366	\$714,787	\$226,245	\$215,824	104.8%
December 31, 2004 Premiums for the year Property and Liability Insurance	\$699,533	\$717,236	\$225,905	\$208,202	108.5%
December 31, 2003 Premiums for the year Property and Liability Insurance	\$644,286	\$654,841	\$202,147	\$191,592	105.5%

SCHEDULE VI — SUPPLEMENTAL INFORMATION CONCERNING PROPERTY/CASUALTY INSURANCE OPERATIONS

(In Thousands)	Deferred Policy Acquisition Costs	Reserves for Unpaid Loss & LAE	Discount, if any deducted from reserves*	Unearned Premiums
@ 12/31/05				
Consolidated P&C Entities	\$ 16,436	\$ 1,019,459	\$ 4,582	\$454,409
Unconsolidated P&C Entities	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0
Total	\$ 16,436	\$ 1,019,459	\$ 4,582	\$454,409
@ 12/31/04				
Consolidated P&C Entities	\$ 17,112	\$ 943,034	\$ 4,094	\$472,553
Unconsolidated P&C Entities	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0
Total	\$ 17,112	\$ 943,034	\$ 4,094	\$472,553
@ 12/31/03				
Consolidated P&C Entities	\$ 16,761	\$ 845,536	\$ 3,303	\$449,606
Unconsolidated P&C Entities	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0
Total	\$ 16,761	\$ 845,536	\$ 3,303	\$449,606

* Workers' compensation case and incurred but not reported (IBNR) loss and loss adjustment reserves were discounted at 2.5% for all years presented.

SCHEDULE VI — SUPPLEMENTAL INFORMATION CONCERNING PROPERTY/CASUALTY INSURANCE OPERATIONS (CONTINUED)

	Earned Premiums	Net Investment Income	Loss and Loss Incurred (1) Current Year	Adjustment Expense Related to (2) Prior Years	Amortization of Deferred Policy Acquisition Costs	Net Loss & LAE Paid	Premiums Written
(In Thousands)							
@ 12/31/05							
Consolidated P&C Entities	\$215,824	\$ 20,267	\$ 146,312	(\$5,927)	\$ 34,227	\$126,314	\$214,149
Unconsolidated P&C Entities	0	0	0	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0	0	0	0
Total	\$215,824	\$ 20,267	\$ 146,312	(\$5,927)	\$ 34,227	\$126,314	\$214,149
@ 12/31/04							
Consolidated P&C Entities	\$208,202	\$ 22,470	\$ 153,563	(\$343)	\$ 34,341	\$133,466	\$216,398
Unconsolidated P&C Entities	0	0	0	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0	0	0	0
Total	\$208,202	\$ 22,470	\$ 153,563	(\$343)	\$ 34,341	\$133,466	\$216,398
@ 12/31/03							
Consolidated P&C Entities	\$191,592	\$ 23,398	\$ 154,816	(\$1,832)	\$ 38,647	\$134,365	\$204,694
Unconsolidated P&C Entities	0	0	0	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0	0	0	0
Total	\$191,592	\$ 23,398	\$ 154,816	(\$1,832)	\$ 38,647	\$134,365	\$204,694

EXHIBIT INDEX

(Pursuant to Item 601 of Regulation S-K)

Exhibit Number	Description of Exhibit	Sequentially Numbered Page
3.5\$	Amended and Restated By-laws of Registrant Section 2.07(a) effective September 9, 2003	
10.67@@@	Addendum to Aggregate Excess of Loss Reinsurance Contract effective January 1, 2003 between Erie Insurance Exchange, by and through its Attorney-in-Fact, Erie Indemnity Company and Erie Insurance Company and its wholly-owned subsidiary Erie Insurance Company of New York	
10.68\$\$	Addendum to Aggregate Excess of Loss Reinsurance Contract effective January 1, 2004 between Erie Insurance Exchange, by and through its Attorney-in-Fact, Erie Indemnity Company and Erie Insurance Company and its wholly-owned subsidiary Erie Insurance Company of New York	
10.69\$\$	Addendum to Employment Agreement effective December 12, 2003 by and between Erie Indemnity Company and John J. Brinling, Jr.	
10.70\$\$	Addendum to Employment Agreement effective December 12, 2003 by and between Erie Indemnity Company and Thomas B. Morgan	
10.71\$\$	Addendum to Employment Agreement effective December 12, 2003 by and between Erie Indemnity Company and Michael J. Krahe	
10.72\$\$	Addendum to Employment Agreement effective December 12, 2003 by and between Erie Indemnity Company and Jeffrey A. Ludrof	
10.73\$\$	Addendum to Employment Agreement effective December 12, 2003 by and between Erie Indemnity Company and Philip A. Garcia	
10.74\$\$	Addendum to Employment Agreement effective December 12, 2003 by and between Erie Indemnity Company and Jan R. Van Gorder	
10.75\$\$	Addendum to Employment Agreement effective December 12, 2003 by and between Erie Indemnity Company and Douglas F. Ziegler	
10.76\$\$	Insurance bonus agreement effective December 23, 2003 by and between Erie Indemnity Company and Jeffrey A. Ludrof	
10.77\$\$	Insurance bonus agreement effective December 23, 2003 by and between Erie Indemnity Company and Jeffrey A. Ludrof	
10.78\$\$	Insurance bonus agreement effective December 23, 2003 by and between Erie Indemnity Company and John J. Brinling, Jr.	
10.79\$\$	Insurance bonus agreement effective December 23, 2003 by and between Erie Indemnity Company and Jan R. Van Gorder	
10.80\$\$	Insurance bonus agreement effective December 23, 2003 by and between Erie Indemnity Company and Michael J. Krahe	
10.81\$\$	Insurance bonus agreement effective December 23, 2003 by and between Erie Indemnity Company and Philip A. Garcia	

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Exhibit Number	Description of Exhibit	Sequentially Numbered Page
10.82\$\$	Insurance bonus agreement effective December 23, 2003 by and between Erie Indemnity Company and Thomas B. Morgan	
10.83\$\$\$	Annual Incentive Plan effective March 2, 2004	
10.84\$\$\$	Long-term Incentive Plan effective March 2, 2004	
10.85	Termination of Aggregate Excess of Loss Reinsurance Contract effective December 31, 2005 between Erie Insurance Exchange, by and through its Attorney-In-Fact, Erie Indemnity Company and Erie Insurance Company and its wholly-owned subsidiary Erie Insurance Company of New York	27
13	2005 Annual Report to Shareholders — Reference is made to the Annual Report furnished to the Commission, herewith	28
14\$\$	Code of Conduct	
21	Subsidiaries of Registrant	88
23	Consent of Independent Registered Public Accounting Firm	89
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes–Oxley Act of 2002	90
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes–Oxley Act of 2002	91
32	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002	92
@@@	Such exhibit is incorporated by reference to the like titled exhibit in the Registrant's Form 10-Q quarterly report for the quarter ended March 31, 2003 that was filed with the Commission on April 24, 2003.	
\$	Such exhibit is incorporated by reference to the like titled exhibit in the Registrant's Form 10-Q quarterly report for the quarter ended September 30, 2003 that was filed with the Commission on October 29, 2003.	
\$\$	Such exhibit is incorporated by reference to the like titled exhibit in the Registrant's Form 10-K annual report for the year ended December 31, 2003 that was filed with the Commission on March 4, 2004.	
\$\$\$	Such exhibit is incorporated by reference to the like titled exhibit in the Registrant's Form 10-K annual report for the year ended December 31, 2004 that was filed with the Commission on March 4, 2005.	

Erie Insurance Company and Erie Insurance Company of New York
Erie, Pennsylvania
AGGREGATE EXCESS OF LOSS REINSURANCE
ADDENDUM NO. 5
TERMINATION ADDENDUM

Amendment to the REINSURANCE CONTRACT made the first day of January, 1998, between ERIE INSURANCE EXCHANGE, by and through its Attorney-in-Fact, ERIE INDEMNITY COMPANY, of Erie, Pennsylvania, (hereafter called the "REINSURER"), and ERIE INSURANCE COMPANY and its wholly owned subsidiary ERIE INSURANCE COMPANY OF NEW YORK, both of Erie, Pennsylvania (herein referred to collectively (or individually as the context requires) as the "COMPANY")

It is understood and agreed that this Reinsurance Contract shall be terminated on December 31, 2005, in accordance with Article 18 — Termination.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their duly authorized representatives.

In Erie, Pennsylvania, this 8th day of November, 2005.

ATTEST:

/s/ Margaret Porter

ERIE INSURANCE COMPANY

/s/ J.R. Van Gorder

J. R. Van Gorder
Sr. Exec. V.P., Secretary & General Counsel

ATTEST:

/s/ Margaret Porter

ERIE INSURANCE COMPANY
OF NEW YORK

/s/ Philip A. Garcia

Philip A. Garcia
Executive Vice President & CFO

ATTEST:

/s/ Margaret Porter

ERIE INSURANCE EXCHANGE, by
ERIE INDEMNITY COMPANY,
Attorney-in-Fact

/s/ Michael S. Zavasky

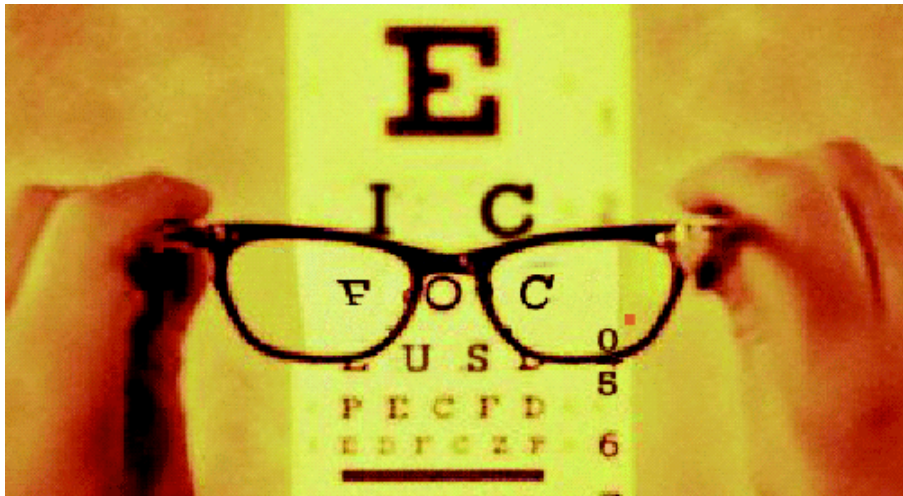
Michael S. Zavasky
Senior Vice President

Selected Consolidated Financial Data

F O C U S 2 0 0 5

	Years ended December 31 (amounts in thousands, except per share data)				
	2005	2004	2003	2002	2001
Operating data					
Total operating revenue	\$1,124,950	\$1,123,144	\$1,048,788	\$ 920,723	\$ 764,938
Total operating expenses	900,731	884,916	820,478	705,871	600,833
Total investment income—unaffiliated	115,237	88,119	66,743	40,549	17,998
Provision for income taxes	111,733	105,140	102,237	84,886	60,561
Equity in earnings of Erie Family Life Insurance, net of tax	3,381	5,206	6,909	1,611	719
Net income	\$ 231,104	\$ 226,413	\$ 199,725	\$ 172,126	\$ 122,261
Per share data					
Net income per share—diluted	\$ 3.34	\$ 3.21	\$ 2.81	\$ 2.41	\$ 1.71
Book value per share—Class A common and equivalent B shares	18.81	18.14	16.40	13.91	12.15
Dividends declared per Class A share	1.335	0.970	0.785	0.700	0.6275
Dividends declared per Class B share	200.25	145.50	117.75	105.00	94.125
Financial position data					
Investments (1)	\$1,452,431	\$1,371,442	\$1,241,236	\$1,047,304	\$ 885,650
Recoverables from the Exchange and affiliates	1,176,419	1,144,625	1,024,146	844,049	655,655
Total assets	3,101,261	2,982,804	2,756,329	2,359,545	1,985,568
Shareholders' equity	1,278,602	1,266,881	1,164,170	987,372	865,255
Cumulative number of shares repurchased at December 31	6,438	4,548	3,403	3,403	3,196

(1) Includes investment in Erie Family Life Insurance Company.



The following discussion and analysis should be read in conjunction with the audited financial statements and related notes found on pages 42–73 as they contain important information helpful in evaluating the Company's operating results and financial condition. The discussions below also focus heavily on the Company's three primary segments: management operations, insurance underwriting operations and investment operations. The segment basis financial results presented throughout Management's Discussion & Analysis herein are those which management uses internally to monitor and evaluate results and are a supplemental presentation of the Company's Consolidated Statements of Operations.

Introduction

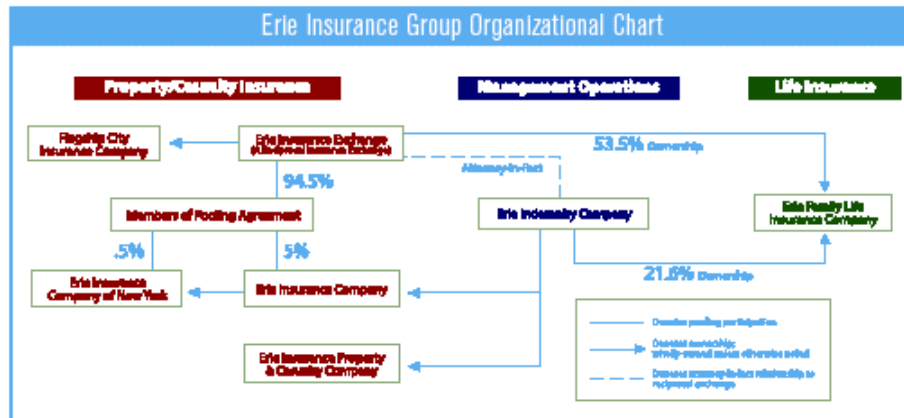
Erie Indemnity Company (Company) operates predominantly as a provider of management services to the Erie Insurance Exchange (Exchange). The Exchange is a reciprocal insurance exchange, which is an unincorporated association of individuals, partnerships and corporations that agree to insure one another. Each applicant for insurance to a reciprocal insurance exchange signs a subscriber's agreement that contains an appointment of an attorney-in-fact. The Company has served since 1925 as the attorney-in-fact for the policyholders of the Exchange. As attorney-in-fact, the Company is required to perform certain services relating to the sales, underwriting and issuance of policies on behalf of the Exchange. For its services as attorney-in-fact, the Company charges a management fee calculated as a percentage, not to exceed 25%, of the direct and affiliated assumed

premiums written of the Exchange. Management fees accounted for approximately 72% of the Company's total revenues for 2005.

The Company also operates as a property/casualty insurer through its three insurance subsidiaries. The Exchange and its property/casualty subsidiary and the Company's three property/casualty subsidiaries (collectively, the "Property and Casualty Group") write personal and commercial lines property/casualty coverages exclusively through independent agents. The financial position or results of operations of the Exchange are not consolidated with those of the Company. During 2005, almost 70% of the direct premiums written by the Property and Casualty Group were personal lines, while 30% were commercial lines.

The Exchange is the Company's sole customer. The members of the Property and Casualty Group pool their underwriting results. Under the pooling agreement, the Exchange assumes 94.5% of the pool. Accordingly, the underwriting risk of the Property and Casualty Group's business is largely borne by the Exchange, which had \$3.4 billion and \$2.8 billion of statutory surplus at December 31, 2005 and 2004, respectively. Through the pool, the Company's property/casualty subsidiaries currently assume 5.5% of the Property and Casualty Group's underwriting results, and, therefore, the Company also has direct incentive to manage the insurance underwriting as effectively as possible.

The Property and Casualty Group seeks to insure standard and preferred risks primarily in private passenger automobile, homeowners and small



commercial lines, including worker's compensation. The Property and Casualty Group's sole distribution channel is its independent agency force, which consists of over 1,700 independent agencies comprised of 7,800 licensed representatives in 11 midwestern, mid-Atlantic and southeastern states (Illinois, Indiana, Maryland, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and Wisconsin) and the District of Columbia. The Property and Casualty Group became licensed in the state of Minnesota in December 2004, although it has not established a definitive date to begin writing business in that state. In addition to their principal role as salespersons, the independent agents play a significant role as underwriters and service providers and are major contributors to the Property and Casualty Group's success.

The company also owns 21.6% of the common stock of Erie Family Life Insurance (EFL), an affiliated life insurance company, of which the Exchange owns 53.5% and public shareholders, including certain of the Company's directors, own 24.9%. The company, together with the Property and Casualty Group and EFL, collectively operate as the "Erie Insurance Group."

For a complete discussion of all intercompany agreements, see the Transactions with Related Parties section following the Liquidity and Capital Resources section herein.

Overview

	Years ended December 31 (dollars in thousands) except per share data		
	2005	2004	2003
Income from management operations	\$209,269	\$242,592	\$253,251
Underwriting income(loss)	14,950	(4,364)	(24,941)
Net revenue from investment operations	118,873	93,717	74,172
Income before income taxes	343,092	331,945	302,482
Provision for income taxes	111,988	105,532	102,757
Net income	\$231,104	\$226,413	\$199,725
Net income per share-diluted	\$ 3.34	\$ 3.21	\$ 2.81

HIGHLIGHTS

- *Net income per share—diluted increased 4.0% in 2005 due to improvements in insurance underwriting operations and investment operations.*
- *Gross margins from management operations decreased to 21.8% in 2005 from 25.1% in 2004.*

- *The management fee rate was 23.75% for 2005 and 23.5% from January to June 2004 and 24.0% for the remainder of 2004 (effectively 23.74% in 2004).*
- *GAAP combined ratios of the insurance underwriting operations improved to 93.1 in 2005 from 102.1 in 2004.*
- *Increase of 26.8% in net revenues from investment operations includes \$10.1 million in adjustments to the market value of limited partnership investments in 2005; these adjustments were not included in income in 2004.*
- *The effective tax rate of 32.9% in 2005 was impacted by a \$.7 million credit related to prior years. A \$ 3.1 million benefit was recorded to the 2004 tax provision related to prior years which decreased the effective tax rate to 32.2% in 2004 from 34.7% in 2003.*
- *The Company repurchased shares of its common stock totaling \$ 99.0 million in 2005 at an average price of \$52.36 per share.*
- *Return on average equity declined to 18.2 for 2005 compared to 18.6 for 2004.*

SEGMENT OVERVIEWS

Management operations

- Management fee revenues decreased .5% in 2005 compared to 2004. The two determining factors of management fee revenue are: 1) the management fee rate charged by the Company, and 2) the direct written premiums of the Property and Casualty Group. The effective management fee rate was 23.75% for 2005 and 23.74% for 2004.
- In 2005, the direct written premiums of the Property and Casualty Group decreased 1.0% compared to an 8.9% increase in 2004. The implementation of a personal lines price segmentation model and the continued refinement of rate classifications contributed to this decrease in premiums written, as the average premiums per policy declined. While price segmentation allows the Property and Casualty Group to provide a better correlation between the associated risk and rates charged to policyholders, the short-term impact of introducing such pricing can be disruptive to new policy growth. New policy direct written premiums of the Property and Casualty Group decreased 7.5% in 2005. The recent improvements in underwriting profitability afforded the Property and Casualty Group the ability to implement rate reductions in 2005 to allow for more attractive prices to potential new policyholders and improve the retention of existing policyholders. The impact of rate changes that were effective in 2005 resulted in a net decrease in written premiums of the Property and Casualty Group of \$9.9 million. Rate reductions are planned for 2006, which will continue to lower the average premium per policy and slow premium growth of the Property and Casualty Group.
 - The Property and Casualty Group continues to maintain its focus on underwriting discipline

and profitability as well as concentrating on quality growth. With the recent improvements in underwriting profitability, the Property and Casualty Group is in a stronger financial position to compete for profitable business. The Property and Casualty Group was able to implement moderate pricing actions during 2005, many of which were rate decreases in its most significant line of business, private passenger auto, in Pennsylvania. The continued refinement and increased utilization of segmented pricing in 2006 will enable the Company to offer competitive rates to more customers, providing greater flexibility in pricing policies with varying degrees of risk. The Company plans to continue its agent appointment efforts, generating an anticipated increase of 125 new independent agents in 2006.

- The cost of management operations increased \$27.3 million, or 3.8%, in 2005 compared to 2004. The increase in cost of management operations in 2005 was the result of:
 - *Commissions*—Total commission costs were up 1.6% to \$539.5 million in 2005 compared to 2004. Agent bonuses increased \$24.9 million, as the bonus structure focuses on underwriting profitability, which improved dramatically over the measurement period used for the bonus formula. Normal scheduled commissions were \$18.2 million lower in 2005 compared to 2004, primarily due to reduced commercial commission rates that became effective on premiums collected beginning January 1, 2005, and the 1.0% decline in direct premiums written of the Property and Casualty Group. New promotional incentive programs that began in 2005, aimed at stimulating premium growth, contributed \$1.6 million in additional costs in 2005.
 - Total costs other than commissions rose \$18.9 million to \$212.0 million in 2005, mostly as a result of increased personnel and underwriting costs. Personnel costs, including external contract labor, increased \$13.4 million and insurance scoring costs increased \$3.6 million in 2005.
 - *Personnel costs*—Salaries and wages and other personnel costs of employees increased \$10.2 million in 2005 driven by increased staffing levels and normal pay rate increases. Contract labor costs increased \$3.2 million, primarily related to information technology projects.
 - *Insurance scoring costs*—In the latter part of 2004, the use of insurance scores was implemented in the underwriting process on new business and was part of the Company's initiatives to focus on underwriting profitability of the Property and Casualty Group. In 2005, insurance scores were obtained for all new and renewal private passenger auto and homeowners business for underwriting and rating purposes, which resulted in increased costs of \$3.6 million in 2005 compared to 2004.

Insurance underwriting operations

Contributing to the improved insurance underwriting operations, resulting in a 93.1 GAAP combined ratio, were the following factors:

- Focused management efforts on improving underwriting profitability by the Property and Casualty Group in 2005 and 2004
- Below normalized level of catastrophe losses during 2005
 - The Property and Casualty Group was not impacted by any of the major hurricanes of 2005, including Hurricanes Katrina, Rita and Wilma
- Lower level of charges related to the reversals of recoveries under the intercompany aggregate excess-of-loss reinsurance agreement between the Company's property/casualty insurance subsidiaries and the Exchange, which were \$2.2 million in 2005, compared to \$7.7 million in 2004.

Investment operations

- Net investment income increased 1.0% in 2005 compared to 2004. While certain funds were reinvested in the market, a portion of the available capital was used to repurchase Company stock of \$99.0 million during 2005, compared to \$54.1 million in 2004. Investment expense rose due to fees being paid to external managers of the common stock portfolio, which were hired in the fourth quarter of 2004. Also, certain taxable corporate debt securities were sold and replaced with tax-exempt municipal bonds.
- A one-time \$10.1 million, or \$.10 per share-diluted, correction was made in 2005 to record limited partnership market value adjustments which increased equity in earnings of limited partnerships. The limited partnership market value adjustment was previously recorded as a component of shareholders' equity. The Company saw improved performance on its limited partnership private equity investments and the number of limited partnerships included in the portfolio increased in 2005.

The topics addressed in this overview are discussed in more detail in the sections that follow.

Critical accounting estimates

The Company makes estimates and assumptions that have a significant effect on amounts and disclosures reported in the financial statements. The most significant estimates relate to valuation of investments, reserves for property/casualty insurance unpaid losses and loss adjustment expenses and retirement benefits. While management believes its estimates are appropriate, the ultimate amounts may differ from the estimates provided. The estimates and the estimating methods used are reviewed continually, and any adjustments considered necessary are reflected in current earnings.

Investment valuation

Management makes estimates concerning the valuation of all investments. Except in rare cases where quoted market prices are not available, the Company values fixed maturities and equity securities based on published market prices.

The primary basis for the valuation of limited partnership interests are financial statements prepared by the general partner. Because of the timing of the preparation and delivery of these financial statements, the use of the most recently available financial statements provided by the general partners typically results in not less than a quarter delay in the inclusion of the limited partnership results in the Company's Consolidated Statements of Operations. The general partners use various methods to estimate fair value of unlisted debt and equity investments, property and other investments for which there is no published market. These valuation techniques may vary broadly depending on the asset class of the partnership. Due to the nature of the investments, general partners must make assumptions about the underlying companies or assets as to future performance, financial condition, liquidity, availability of capital, market conditions and other factors to determine the estimated fair value. The valuation procedures can include techniques such as cash flow multiples, discounted cash flows or the pricing used to value the entity or similar entities in recent financing transactions. The general partners' estimate and assumption of fair value of nonmarketable securities may differ significantly from the values that could have been derived had a ready market existed. These values are not necessarily indicative of the value that would be received in a current sale and valuation differences could be significant. Upon receipt of the quarterly and annual financial statements, management performs an in-depth analysis of the valuations provided by the general partners. Management surveys each of the general partners about expected significant changes (plus or minus 10% compared to previous quarter) to valuations prior to the release of the fund's quarterly and annual financial statements. In the event of an expected significant change, the general partner will notify the Company and the Company will evaluate the potential change.

Investments are evaluated monthly for other-than-temporary impairment loss. Some factors considered in evaluating whether or not a decline in fair value is other-than-temporary include:

- the extent and duration for which fair value is less than cost
- historical operating performance and financial condition of the issuer
- near-term prospects of the issuer and its industry based on analysts' recommendations
- specific events that occurred affecting the issuer, including rating downgrades
- the Company's ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value.

An investment deemed impaired is written down to its estimated net realizable value. Impairment charges are included as a realized loss in the Consolidated Statements of Operations.

Property/casualty insurance liabilities

Reserves for property/casualty insurance unpaid losses and loss adjustment expenses reflect the Company's best estimate of future amounts needed to pay losses and related expenses with respect to insured events. The process of establishing the liability for property/casualty unpaid loss and loss adjustment expense reserves is a complex process, requiring the use of informed judgments and estimates. Reserve estimates are based on management's assessment of known facts and circumstances, review of historical settlement patterns, estimates of trends in claims frequency and severity, legal theories of liability and other factors. Variables in the reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, economic inflation, legal trends and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. There may be significant reporting lags between the occurrence of the policy event and the time it is actually reported to the insurer.

Management reviews reserve estimates on a quarterly basis. Product line data is grouped according to common characteristics. Multiple estimation methods are employed for each product line and product coverage combination analyzed at each evaluation date. Most estimation methods assume that past patterns discernible in the historical data will be repeated in the future, absent a significant change in pertinent variables. Significant changes, which are either known or reasonably projected through analysis of internal and external data, are quantified in the reserve estimates each quarter. The estimation methods chosen are those that are believed to produce the most reliable indication at that particular evaluation date for the losses being evaluated.

Using multiple estimation methods results in a reasonable range of estimates for each product line and product coverage combination. The nature of the insurance product, number of risk factors, pervasiveness of the risk factors across product lines, and interaction of risk factors all influence the size of the range of reasonable reserve estimates. Whether the risk factor is sudden or evolutionary in nature, and whether a risk factor is temporary or permanent, also influences reserve estimates. The final estimate recorded by management is a function of detailed analysis of historical trends, which is adjusted as new emerging data indicates.

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, which result in costs significantly different from the past; and claims patterns on current business that differ significantly from historical patterns.

The Company also performs analyses to evaluate the adequacy of past reserves. Using subsequent information, the Company performs retrospective reserve analyses to test whether previously established estimates for reserves were reasonable. See also the Financial Condition section herein.

A relatively small percentage change in the estimate of net loss reserves would have impacted the Company's operating results. For example, a hypothetical 1% increase in net loss reserves at December 31, 2005, would have resulted in a pre-tax charge of approximately \$2.0 million. The Property and Casualty Group's coverage that has the greatest potential for variation is the pre-1986 automobile catastrophic injury liability reserve. Automobile no-fault law in Pennsylvania before 1986 provided for unlimited medical benefits. The estimate of ultimate liabilities for these claims is subject to significant judgment due to variations in claimant health and mortality over time. At December 31, 2005, the range of reasonable estimates for reserves related to these claims, net of reinsurance recoverables, for both personal and commercial lines is from \$188.5 million to \$443.3 million for the Property and Casualty Group. The reserve carried by the Property and Casualty Group, which is management's best estimate of this liability at this time, was \$262.8 million at December 31, 2005, which is net of \$127.1 million of anticipated reinsurance recoverables. The Company's property/casualty subsidiaries share of the net automobile catastrophic injury liability reserve is \$14.5 million at December 31, 2005.

Pension and postretirement health benefits

The Company's pension plan for employees is the largest and only funded benefit plan of the Company. The Company also provides postretirement medical and pharmacy coverage for eligible retired employees and eligible dependents. The Company's pension and other postretirement benefit obligations are developed from actuarial estimates in accordance with Financial Accounting Standard (FAS) 87, "Employers' Accounting for Pensions," and FAS 106, "Employers' Accounting for Postretirement Benefits Other than Pensions." The Company uses a consulting actuarial firm to develop these estimates. As pension and other postretirement obligations will ultimately be settled in future periods, the determination of annual expense and liabilities is subject to estimates and assumptions. With the assistance of the consulting actuarial firm, Company management reviews these assumptions annually and modifies them based on historical experience and expected future trends. Changes in the Company's pension and other postretirement benefit obligations may occur in the future due to variances in actual results from the key assumptions made by Company management. At December 31, 2005, the fair market value of the pension assets totaled \$220.5 million, which continues to exceed the accumulated

benefit obligation of \$164.1 million at that date. Unrecognized actuarial gains and losses are being recognized over a 16-year period, which represents the expected remaining service life of the employee group.

Because of the amount of sensitivity in reported assets, operating results and financial position, the most critical assumptions are the discount rate and the expected long-term rate of return. For both the pension and other postretirement health benefit plans, the discount rate is estimated to reflect the prevailing market rate of a portfolio of high-quality fixed-income debt instruments that would provide the future cash flows needed to pay the projected benefits included in the benefit obligations as they become due. In determining the discount rate, management engaged the Company's consulting actuarial firm to complete a bond-matching study in accordance with guidance provided in FAS 87 and FAS 106 and Securities and Exchange Commission Staff Accounting Bulletins. The study developed a portfolio of non-callable bonds rated AA- or better. The cash flows from the bonds were matched against the Company's projected benefit payments in the pension plan. This bond-matching study supported the selection of a 5.75% discount rate for the 2006 pension expense. The same discount rate was selected for the postretirement health benefits. The 2005 expense was based on a discount rate assumption of 6.00%. A change of 25 basis points in the discount rate assumption, with other assumptions held constant, would have an estimated \$2.1 million impact on net pension and other postretirement benefit cost in 2006, before consideration of reimbursement of affiliates.

The expected long-term rate of return for the pension plan represents the average rate of return to be earned on plan assets over the period the benefits included in the benefit obligation are to be paid. The expected long-term rate of return is less susceptible to annual revisions as there are typically not significant changes in the asset mix. The long-term rate-of-return is based on historical long-term returns for asset classes included in the pension plan's target allocation. A reasonably possible change of 25 basis points in the expected long-term rate of return assumption, with other assumptions held constant, would have an estimated \$.5 million impact on net pension benefit cost, before consideration of reimbursement from affiliates. Further information on the Company's pension and postretirement benefit plans is provided on page 58 in Note 8.

New accounting standards

See Note 2 to the Consolidated Financial Statements for a discussion of recently issued accounting pronouncements.

Management fee revenue by state and line of business

State	Total	For the year ended December 31, 2005 (dollars in thousands)					
		Private passenger auto	Homeowners	Commercial multi-peril	Workers' compensation	Commercial auto	All other lines of business
Pennsylvania	\$ 430,863	\$ 235,183	\$ 70,049	\$ 39,691	\$ 40,712	\$ 30,895	\$ 14,333
Maryland	118,419	56,182	24,974	9,682	11,971	10,436	5,174
Virginia	81,913	30,748	14,044	11,394	12,640	8,509	4,578
Ohio	77,468	35,530	16,858	13,740	0	6,912	4,428
North Carolina	56,447	21,017	13,558	7,063	4,531	6,423	3,855
West Virginia	45,055	25,621	9,064	4,784	0	3,824	1,762
Indiana	38,055	17,597	10,318	3,684	2,084	2,325	2,047
New York	36,942	16,588	5,079	6,396	3,219	4,162	1,498
Illinois	22,481	7,836	4,646	3,340	3,462	1,972	1,225
Tennessee	18,365	5,196	3,247	3,907	2,665	2,282	1,068
Wisconsin	9,701	4,503	2,278	1,158	600	517	645
District of Columbia	4,065	947	655	888	1,061	159	355
Total	\$ 939,774	\$ 456,948	\$ 174,770	\$ 105,727	\$ 82,945	\$ 78,416	\$ 40,968

This table is gross of an allowance for management fees returned on mid-term cancellations and the intersegment elimination of management fee revenue.

Analysis of business segments

Management operations

(dollars in thousands)	Years ended December 31		
	2005	2004	2003
Management fee revenue	\$940,274	\$945,066	\$878,380
Service agreement revenue	20,568	21,855	27,127
Total revenue from management operations	960,842	966,921	905,507
Cost of management operations	751,573	724,329	652,256
Income from management operations	\$209,269	\$242,592	\$253,251
Gross margins	21.8%	25.1%	28.0%
Effective management fee rate	23.75%	23.74%	24%

HIGHLIGHTS

- Effective management fee rate was 23.75% in 2005 and 23.74% in 2004
- Direct written premiums of the Property and Casualty Group decreased 1.0% in 2005
- Policies in force were 3,759,599 and 3,771,105 at December 2005 and 2004, respectively, a decrease of .3%

- Year-over-year premium per policy was \$1,052 in 2005 and \$1,060 in 2004, a decrease of .7%
- Premium rate decreases resulted in a \$9.9 million decrease in written premiums in 2005
- Cost of management operations increased 3.8% with commission costs increasing 1.6% and costs other than commissions increasing 9.8%
- Agent bonuses increased \$24.9 million in 2005 while commercial commission costs decreased \$17.5 million
- Personnel costs increased \$13.4 million, including a \$3.2 million increase in external contract labor costs

Management fee revenue

Management fees represented 71.6% of the Company's total revenues for 2005 and 73.7% and 74.4% of the Company's total revenues for 2004 and 2003, respectively. The management fee rate set by the Company's Board of Directors and the volume of direct written premiums of the Property and Casualty Group determine the level of management fees. Changes in the management fee rate affect the Company's revenue and net income significantly. The management fee rate was set at 23.75% in 2005. In 2004, the management fee rate was set at 23.5% for the first six months of the year and 24.0% for the last six months of the year, effectively 23.74% for the year. In 2003, the rate was 24%. The Company's Board of Directors set the management fee rate at 24.75% beginning January 1, 2006. If the management fee rate had been 24.75% in 2005, management fee revenue would have increased \$39.6 million, or \$.37 per share-diluted.

Management fees are returned to the Exchange when policyholders cancel their insurance coverage mid-term and unearned premiums are refunded to them. The

Company maintains an allowance for management fees returned on mid-term policy cancellations that recognizes the management fee anticipated to be returned to the Exchange based on historical mid-term cancellation experience. Due to changes in the allowance, management fee revenues were increased by \$5 million in 2005, compared to being reduced by \$4.1 million and \$3.0 million in 2004 and 2003, respectively. The 2005 adjustment reflects a leveling off of mid-term cancellations evidenced by policy retention ratios of 88.6% at December 31, 2005, compared to 88.4% at December 31, 2004. The reduction in management fee revenues of \$4.1 million in 2004 reflected higher cancellations, as anticipated with the introduction of segmented pricing, evidenced by the decrease in retention ratios from 90.2% at December 31, 2003, to 88.4% at December 31, 2004. The cash flows of the Company are unaffected by the recording of the allowances.

Management fee revenue derived from the direct written premiums of the Property and Casualty Group, before consideration of the allowance for mid-term cancellations, was \$939.8 million in 2005, compared to \$949.2 million in 2004. The direct written premiums of the Property and Casualty Group were \$4.0 billion in 2005 and 2004, reflecting a 1.0% decrease, compared to growth of 8.9% in 2004 from \$3.7 billion in 2003. The decline in growth of direct written premiums of the Property and Casualty Group in 2004 and the further decrease in 2005 reflects the impact of the decline in new policy growth and lower average premium per policy partially as a result of rate decreases. In 2004, much of the growth resulted from offsetting rate increases.

Premium production

The Property and Casualty Group's premiums produced from new business declined as anticipated in 2005. New business premiums written in total were \$369.0 million in 2005, down 7.5% from \$399.0 million in 2004, and significantly lower than the \$501.9 million produced in 2003. Policy retention ratios stabilized to a 12-month moving average of 88.6% in 2005, up slightly from 88.4% in 2004, after decreasing from 90.2% in 2003.

Personal lines—Personal lines new business premiums written decreased 12.4% to \$246.2 million in 2005 from \$281.0 million in 2004 and \$333.3 million in 2003. The Property and Casualty Group's largest personal line of business is private passenger auto for which new business premiums written decreased to \$149.1 million in 2005 from \$177.8 million and \$218.2 million in 2004 and 2003, respectively. The 12-month moving average policy retention ratio for personal lines was 89.1%, 88.8% and 90.5% in 2005, 2004 and 2003, respectively. The 12-month moving average policy retention ratio for private passenger auto was 90.0% in 2005 and 2004, and 91.6% in 2003.

During 2003 and 2004, the Property and Casualty Group implemented various initiatives to focus on underwriting profitability to control exposure growth and improve underwriting risk selection.

The Company also implemented significant rate increases in all lines. In 2005, the Company introduced the use of insurance scoring for underwriting purposes for private passenger auto and homeowners lines of business in all operating states, except Maryland. The introduction of the pricing segmentation model for personal lines, that included insurance scoring, segments policyholders into different rate classes based on the associated risks, and was a significant change from the judgment-based underwriting model previously used by the Company. Segmenting policyholders into rate classes helps insurers provide a better matching of prices and related risks. The short-term impact of segmented pricing is higher policy retention among policyholders realizing either base rate decreases or greater discounts, which reduces the premium base, and lower policy retention among policyholders whose rates rise under the new rate plan. The long-term impact should result in a more desirable pool of risks contributing to improvements in claims severity. Introducing new variables into the pricing plan should result in improvements in frequency of claims. In the long run, the plan results in better risk selection, lower loss costs and the ability to offer lower prices to consumers and attract the most favorable risks. Current personal lines market conditions reflect price stabilization, or slightly reducing rate levels. It is anticipated that the Property and Casualty Group's 2006 pricing strategy on introducing further refinements in personal lines price segmenting will contribute to an improved competitive position in the marketplace. Many insurers in the property/casualty industry were impacted by the major hurricanes in 2005, which in turn will need to be considered in their underwriting, pricing and capital allocation decisions in 2006. These decisions may affect the pricing environment for personal lines insurance in 2006 and beyond. The regions in which the Property and Casualty Group operates were not impacted by the major hurricanes of 2005.

Commercial lines—The commercial lines new business premiums written rose 4.0% to \$122.3 million in 2005 from \$117.5 million in 2004, which had decreased 30.2% from \$168.4 million in 2003. The 12-month moving average policy retention ratio for commercial lines was 85.2%, 85.1% and 87.3% in 2005, 2004 and 2003, respectively. The Property and Casualty Group's largest commercial lines of business, based upon written premiums, are commercial auto and workers' compensation. During 2005, the Property and Casualty Group implemented initiatives to provide more competitive rates for higher quality workers' compensation risks. A more formalized process of evaluating workers' compensation accounts should allow a better alignment between rate and risk level similar to the pricing segmentation efforts in the personal lines.

While premiums per policy have decreased, these premiums are associated with more preferred risks.

Premium rates and rate change impacts

The average premium per policy decreased .7% to \$1,052 in 2005 from \$1,060 in 2004, which had increased 8.1% in 2003. The average premium per personal lines policy decreased 1.6% while commercial lines average premiums increased .6% from 2004. In 2004, compared to 2003, the average premium per personal lines policy increased 8.6% and commercial lines average premiums increased 6.9%.

The recent improvement in underwriting results afforded the Property and Casualty Group the ability to implement rate reductions in 2005 to be more price competitive for potential new policyholders and improve retention of existing policyholders. Significant rate increases had been obtained in 2004 and 2003 to offset growing loss costs in certain lines. The Property and Casualty Group writes one-year policies. Consequently, rate actions take 12 months to be fully recognized in written premium and 24 months to be recognized fully in earned premiums. Since rate changes are realized at renewal, it takes 12 months to implement a rate change to all policyholders and another 12 months to earn the decreased or increased premiums in full. As a result, certain rate increases approved in 2004 were reflected in written premium in 2005 and some rate actions in 2005 will be reflected in 2006. The effect of all rate actions in 2005 resulted in a net decrease in written premiums of \$9.9 million. Rate increases accounted for \$298.3 million and \$208.4 million in additional written premium for the Property and Casualty Group in 2004 and 2003. Management continuously evaluates pricing actions and estimates that those approved, filed and contemplated for filing during 2006 could reduce direct written premiums by \$96.7 million in 2006.

Personal lines—The private passenger auto average premium per policy decreased 1.3% to \$1,174 in 2005 from \$1,190 in 2004, which had increased 6.1% from 2003. The homeowners average premium per policy decreased .5% to \$543 in 2005 from \$546 in 2004, compared to a 17.4% increase from \$465 in 2003. The most significant rate decreases effective in 2005 were in the private passenger auto and homeowners lines of business in Pennsylvania. The most significant rate decreases approved and effective in 2006 are in the private passenger auto and homeowners lines of business in Pennsylvania and Maryland.

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. Segmented pricing provides the Property and Casualty Group greater flexibility in pricing policies with varying degrees of risk, which 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 states on new business in March 2005 and on renewal business in April 2005.

The Property and Casualty Group has focused pricing initiatives to focus on quality growth. During July 2005, an 8% rate reduction on certain coverages for new private passenger auto policyholders with no claims or violations was effective in the majority of the states served by the Property and Casualty Group. In Tennessee and Virginia, this rate reduction for claim-free and violation-free policyholders was 6%. Other initiatives include discontinuing the surcharge placed on permitted drivers and targeting more profitable risks through the introduction of new rating variables into the pricing segmentation model for both auto and homeowners. The Property and Casualty Group is also evaluating potential new personal lines product extensions and enhancements that could be offered as well as new coverages, such as identity recovery. Also, effective January 1, 2006, additional discounts and interactions will be introduced into the pricing plan for auto and home, including number of cars and drivers in a household, discounts for policyholders who buy life insurance and for those who pay premiums up front.

Commercial lines—The commercial auto average premium per policy decreased .3% to \$2,781 in 2005 from \$2,790 in 2004, which had increased 4.2% from 2003. The workers' compensation average premium per policy increased 6.7% to \$6,212 in 2005 from \$5,820 in 2004, which had increased 12.8% in 2003. Rate decreases approved and effective in 2006 related primarily to these two lines of business in Pennsylvania, and for commercial auto, Tennessee.

As mentioned previously, the Property and Casualty Group has been implementing initiatives focused on workers' compensation to better align rate and risk levels, control losses and implement rate changes. Rate changes became 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 the first half of 2006. The Property and Casualty Group is evaluating the potential of expanding its penetration of the small business market.

All lines—In 2005, the Company appointed 65 new agents, compared to 33 new agent appointments in 2004. The Company expects 125 new agent appointments in 2006. Expanding the size of the agency force will contribute to future growth as new agents build up their book of business with the Property and Casualty Group.

Service agreement revenue

Service agreement revenue includes service charges the Company collects from policyholders for providing extended payment terms on policies written by the Property and Casualty Group. These service charges are fixed dollar amounts per billed installment. Such service charges amounted to \$20.5 million, \$21.1 million and \$19.9 million in 2005, 2004 and 2003, respectively. The Property and Casualty Group is implementing certain changes in the service charge amounts to be billed to various installment arrangements. The outcome of such changes will be dependent upon the mix of installment programs selected by policyholders. See Factors That May Affect Future Results.

Prior to March 2005, service agreement revenue also included service income received from the Exchange as compensation for the management and administration of voluntary assumed reinsurance from nonaffiliated insurers. The Company received a service fee of 6.0% of nonaffiliated assumed reinsurance premiums. These fees were minimal in 2005 and 2004 as the Exchange exited the nonaffiliated assumed reinsurance business effective December 31, 2003. Service fees totaled \$7.2 million on net voluntary nonaffiliated assumed reinsurance premiums in 2003.

Cost of management operations

The cost of management operations rose 3.8% to \$751.6 million in 2005, from \$724.3 million in 2004, and 11.1% in 2004, from \$652.3 million in 2003. In 2005, commissions costs rose 1.6% while costs other than commissions rose 9.8%. Personnel costs increased 11.7% in 2005 as a result of staffing levels and pay rate increases, as well as external labor costs related to information technology projects. The use of insurance scoring for the full year of 2005 and for all new and renewal business resulted in \$3.6 million in additional costs in 2005 compared to 2004. 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.

(dollars in thousands)	Years ended December 31		
	2005	2004	2003
Scheduled and accelerated rate commissions	\$ 466,064	\$ 486,860	\$ 452,245
Agent bonuses	71,083	46,163	24,034
Promotional incentives	1,792	175	361
Commission effect from change in allowance for mid-term policy cancellations	600	(2,000)	(1,900)
Total commissions	\$ 539,539	\$ 531,198	\$ 474,740

Scheduled and accelerated rate commissions— Scheduled rate commissions were impacted by a 1.0% decrease in the direct written premiums of the Property and Casualty Group in 2005 and the reduction in certain commercial commission rates. Commercial commission rate reductions became effective January 1, 2005, for premiums collected after December 31, 2004, and resulted in a \$20.5 million reduction in scheduled rate commissions in 2005.

Commission rates were reduced for certain new and renewal commercial lines business effective January 1, 2005. Thus all premiums collected after December 2004 were commissioned at the new post-January 1, 2005 rates. Commissions accrued at the end of 2004 were reduced by \$5.2 million related to commissions to be paid in 2005 on uncollected 2004 policy premium.

Accelerated rate commissions are offered to some newly-recruited agents for their initial three years. Accelerated commissions were lower in 2005 as new agency appointments were curtailed for the latter part of 2004, and existing accelerated commission contracts expired. The Company slowed agency appointments in conjunction with its efforts to control exposure growth. Agent appointments resumed in 2005, with 65 new agents added, and accelerated commissions will begin to increase as new agent appointments for 2006 increase.

Agent bonuses—Agent bonuses are based on an individual agency's property/casualty underwriting profitability over a three-year period. There is also a growth component to the bonus, paid only if the agency is 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. The increase in agent bonuses in 2005 reflects the impact of improved underwriting profitability of the Property and Casualty Group in 2005 and 2004. The bonus for 2003 was lower given the less favorable underwriting results in 2003 and 2002.

Significant changes to the bonus formula were effective January 1, 2004, with the intent of rewarding truly profitable agencies. The growth component was also added. These changes and improved underwriting results in 2004 contributed to an increase in 2004 annual agent bonus expense of \$22.1 million as compared to 2003. Of the 2004 increase, approximately \$5.0 million related to one-time special transition rules for the new bonus.

Other costs of management operations—The cost of management operations, excluding commission costs, increased 9.8% in 2005 to \$212.0 million, from \$193.1 million in 2004, and 8.8% in 2004 from \$177.5 million in 2003. Personnel-related costs are the second largest component in cost of management operations. The Company's personnel costs increased 11.7% to \$128.7 million in 2005, from \$115.3 million in 2004, and increased 12.1% in 2004, from \$102.8

million in 2003. Contributing to the increase in 2005 was a 12.2% increase in salaries and wages. This increase includes both base pay rate and staffing level increases as well as higher costs of external contract labor. Costs incurred related to external contract labor primarily related to information technology projects which increased to \$6.0 million in 2005 from \$2.8 million in 2004.

Also contributing to the increase in the cost of management operations were the cost of obtaining insurance scores on new and renewal personal lines business of \$4.0 million during 2005. The Company began using insurance scoring in the latter half of 2004 on renewal personal lines business only and had incurred \$.4 million in 2004 for insurance scores.

Insurance underwriting operations

(dollars in thousands)	Years ended December 31		
	2005	2004	2003
Premiums earned	\$215,824	\$208,202	\$191,592
Losses and loss adjustment expenses incurred	140,386	153,220	152,984
Policy acquisition and other underwriting expenses	60,488	59,346	63,549
Total losses and expenses	200,874	212,566	216,533
Underwriting income (loss)	\$ 14,950	\$ (4,364)	\$ (24,941)

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. The two main components of insurance underwriting operations are the direct business written by the Property and Casualty Group and the assumed reinsurance business. Because the Exchange exited the assumed reinsurance business in 2003, the only assumed reinsurance included in 2004 and 2005 is runoff activity. The detail of the Property and Casualty Group provides financial data for the direct business and the reinsurance business separately.

Reconciliation of Property and Casualty Group underwriting results to company underwriting results

(dollars in thousands)	Years ended December 31		
	2005	2004	2003
Property and Casualty Group insurance underwriting operations (SAP basis)			
Direct underwriting results:			
Direct written premium	\$3,956,942	\$3,997,330	\$3,672,419
Premium earned	3,984,648	3,877,844	3,460,792
Loss and loss adjustment expenses incurred	2,561,504	2,623,731	2,808,678
Policy acquisition and other underwriting expense	1,100,772	1,105,028	1,023,177
Total losses and expense	3,662,276	3,728,759	3,831,855
Direct underwriting income (loss)	322,372	149,085	(371,063)
Nonaffiliated reinsurance underwriting results—net	49,427	(24,538)	(32,588)
Net underwriting gain (loss) (SAP Basis)	371,799	124,547	(403,651)
Erie Indemnity Company insurance underwriting operations (SAP to GAAP basis)			
Percent of pool assumed by Company	5.5%	5.5%	5.5%
Company preliminary underwriting income (loss):			
Direct	17,730	8,200	(20,408)
Nonaffiliated reinsurance	2,719	(1,350)	(1,793)
Net underwriting gain (loss) (SAP basis)	20,449	6,850	(22,201)
Excess-of-loss premiums ceded to the Exchange	(3,262)	(3,628)	(2,530)
Excess-of-loss changes to recoveries under the agreement*	(2,226)	(7,740)	6,461
SAP to GAAP adjustments	(11)	154	(6,671)
Company underwriting income (loss) (GAAP basis)	\$ 14,950	\$ (4,364)	\$ (24,941)

* 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.

	Years ended December 31		
	2005	2004	2003
Company GAAP combined ratio(1)	93.1	102.1(3)	113.0
P&C Group statutory combined ratio	90.5	95.6	109.5
P&C Group statutory combined ratio, excluding catastrophes	90.0	93.7	104.4
P&C Group adjusted statutory combined ratio(2)	85.7	90.1	103.3
P&C Group adjusted statutory combined ratio, excluding catastrophes	85.2	88.2	98.2
Loss ratio points from prior accident year reserve development —(redundancy) deficiency—statutory basis	(1.9)	(1.5)	1.6
Loss ratio points from salvage and subrogation recoveries collected—statutory basis	(1.5)	(1.5)	(1.5)
Total loss ratio points from prior accident years— statutory basis	(3.4)	(3.0)	0.1

- (1) 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.
- (2) The adjusted statutory combined ratio removes the profit component of the management fee earned by the Company.
- (3) For 2004, the less favorable GAAP combined ratio, as compared to the statutory combined ratio, was driven by \$7.7 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 3.7 GAAP combined ratio points.

Direct underwriting results

	Years ended December 31		
(dollars in thousands)	2005	2004	2003
SAP Basis			
Property and Casualty Group direct underwriting income (loss)	\$322,372	\$149,085	\$(371,063)
Percent of pool assumed by Company	5.5%	5.5%	5.5%
Company direct underwriting income (loss), before adjustments	\$ 17,730	\$ 8,200	\$ (20,408)
P&C Group Direct business only combined ratio	91.6%	95.4%	109.8%

HIGHLIGHTS

- Low level of catastrophe losses contributed only .5 points to the combined ratio (1.9 points in 2004 and 5.2 points in 2003). Normalized catastrophes for the Property and Casualty Group are 5.0 combined ratio points
- Favorable development of prior accident years improved combined ratio by 1.5 points in 2005; however, an increase to the pre-1986 automobile catastrophe injury liability reserves contributed 1.2 points to the combined ratio, resulting in a net favorable development of .3 combined ratio points
- Pre-1986 automobile catastrophe injury liability reserves were increased in 2005, contributing 1.2 points to combined ratio, net of estimated reinsurance recoverables

The improvement in 2005 and 2004 underwriting results on direct business were the result of initiatives implemented in 2004 to help offset increased claim severity and control exposure growth. Additionally, the Property and Casualty Group experienced positive development on losses of prior accident years on a direct basis of \$11.0 million in 2005 and \$71.6 million

in 2004, compared to adverse development on losses of prior accident years of \$4.2 million in 2003. While still favorable in 2005, the development of the direct business prior accident years deteriorated as a result of an increase in the pre-1986 automobile catastrophe injury liability reserves. The Property and Casualty Group increased these reserves by \$47 million (net of ceded recoveries) as a result of re-estimations on these claims during the second half of 2005, which took into account updated trends with respect to ongoing attendant care costs for claimants. Catastrophe losses of the Property and Casualty Group were \$21.1 million, \$73.3 million and \$182.7 million in 2005, 2004 and 2003, respectively.

The 2003 underwriting losses on direct business resulted primarily from continued increases in claims severity and increased catastrophe losses. Claims severity rose in 2003 in certain lines of business at rates much higher than general inflation. While loss reserves continued to grow in 2004, this growth was a reflection of increases in exposure, not deterioration in prior year reserves.

Development of direct loss reserves

The Company's 5.5% share of the Property and Casualty Group's positive development on losses for prior accident years was \$6 million in 2005, which includes the effects of the Company's share of the increase in the automobile catastrophe liability reserve of \$2.6 million. The Company's share of positive development on losses for prior accident years was \$3.9 million in 2004, compared to its share of adverse development on losses for prior accident years of \$0.2 million in 2003. The positive development on losses of prior accident years in 2005 was experienced primarily in the commercial multi-peril and the private passenger auto uninsured motorists lines of business. In 2004, certain unusual and significant claims emerged that related to prior years and were factored into the trend analysis for 2005. However, these trends did not continue into 2005, which led to an improvement in prior accident year loss reserves. The Company employed specialty claims units in Pennsylvania to focus on uninsured motorists claims to improve claims handling and control severity.

The positive development on losses of prior accident years in 2004 was experienced primarily in the homeowners and commercial multi-peril lines of business. Generally, the Company experienced improving loss development trends, which were reflected in the new estimate of prior year reserves. Contributing to the improving loss development on prior accident year losses was the implementation of new claims tools, such as new property loss estimation software, which has helped in controlling property claims severity. Additionally, property adjusters received extensive third-party training in property

claims estimating in 2004. Property occurrences make up a majority of the claims in the homeowners line of business and approximately half of the commercial multi-peril claims.

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 property catastrophe reinsurance coverage from unaffiliated insurers (see page 39). The Company's property/ casualty insurance subsidiaries' all-lines excess-of-loss reinsurance agreement with the Exchange was purchased to mitigate the effect of catastrophe losses on the Company's financial position. The excess-of-loss agreement was not renewed for the 2006 accident year due to the proposed pricing for the coverage as well as the loss profile of the Property and Casualty Group. The Property and Casualty Group maintains sufficient property catastrophe coverage from unaffiliated reinsurers and no longer participates in the assumed reinsurance business, which lowers the variability of the underwriting results of the Property and Casualty Group.

There was no impact on the Property and Casualty Group's underwriting results from Hurricanes Katrina, Rita or Wilma during 2005. During 2005, 2004 and 2003, the Company's share of catastrophe losses, as defined by the Property and Casualty Group, amounted to \$1.2 million, \$4.0 million and \$10.0 million, respectively. The 2004 catastrophe losses were largely driven by Hurricane Ivan, which affected the states of North Carolina, Virginia, West Virginia and Pennsylvania. The 2003 Property and Casualty Group catastrophe losses were primarily due to Hurricane Isabel, which affected the states of North Carolina, Maryland, Virginia, Pennsylvania and the District of Columbia. For the Company, these 2003 catastrophe losses were offset with recoveries recorded under the intercompany excess-of-loss reinsurance agreement. Catastrophe losses in 2005 contributed .5 points to the Company's GAAP combined ratio, compared to 1.9 points in 2004 and 5.2 points in 2003.

Reinsurance underwriting results

(dollars in thousands)	Years ended December 31		
	2005	2004	2003
SAP Basis			
Company insurance underwriting operations:			
Nonaffiliated reinsurance	\$ 2,719	\$ (1,350)	\$(1,793)
Affiliated reinsurance			
Premiums ceded to Exchange	(3,262)	(3,628)	(2,530)
Change to recoveries under the excess-of-loss agreement	(2,226)	(7,740)	6,461
Affiliated reinsurance	\$(5,488)	\$(11,368)	\$ 3,931

HIGHLIGHTS

- Assumed loss reserves related to September 11, 2001, were reduced by \$42 million of which the Company's share was \$2.3 million. Reversal of previously recorded recoveries under the intercompany excess-of-loss reinsurance agreement resulted in no material financial impact
- Termination of the intercompany excess-of-loss reinsurance agreement effective December 31, 2005, for the 2006 accident year

The Company's property/casualty insurance subsidiaries' nonaffiliated reinsurance business includes its share of the Property and Casualty Group's

voluntary and involuntary assumed reinsurance business and ceded reinsurance business. The Exchange exited the voluntary assumed reinsurance business as of December 31, 2003, to allow the Property and Casualty Group to focus on its core business and lessen its underwriting exposure. In 2005 and 2004, only runoff activity of the assumed reinsurance business remains. The effects of the excess-of-loss reinsurance agreement between the Company's property/casualty insurance subsidiaries and the Exchange is also reflected in the reinsurance business when looking at the Company's results on a segment basis. The excess-of-loss reinsurance agreement is not subject to the intercompany pooling agreement.

Assumed loss reserves related to September 11th

During 2005, the Property and Casualty Group's estimate of assumed loss and loss adjustment expenses related to the September 11, 2001, event was reduced by \$42 million. While the Company's share of this reduction was \$2.3 million (see Financial Condition for further discussion), this reserve change triggered a \$2.2 million reduction in recoveries due to the Company under the aggregate excess-of-loss reinsurance agreement for the 2001 accident year. The net effect of this World Trade Center reserve activity to the Company was a \$.1 million reduction in expense in 2005.

Aggregate excess-of-loss reinsurance agreement

(Charges) Recoveries by accident year are as follows:

(dollars in thousands) Calendar year	Accident year						Total (charges) recoveries
	2004	2003	2002	2001	2000	1999	
2005	\$ 0	\$ 0	\$ 0	\$(1,881)	\$ 41	\$ (386)	\$(2,226)
2004	—	(6,012)	(33)	(1,637)	(488)	430	(7,740)
2003 ⁽¹⁾	—	6,012	(1,969)	2,645	(57)	(170)	6,461
2002	—	—	2,002	2,176	2,213	2,424	8,815
2001	—	—	—	6,506	0	735	7,241
2000	—	—	—	—	0	0	0

(1) During calendar year 2003, the \$6.0 million in recoveries from the 2003 accident year included the recoveries of losses incurred from Hurricane Isabel.

The charges and recoveries under the excess-of-loss reinsurance agreement are recorded to the Company's loss and loss adjustment expenses on the Consolidated Statements of Operations. Included in the 2005 net changes to recoveries under the excess-of-loss agreement of \$2.2 million are charges for unexpired accident years of \$1.5 million plus charges of \$.7 million related to the commutations of the 1999 and 2000 accident years. In accordance with the agreement, commutation of an accident year occurs five years after the accident year expires. The unpaid loss recoverable related to the 1999 accident year of \$3.4 million was settled in March 2005. The present value of the estimated losses from the 1999 accident year, or \$3.0 million, was settled with the Exchange and cash was paid by the Company's property/casualty insurance subsidiaries resulting in a charge to the Company of \$.4 million.

The \$2.0 million unpaid loss recoverable related to the 2000 accident year was settled in December 2005. The present value of these estimated losses from the 2000 accident year, or \$1.7 million, was settled with the Exchange by the Company's property/casualty insurance subsidiaries resulting in a charge to the Company of \$.3 million. Cash payment of the present value of these losses will occur in the first quarter of 2006.

The purpose of the excess-of-loss agreement was to reduce the variability of earnings and thereby reduce the adverse effects on the results of operations of EIC and EINY in a given year if the frequency or severity of claims were substantially higher than historical averages. The Property and Casualty Group did not renew the excess-of-loss agreement for the 2006 accident year. While the excess-of-loss agreement was not renewed for 2006, the unexpired accident years of 2001 through 2005 will be settled and losses will be commuted as the 60-month periods expire. The Company has the option of purchasing the coverage for future accident year periods.

Policy acquisition and other underwriting expenses

Policy acquisition and other underwriting expenses of the Property and Casualty Group include the management fee to the Company of \$939.8 million, \$949.2 million and \$881.4 million in 2005, 2004 and 2003, respectively. The amount presented on the Company's Statements of Operations as management fee revenue reflects the elimination of intercompany management fee revenue between the Erie Insurance Company, the Erie Insurance Company of New York and the Company, and the allowance for mid-term policy cancellations.

Investment operations

	Years ended December 31		
(dollars in thousands)	2005	2004	2003
Net investment income	\$ 61,555	\$60,988	\$58,298
Net realized gains on investments	15,620	18,476	10,445
Equity in earnings of EFL	3,636	5,598	7,429
Equity in earnings (losses) of limited partnerships	38,062	8,655	(2,000)
Net revenue from investment operations	\$118,873	\$93,717	\$74,172

HIGHLIGHTS

- *Equity on earnings of limited partnerships increased dramatically to \$38.1 million in 2005, from \$8.7 million in 2004*
- *Earnings of limited partnerships reflects a correction in accounting for the market value adjustment which increased earnings by \$10.1 million in 2005*
- *Funds used to repurchase Company stock amounted to \$99.0 million in 2005 compared to \$54.1 million in 2004*

Net investment income increased 1.0% in 2005 and 4.6% in 2004. Included in net investment income are primarily interest and dividends on the Company's fixed maturity and equity security portfolios. Net investment income in 2005 remained at a comparable level to 2004 as the Company continued to repurchase shares of its common stock under its three-year stock repurchase program, which diverted some available funds away from the investment market. The stock repurchase program runs from 2004 through 2006. Increases in investments in taxable bonds contributed to the growth in net investment income in 2004 and 2003. However, declines in overall market yields caused a lower growth rate in 2004 investment income compared to 2003.

Net revenue from investment operations increased in 2004 compared to 2003 largely due to the increase in realized gains on investments attributable to the sale of common stock securities in conjunction with the conversion to the use of external equity managers.

Limited partnership earnings pertain to investments in U.S. and foreign private equity, real estate and mezzanine debt partnerships. Private equity and mezzanine debt limited partnerships generated earnings of \$20.3 million and \$4.3 million in 2005 and 2004, respectively, compared to losses of \$5.3 million in 2003. Real estate limited partnerships reflected

earnings of \$7.7 million, \$4.4 million and \$3.3 million in 2005, 2004 and 2003, respectively. Impairment charges on limited partnerships were \$1.2 million and \$5.0 million in 2004 and 2003, respectively. The components of equity in earnings of limited partnerships, including the valuation adjustments to record limited partnerships at fair value, for the years ended December 31 are as follows:

<i>(dollars in thousands)</i>	2005	2004	2003
Private equity	\$16,732	\$2,324	\$(3,983)
Real estate	7,657	4,350	3,349
Mezzanine debt	3,530	1,981	(1,366)
Valuation adjustments	10,143	0	0
Total equity in earnings of limited partnerships	\$38,062	\$8,655	\$(2,000)

Valuation adjustments are recorded to reflect the fair value of limited partnerships. These adjustments are recorded as a component of equity in earnings of limited partnerships in the Consolidated Statements of Operations. The limited partnership market value adjustment was previously recorded as a component of shareholders' equity.

The Company's performance of its fixed maturities and equity securities, compared to selected market indices, is presented below.

Pre-tax annualized returns

	Two years ended December 31, 2005
Fixed maturities—corporate	3.83%
Fixed maturities—municipal	2.90
Preferred stock	5.04
Common stock ⁽¹⁾	6.58
Other indices:	
Lehman Brothers— U.S. Aggregate	3.38%
S&P500 Composite Index	7.85

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

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 December 31, 2005 and 2004, the Company's investment portfolio of investment-grade bonds, common stock, investment-

grade preferred stock and cash and cash equivalents represents 40.3% and 39.4%, respectively, of total assets. These investments provide the liquidity the Company requires to meet the demands on its funds.

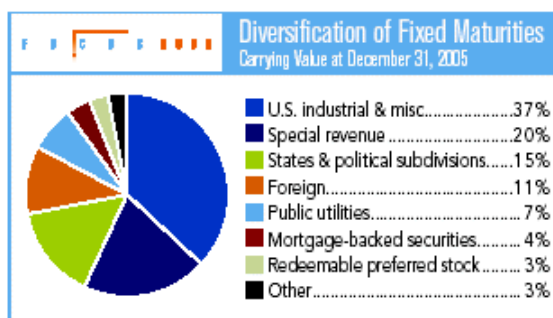
Distribution of investments

<i>(dollars in thousands)</i>	Carrying value at December 31			
	2005	%	2004	%
Fixed maturities	\$ 972,210	70	\$ 974,512	74
Equity securities:				
Preferred stock	170,774	12	143,851	11
Common stock	95,560	6	58,843	4
Limited partnerships	153,159	11	130,464	10
Real estate mortgage loans	4,885	1	5,044	1
Total investments	\$1,396,588	100%	\$1,312,714	100%

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 and equity limited partnerships 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 of the Company to hold the position until recovery has occurred.

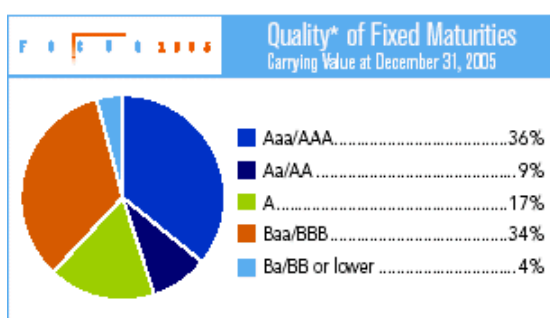


Fixed maturities

Under its investment strategy, the Company maintains a fixed maturities portfolio that is of high quality and well diversified within each market sector. This investment strategy also achieves a balanced maturity schedule in order to moderate investment income in the event of interest rate declines in a year in which a large amount of securities could be redeemed or mature. The fixed maturities portfolio is managed with the goal of achieving reasonable returns while limiting exposure to risk.

The Company's fixed maturity investments include 96.1% of high-quality, marketable bonds and redeemable preferred stock, all of which were rated at investment-grade levels (above Ba1/BB+) at December 31, 2005. Included in this investment-grade category are \$435.1 million, or 44.8%, of the highest quality bonds and redeemable preferred stock rated Aaa/AAA or Aa/AA or bonds issued by the United States government. Generally, the fixed maturities in the Company's portfolio are rated by external rating agencies. If not externally rated, they are rated by the Company on a basis consistent with that used by the rating agencies. Management classifies all fixed maturities as available-for-sale securities, allowing the Company to meet its liquidity needs and provide greater flexibility for its investment managers to appropriately respond to changes in market conditions or strategic direction.

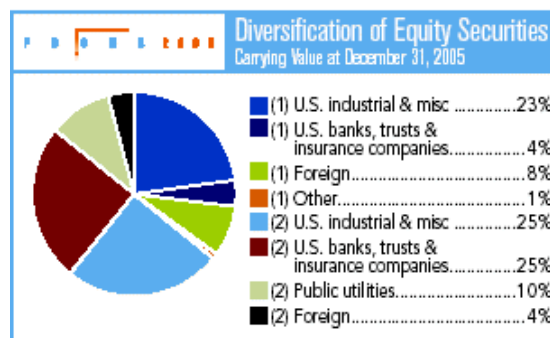
Securities classified as available-for-sale are carried at market value with unrealized gains and losses net of deferred taxes included in shareholders' equity. At December 31, 2005, the net unrealized gain on fixed maturities, net of deferred taxes, amounted to \$6.4 million, compared to \$22.9 million at December 31, 2004.



* As rated by Standard & Poor's or Moody's Investor's Service, Inc.

Equity securities

The Company's equity securities consist of common stock and nonredeemable preferred stock. Investment characteristics of common stock and nonredeemable preferred stock differ substantially from one another. The Company's nonredeemable preferred stock portfolio provides a source of highly predictable current income that is competitive with investment-grade bonds. Nonredeemable preferred stocks generally provide for fixed rates of return that, while not guaranteed, resemble fixed income securities and are paid before common stock dividends. Common stock provides capital appreciation potential within the portfolio. Common stock investments inherently provide no assurance of producing income because dividends are not guaranteed.



(1) Common stock (2) Nonredeemable preferred stock

The Company's equity securities are carried on the Consolidated Statements of Financial Position at market value. At December 31, 2005, the net unrealized gain on equity securities, net of deferred taxes, amounted to \$11.0 million, compared to \$17.4 million at December 31, 2004.

Limited partnership investments

The Company's limited partnership investments include U.S. and foreign private equity, real estate and mezzanine debt investments. During 2005, limited partnership investments increased \$22.7 million to \$153.2 million. Mezzanine debt and real estate limited partnerships, which comprise 57.9% of the total limited partnerships, produce a more predictable earnings stream while private equity limited partnerships, which comprise 42.1% of the total limited partnerships, tend to provide a less predictable earnings stream but the potential for greater long-term returns.

Liabilities

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.

Loss and loss adjustment expense reserves are presented on the Company's Statements of Financial Position on a gross of reinsurance basis for EIC, EINY and EIPC. The property/casualty insurance subsidiaries of the Company wrote about 17% of the direct property/casualty premiums of the Property and Casualty Group in 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:

(dollars in thousands)	As of December 31	
	2005	2004
Gross reserve liability		
Personal:		
Private passenger auto	\$ 413,118	\$400,609
Catastrophic injury	123,875	86,239
Homeowners	23,995	22,798
Other personal	6,978	6,322
Commercial:		
Workers' compensation	231,858	216,808
Commercial auto	83,688	78,646
Commercial multi-peril	65,891	63,118
Catastrophic injury	468	454
Other commercial	15,894	15,288
Reinsurance	53,694	52,752
Gross reserves	1,019,459	943,034
Reinsurance recoverables*	828,447	765,914
Net reserve liability	\$ 191,012	\$177,120

* Includes \$827.1 million in 2005 and \$765.0 million in 2004 due from the Exchange.

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 combination. 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 lines is from \$188.5 million to \$443.3 million for the Property and Casualty Group. The reserve carried by the Property and Casualty Group, which is management's best estimate of this liability at this time, was \$262.8 million at December 31, 2005, which is net of \$127.1 million of anticipated reinsurance recoverables. The reserve carried by the Property and Casualty Group at December 31, 2004, was \$200.0 million, which was net of \$95.8 million of anticipated reinsurance recoverables. The majority of the increase during 2005

was the result of higher cost expectations of future attendant care services as a result of the settlement of class action litigation involving attendant care liabilities. The Company's property/casualty subsidiaries share of the net automobile catastrophic injury liability reserve is \$14.5 million at December 31, 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.

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 \$2.6 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's share of the automobile catastrophic injury claim payments made was \$.6 million and \$.4 million during 2005 and 2004, respectively.

During the third quarter of 2005, the Property and Casualty Group re-evaluated its estimate of assumed loss and loss adjustment expense reserves estimated for the September 11, 2001, event. Based on that assessment, the Property and Casualty Group reduced its World Trade Center reserves by \$42 million as of September 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. As of the third quarter 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, and a thorough review of all contracts, supported the reduction in the World Trade Center reserve. 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. At December 2005, the Property and Casualty Group's estimated total loss exposure includes \$29 million related to the coverage disputes with respect to the number of events.

Impact of inflation

Property/casualty insurance premiums are established before losses and loss adjustment expenses, and the extent to which inflation may impact such expenses are known. Consequently, in establishing premium rates, the Company attempts to anticipate the potential impact of inflation.

Quantitative and qualitative disclosures about market risk

The Company is exposed to potential loss from various market risks, including changes in interest rates, equity prices, foreign currency exchange rate risk and credit risk.

Interest rate risk

The Company's exposure to interest rates is concentrated in the fixed maturities portfolio. The fixed maturities portfolio comprises 69.6% of invested assets at December 31, 2005 and 2004. The Company does not hedge its exposure to interest rate risk since it has the capacity and intention to hold the fixed maturity positions until maturity. The Company calculates the duration and convexity of the 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.

Principal cash flows and related weighted-average interest rates by expected maturity dates for financial instruments sensitive to interest rates are as follows:

(dollars in thousands)	As of December 31, 2005	
	Principal cash flows	Weighted average interest rate
Fixed maturities, including note from EFL:		
2006	\$ 83,351	5.2%
2007	61,664	5.2
2008	96,083	4.9
2009	96,015	4.8
2010	81,885	4.8
Thereafter	554,173	5.8
Total	\$973,171	
Market value	\$997,210	

(dollars in thousands)	As of December 31, 2004	
	Principal cash flows	Weighted average interest rate
Fixed maturities, including notes from EFL:		
2005	\$ 59,294	5.9%
2006	76,236	4.5
2007	79,242	4.6
2008	100,742	4.7
2009	100,834	4.9
Thereafter	557,643	5.9
Total	\$ 973,991	
Market value	\$1,014,512	

Actual cash flows may differ from those stated as a result of calls, prepayments or defaults. The Company received payment from EFL during December 2005 for a \$15 million surplus note, due for repayment, resulting in only the remaining \$25 million surplus note with EFL included in the principal cash flows as of December 31, 2005.

A sensitivity analysis is used to measure the potential loss in future earnings, fair values or cash flows of market-sensitive instruments resulting from one or more selected hypothetical changes in interest rates and other market rates or prices over a selected period. In the Company's sensitivity analysis model, a hypothetical change in market rates is selected that is expected to reflect reasonably possible changes in those rates. The following pro forma information is presented assuming a 100-basis point increase in interest rates at December 31 of each year and reflects the estimated effect on the fair value of the Company's fixed maturity investment portfolio. The Company used the modified duration of its fixed maturity investment portfolio to model the pro forma effect of a change in interest rates at December 31, 2005 and 2004.

Fixed maturities interest-rate sensitivity analysis

100-basis point rise in interest rates

(dollars in thousands)	As of December 31	
	2005	2004
Current market value	\$997,210	\$1,014,512
Change in market value (1)	(35,325)	(37,251)
Pro forma market value	\$961,885	\$ 977,261
Modified duration (2)	3.9	4.2

- (1) The change in market value is calculated by taking the negative of the product obtained by multiplying (i) modified duration by (ii) change in interest rates by (iii) market value of the portfolio.
- (2) Modified duration is a measure of a portfolio's sensitivity to changes in interest rates. It is interpreted as the approximate percentage change in the market value of a portfolio for a certain basis point change in interest rates.

Equity price risk

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 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 small- 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 they invested. The limited partnership portfolio comprises 11% of total invested assets at December 31, 2005. These investments consist primarily of equity and mezzanine investments in small, medium and large companies and in real estate. The Company achieves diversification within the limited partnership portfolio by investing in 88 partnerships that have 1,501 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 or geographic area. The Company performs extensive research prior to investment in these partnerships.

Foreign currency risk

The Company has foreign currency risk in the limited partnership and common equity portfolio. The limited partnership portfolio includes approximately \$21.6 million of partnerships that are denominated in Euros, \$2.6 million denominated in Japanese yen and \$4.0 million denominated in British pounds sterling (pounds). The Company also is exposed to foreign currency risk through commitments to Euro-, yen- and pound-denominated partnerships of approximately \$25.4 million, \$14.1 million and \$1.2 million, respectively. The foreign currency risk in the partnerships and the commitments due, denominated in Euros, yens and pounds, are partially offsetting. This risk is not hedged, although the Euro, yen and pound rates are monitored daily and the Company may decide to hedge all or some of the partnership-related foreign currency risk at some time in the future. The Company has additional foreign currency exposure through common stock investments of \$13.6 million in seven different currencies which are not hedged.

Credit risk

The Company's objective is to earn competitive returns by investing in a diversified portfolio of securities. The Company's portfolios of fixed maturity securities, nonredeemable preferred stock, mortgage loans and, to a lesser extent, short-term investments are subject to credit risk. This risk is defined as the potential loss in market value resulting from adverse changes in the borrower's ability to repay the debt. The Company manages this risk by performing upfront underwriting analysis and ongoing reviews of credit quality by position and for the fixed maturity portfolio in total. The Company does not hedge the credit risk inherent in its fixed maturity investments.

The Company is also exposed to a concentration of credit risk with the Exchange. See the section, "Transactions and Agreements with Related Parties," for further discussion of this risk.

Liquidity and capital resources

Liquidity

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 management operations, the net cash flow from Erie Insurance Company's and Erie Insurance Company of New York's 5.5% participation in the underwriting results of the reinsurance pool with the Exchange, and investment income from affiliated and nonaffiliated investments.

The Company generates sufficient net positive cash flow from its operations to fund its commitments and build its investment portfolio, thereby increasing future investment returns. The Company 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 for the years ended December 31, 2005, 2004 and 2003, were \$301.1 million, \$257.7 million and \$246.6 million, respectively.

With respect to the management fee, funds are received generally 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 at December 31 from the Exchange were \$194.8 million and \$207.2 million in 2005 and 2004, respectively. A receivable from EFL for cash settlements totaled \$3.9 million at December 31, 2005, compared to \$4.3 million at 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 rose 6.7% to \$952.7 million from \$893.1 million at December 31, 2005 and 2004, respectively. This increase is the result of corresponding increases in direct loss reserves, loss adjustment expense reserves of the Company's property/casualty insurance subsidiaries that are ceded to the Exchange under the intercompany pooling agreement. Total receivables from the Exchange represented 12.7% of the Exchange's assets at December 31, 2005, and 13.3% at December 31, 2004.

Cash flows provided by operating activities were positively impacted in 2005 by the reduction in certain commercial commission rates, which became effective January 1, 2005. Commissions paid during 2005 decreased \$9.2 million compared to 2004. Salaries and wages paid during the year increased due to a 2.9% increase in staffing levels, as well as for external contract labor costs. Pension funding and employee benefits paid decreased as there was no contribution made to the employee pension plan in 2005 compared to a \$7.7 million contribution in 2004. The Company has generally contributed the maximum deductible amount to its pension plan for employees under IRS Code Section 404(a)(1). In 2005, the maximum contribution was zero, therefore no contribution could be made by the Company to the plan. The Company expects to make a \$7.5 million contribution to its pension plan in 2006. Payments for agent bonuses increased in 2005 as a result of changes in the agent bonus program. The Company's expected agent bonus payout in 2006 related to the period ended in 2005 is \$70.2 million.

Cash used in investing activities in 2005 reflects an increase in limited partnership activity. The number of limited partnership investments grew to 88 partnerships at December 2005 from 72 at December 2004. During 2004, sales of equity securities were higher as the Company liquidated certain of its internally managed equity securities to allow external managers to manage the portfolio. This process was completed during 2005. Overall, cash used in investing activities is lower than 2004, as some available funds were used to repurchase shares of the Company's outstanding common stock during the year.

Proceeds from the sales, calls and maturities of fixed maturity positions totaled \$348.0 million, \$263.4 million and \$359.0 million in 2005, 2004 and 2003, respectively. The higher sales transactions of fixed maturities in 2005 was related to some repositioning of the investment portfolio from taxable corporate debt securities to tax-exempt municipal bonds.

Dividends paid to shareholders totaled \$81.9 million, \$55.1 million and \$49.0 million in 2005, 2004 and 2003, respectively. As part of its capital management activities in 2004, the Company increased its Class A shareholder quarterly dividend for 2005 by 51% to \$.325 per share from \$.215 per share. The Class B shareholder quarterly dividend was increased from \$32.25 to \$48.75, also a 51% increase. This change in dividends increased the Company's 2005 payout by \$26.8 million from the prior dividend level. This action was approved by the Company's Board of Directors in December 2004 considering, among other factors, the Company's strong financial results, capital levels and return on capital targets. Based on the share market price at the time of the decision, the new dividend results in a dividend yield of about 2.5%. 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 subsidiaries to the Company. The Company increased the 2006 dividends by 10.8%.

The Company also continues to use its capital to repurchase outstanding shares under its current three-year, \$250 million repurchase plan. The plan allows the Company to repurchase up to \$250 million of its Class A common stock from January 1, 2004, through December 31, 2006. In 2005, 1.9 million shares were repurchased at a total cost of \$99.0 million. The Company intends to be active in repurchasing shares in 2006; however, the Company is unable to estimate the number of shares that will be repurchased during a specified period. Approximately \$97.0 million of outstanding repurchase authority remains under the plan at December 31, 2005.

On February 21, 2006, the Company's Board of Directors approved a continuation of the current stock repurchase program allowing the Company to repurchase an additional \$250 million of its Class A common stock through December 31, 2009.

Contractual obligations

Cash outflows are variable because the fluctuations in settlement dates for claims 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. Based on a historical 15-year average, 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. Losses that are paid out after that five-year period are comprised of such long-tail lines as workers' compensation and auto bodily injury. Such payments are reduced by recoveries under the intercompany reinsurance pooling agreement.

The Company has certain obligations and commitments to make future payments under various contracts. As of December 31, 2005, the aggregate obligations were:

(dollars in thousands)	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	Thereafter
Fixed obligations:					
Limited partnership commitments	\$ 243,186	\$ 42,947	\$ 74,385	\$112,582	\$ 13,272
Other commitments	40,532	18,001	19,556	2,537	438
Operating leases—vehicles	17,353	5,313	9,118	2,922	0
Operating leases—real estate	10,203	3,287	4,907	2,009	0
Operating leases—computer	6,011	3,145	2,866	0	0
Financing arrangements	860	385	475	0	0
Fixed contractual obligations	318,145	73,078	111,307	120,050	13,710
Gross loss and loss expense reserves	1,019,459	509,730	299,721	99,907	110,101
Gross contractual obligations	\$1,337,604	\$582,808	\$411,028	\$219,957	\$123,811

Gross contractual obligations net of estimated reinsurance recoverables and reimbursements from affiliates are as follows:

(dollars in thousands)	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	Thereafter
Gross contractual obligations	\$1,337,604	\$582,808	\$411,028	\$219,957	\$123,811
Estimated reinsurance recoverables	827,917	413,959	243,408	81,136	89,414
Estimated reimbursements from affiliates	54,983	21,973	27,105	5,565	340
Net contractual obligations	\$ 454,704	\$146,876	\$140,515	\$133,256	\$ 34,057

The limited partnership commitments included in the table above will be funded as required for capital contributions at any time prior to the agreement expiration date. The commitment amounts are presented using the expiration date as the factor by which to age when the amounts are due. At December 31, 2005, the total commitment to fund limited partnerships that invest in private equity securities is \$86.5 million, real estate activities \$108.7 million and mezzanine debt of \$48.0 million. The Company expects to have sufficient cash flows from operations and from positive cash flows generated from existing limited partnership investments to meet these partnership commitments.

The other commitments include various agreements for service, including such things as computer software, telephones, and maintenance. The Company has operating leases for 16 of its 23 field offices that are operated in the states in which the Property and Casualty Group does business and three operating leases for warehousing facilities and remote office locations. One of the branch locations is leased from EFL. The computer operating leases are for computer equipment and were entered into in conjunction with the Company's recent technology initiatives. The total of these obligations, including the financing arrangement, is \$75.0 million, of which \$55.0 million will be reimbursed to the Company from its affiliates.

Not included in the table above are the obligations for the Company's unfunded benefit plans, including the Supplemental Employee Retirement Plan (SERP) for its executive and senior management and the directors' retirement plan. The recorded accumulated benefit

obligations for these plans at December 31, 2005, is \$17.2 million. The Company expects to have sufficient cash flows from operations to meet the future benefit payments as they become due. See also Footnote 8 in the notes to the Consolidated Financial Statements.

Off-balance sheet arrangements

Off-balance sheet arrangements include those with unconsolidated entities that may have a material current or future effect on the financial condition or results of operations of the Company, including material variable interests in unconsolidated entities that conduct certain activities. There are no off-balance sheet obligations related to the variable interest the Company has in the Exchange. Any liabilities between the Exchange and the Company are recorded in the Consolidated Statements of Financial Position of the Company. The Company has no other material off-balance sheet obligations or guarantees.

Financial ratings

The property/casualty insurers of the Company are rated by rating agencies that provide insurance consumers with meaningful information on the financial strength of insurance entities. Higher ratings generally indicate financial stability and a strong ability to pay claims. The ratings are generally based upon factors relevant to policyholders and are not directed toward return to investors. The insurers of the Erie Insurance Group are currently rated by A.M. Best Company as follows:

Erie Insurance Exchange	A+
Erie Insurance Company	A+
Erie Insurance Property and Casualty Company	A+

Erie Insurance Company of New York
 Flagship City Insurance
 Erie Family Life Insurance

A+
 A+
 A

- the Company's Board ratifies other significant intercompany activity, for example any new cost-sharing agreements.

According to A.M. Best, a Superior rating (A+) is assigned to those companies that, in A.M. Best's opinion, have achieved superior overall performance when compared to the standards established by A.M. Best and have a superior ability to meet their obligations to policyholders over the long term. The A (Excellent) rating of EFL continues to affirm its strong financial position, indicating that EFL has an excellent ability to meet its ongoing obligations to policyholders. By virtue of its affiliation with the Property and Casualty Group, EFL is typically rated one financial strength rating lower than the property/casualty companies by A.M. Best Company. The insurers of the Erie Insurance Group are also rated by Standard & Poor's, but this rating is based solely on public information. Standard & Poor's rates these insurers Api, "strong." Financial strength ratings continue to be an important factor in evaluating the competitive position of insurance companies.

Regulatory risk-based capital

The standard set by the National Association of Insurance Commissioners (NAIC) for measuring the solvency of insurance companies, referred to as Risk-Based Capital (RBC), is a method of measuring the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The RBC formula is used by state insurance regulators as an early warning tool to identify, for the purpose of initiating regulatory action, insurance companies that potentially are inadequately capitalized. In addition, the formula defines minimum capital standards that will supplement the current system of low fixed minimum capital and surplus requirements on a state-by-state basis. At December 31, 2005, the companies comprising the Property and Casualty Group all had RBC levels substantially in excess of levels that would require regulatory action.

Transactions and agreements with related parties

Board oversight

The Company's Board of Directors (Board) has broad oversight responsibility over intercompany relationships within Erie Insurance Group. As a consequence, the Board must make decisions or take actions that are not solely in the interest of the Company's shareholders, but balance these interests in these separate fiduciary duties such as:

- the Company's Board sets the management fee rate paid by the Exchange to the Company,
- the Company's Board of Directors determines the participation percentages of the intercompany pooling agreement, and
- the Company's Board approves the annual shareholders' dividend, and

If the Board determines that the Exchange's surplus requires strengthening, it could decide to reduce the management fee rate, change the Company's property/ casualty insurance subsidiaries' intercompany pooling participation percentages or reduce the shareholder dividends level in any given year. The Board could also decide, under such circumstances, that the Company should provide capital to the Exchange, although there is no legal obligation to do so. The Board, however, recognizes that the long-term financial strength of the Exchange enures to the benefit of the Company.

The Board of the Company is also the Board for EFL.

Intercompany agreements

Pooling: Members of the Property and Casualty Group participate in an intercompany reinsurance pooling agreement. Under the pooling agreement, all insurance business of the Property and Casualty Group is pooled in the Exchange. The Erie Insurance Company and Erie Insurance Company of New York share in the underwriting results of the reinsurance pool through retrocession. Since 1995, the Board of Directors has set the allocation of the pooled underwriting results at 5.0% participation for Erie Insurance Company, 0.5% participation for Erie Insurance Company of New York and 94.5% participation for the Exchange.

Excess-of-loss reinsurance: From 1997 through December 2005, the Company's property/casualty insurance subsidiaries had in effect an all-lines aggregate excess-of-loss reinsurance agreement with the Exchange which was excluded from the intercompany pooling agreement. The excess-of-loss reinsurance agreement limited the amount of sustained ultimate net losses in any applicable accident year for the Erie Insurance Company and Erie Insurance Company of New York. Company management set the terms for this excess-of-loss reinsurance agreement, obtaining third party quotes in setting the premium, determining the loss level at which the excess agreement becomes effective and the portion of ultimate net loss to be retained by each of the companies. The Property and Casualty Group did not renew this coverage for the 2006 accident year.

Technology development: The Erie Insurance Group undertook a program of information technology initiatives to develop eCommerce capabilities which began in 2001. In connection with this program, the Company and the Property and Casualty Group entered into a Cost-Sharing Agreement for Information Technology Development ("Agreement"). The Agreement describes how member companies of the Erie Insurance Group share certain costs to be incurred for the development and maintenance of new Internet-enabled property/casualty agency interface, policy administration and customer relationship management systems. Costs are shared under the Agreement in the same proportion as the underwriting results of the Property and Casualty Group are shared. The Agreement confers ownership of the certain systems being developed under the Agreement to the Exchange

and grants the Company's property/casualty insurance subsidiaries a perpetual right to use the system. The financial terms and conditions of the Company's eventual use of the system have not, as yet, been determined, and could have an impact on the Company's future earnings.

Leased property: The Exchange leases certain office facilities to the Company on a year-to-year basis. Rents are determined considering returns on invested capital and building operating and overhead costs. Rental costs of shared facilities are allocated based on square footage occupied.

Intercompany cost allocation

Company management makes judgments affecting the financial condition of the Erie Insurance Group companies, including the allocation of shared costs between the companies. Management must determine that allocations are consistently made in accordance with intercompany agreements, the attorney-in-fact agreements with the policyholders of the Exchange and applicable insurance laws and regulations.

While allocation of costs under these various agreements requires management judgment and interpretation, such allocations are performed using a consistent methodology, which in management's opinion, adheres to the terms and intentions of the underlying agreements.

Intercompany receivables

(dollars in thousands)

	2005	Percentage of total Company assets	2004	Percentage of total Company assets
Reinsurance recoverable from and ceded unearned premiums to the Exchange	\$ 952,705	30.7%	\$ 893,137	29.9%
Other receivables from the Exchange and affiliates (management fees, costs & reimbursements)	198,714	6.4	211,488	7.1
Notes receivable from EFL	25,000	.8	40,000	1.3
Total intercompany receivables	\$1,176,419	37.9%	\$1,144,625	38.3%

The Company has significant receivables from the Exchange that result in a concentration of credit risk. These receivables include unpaid losses and unearned premiums ceded to the Exchange under the intercompany pooling agreement and from management services performed by the Company for the Exchange. Credit risks related to the receivables from the Exchange are evaluated periodically by Company management. Reinsurance contracts do not relieve the Company from its primary obligations to policyholders if the Exchange were unable to satisfy

its obligation. The Company collects its reinsurance recoverable amount generally within 30 days of actual settlement of losses.

The Company also has a receivable from the Exchange for management fees and costs paid by the Company on behalf of the Exchange. The Company also pays certain costs for, and is reimbursed by, EFL. Since the Company's inception, it has collected these amounts due from the Exchange and EFL in a timely manner (generally within 120 days).

The Company has a surplus note for \$25 million with EFL that is payable on demand on or after December 31, 2018. A second surplus note for \$15 million was repaid by EFL to the Company on December 30, 2005. EFL paid interest to the Company on the surplus notes totaling \$2.7 million in both 2005 and 2004 and \$1.6 million during 2003. No other interest is charged or received on these intercompany balances due to the timely settlement terms and nature of the items.

Factors that may affect future results

Financial condition of the Exchange

The Company has a direct interest in the financial condition of the Exchange because management fee revenues are based on the direct written premiums of the Exchange and the other members of the Property and Casualty Group. Additionally, the Company participates in the underwriting results of the Exchange through the pooling arrangement in which the Company's insurance subsidiaries have 5.5% participation. A concentration of credit risk exists related to the unsecured receivables due from the Exchange for certain fees, costs and reimbursements.

To the extent that the Exchange incurs underwriting losses or investment losses resulting from declines in the value of its marketable securities, the Exchange's policyholders' surplus would be adversely affected. If the surplus of the Exchange were to decline significantly from its current level, the Property and Casualty Group could find it more difficult to retain its existing business and attract new business. A decline in the business of the Property and Casualty Group would have an adverse effect on the amount of the management fees the Company receives and the underwriting results of the Property and Casualty Group in which the Company has 5.5% participation. In addition, a decline in the surplus of the Exchange from its current level would make it more likely that the management fee rate would be reduced.

Insurance premium rate actions

The changes in premiums written attributable to rate changes of the Property and Casualty Group directly affects underwriting profitability of the Property and Casualty Group, the Exchange and the Company. In 2005, the industry trend has been for insurers to maintain or reduce rate levels. Rate reductions have been implemented and additional reductions are being sought by the Property and Casualty Group in 2006 to recognize improved underwriting results and to be more price competitive. 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 2006, 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. Management estimates that pricing actions approved, contemplated or filing and awaiting approval through 2005, could reduce premium for the Property and Casualty Group by \$96.7 million in 2006.

The Property and Casualty Group continues refining its pricing segmentation model 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 for policyholders with varying degrees of risk. Insurance scoring is among the most significant risk factors the Company has recently incorporated into the rating plan. Refining pricing segmentation should enable the Company to provide more competitive rates to policyholders with varying risk characteristics, as risks can be more accurately priced over time.

The continued introduction of new pricing variables could impact retention of existing policyholders and could affect the Property and Casualty Group's ability to attract new policyholders.

Policy growth

Premium levels attributable to growth in policies in force of the Property and Casualty Group directly affects the profitability of management operations of the Company. The recent focus on underwriting discipline and implementation of the new rate classification plan through the pricing segmentation model have resulted in a reduction in new policy sales and policy retention ratios, as expected. The continued growth of the policy base 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.

Premium service charges

Effective for policies renewing on or after January 1, 2006, paid in installments, the service charge assessed policyholders will increase from \$3 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 using the installment plans and the direct debit program were to remain the same, premium service charges would increase approximately \$7.5 million in 2006, and \$13 million on an annual basis once fully realized in subsequent years.

Catastrophe losses

The Property and Casualty Group conducts business in 11 states and the District of Columbia, primarily in the mid-Atlantic, midwestern and southeastern portions of the United States. A substantial portion of the business is private passenger and commercial automobile, homeowners and workers' compensation insurance in Ohio, Maryland, Virginia and, particularly, Pennsylvania. As a result, a single catastrophe occurrence or destructive weather pattern could materially adversely affect the results of operations and surplus position of the members of the Property and Casualty Group. Common catastrophe events include severe winter storms, hurricanes, earthquakes, tornadoes, wind and hail storms. In its homeowners line of insurance, the Property and Casualty Group is particularly exposed to an Atlantic hurricane, which might strike the states of North Carolina, Maryland, Virginia and Pennsylvania. The Property and Casualty Group maintains a property catastrophe reinsurance treaty to mitigate the future potential catastrophe loss exposure. The property catastrophe reinsurance coverage in 2005 provided coverage of up to 95% of a loss of \$400 million in excess of the Property and Casualty Group's loss retention of \$200 million per occurrence. This agreement was renewed for 2006 under the terms of coverage of up to 95% of a loss of \$400 million in excess of the Property and Casualty Group's loss retention of \$300 million per occurrence.

Incurred But Not Reported (IBNR) losses

The Property and Casualty Group is exposed to new claims on previously closed files and to larger than historical settlements on pending and unreported claims. The Company is exposed to increased losses by virtue of its 5.5% participation in the intercompany reinsurance pooling agreement with the Exchange. The Company exercises professional diligence to establish reserves at the end of each period that are fully reflective of the ultimate value of all claims incurred. However, these reserves are, by their nature, only estimates and cannot be established with absolute certainty.

The product coverage that has the greatest potential for variation is the pre-1986 automobile catastrophic injury liability reserve, as automobile no-fault law in Pennsylvania at that time provided for unlimited medical benefits. The estimation of ultimate liabilities for these claims is subject to significant judgment due to variations in claimant health and mortality over time. Actual experience, different than that assumed, could have a significant impact on the reserve estimates.

Information technology development

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

ERIEConnection®, the central policy administration and agent interface application under development in the eCommerce program, has not progressed as originally expected. Development costs have substantially exceeded estimates made in 2002. Target delivery dates established in 2002 have generally not been met. While functional as a personal lines rating and policy administration system, the agency interface component of ERIEConnection® 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 for alternative approaches 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. Through December 31, 2005, the total costs incurred for the development of the ERIEConnection® application amounted to approximately \$100 million. This amount includes approximately \$10 million related to the development of an alternative agent interface approach which has been abandoned.

During 2005, all independent agencies were migrated to a common, Windows XP-based agency interface platform called DSpro®. 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 Windows XP platform does not interface to ERIEConnection®, this migration mitigated the risk of business interruption posed by the DOS system and gives the Company the time necessary to thoroughly research and plan for its future interface development and rollout strategy using ERIEConnection®. In the first quarter 2006, the Company is implementing broadband connectivity with most agencies through DSpro®.

Since the substantial majority of the costs for program development are borne by the Exchange, the Company's operating results are not expected to be materially impacted in the near term by ERIEConnection® development decisions. However, the financial terms and conditions of the Company's eventual use of the ERIEConnection® system have not, as yet, been determined, and could have an impact on the Company's future earnings. In addition, the Property and Casualty Group's ability to attract new policyholders, which bears significantly on the Company's management fee revenue, is directly influenced by the Company's independent agent decisions to place business with the Property and Casualty Group. To the extent that technological capabilities of alternative carriers represented by the Company's agents are greater than those of the Property and Casualty Group, the Property and Casualty Group's sales could be adversely affected, thereby reducing the Company's management fee.

It is also possible that the development of the ERIEConnection® system could be abandoned, which would require a charge to the Company's earnings of \$2.0 million.

Terrorism

The Terrorism Risk Insurance Act of 2002, which established a federal program for commercial/property casualty losses resulting from foreign acts of terrorism, originally scheduled to expire on December 31, 2005, was extended through December 31, 2007. The Act continues to require commercial insurers to make terrorism coverage available for commercial property/

casualty losses, including workers' compensation. Commercial auto, burglary/theft, surety, professional liability and farmowners multiple-peril are no longer included in the program. Industry deductible levels were increased and an "event trigger" was added providing that in the case of a certified act of terrorism occurring after March 31, 2006, no federal compensation shall be paid by the Secretary of Treasury unless aggregate industry losses exceed \$50 million for the rest of 2006 and \$100 million in 2007. The federal government will pay 90% of covered terrorism losses above insurer retention levels in 2006 and 85% of covered terrorism losses in 2007.

The Erie Insurance Group is continuing to take the steps necessary to comply with the Act by providing notices to commercial policyholders disclosing the premium, if any, attributable to coverage for acts of terrorism, as defined in the Act, and disclosing federal participation in payment of terrorism losses. Terrorism coverage is not excluded under the majority of the Property and Casualty Group commercial property/ casualty policies. Other than workers' compensation, which incur charges consistent with state law, premium charges for terrorism coverage are currently applied only for a small number of new and renewal commercial policies where deemed appropriate based upon individual risk factors and characteristics. Appropriate disclosure notices are provided in accordance with the Act.

Personal lines are not included under the protection of the Act and state regulators have not approved exclusions for acts of terrorism on personal lines policies. The Property and Casualty Group is exposed to terrorism losses for personal lines. While the Property and Casualty Group is exposed to terrorism losses in commercial lines and workers' compensation, these lines are afforded a limited backstop above insurer deductibles for foreign acts of terrorism under the federal program. The Property and Casualty Group has no personal lines terrorist coverage in place. The Property and Casualty Group could incur large losses if future terrorism attacks occur.

"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 expressions. These 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.

Selected Segment & State Information

F O C U S 2 0 0 5

The direct written premiums of the Property and Casualty Group have a direct impact on the Company's management fee revenue and, consequently, the Company's management operations. Below is a summary of direct written premiums of the Property and Casualty Group by state and line of business.

	Years ended December 31		
	2005	2004	2003
Premiums written as a percent of total by state:			
Pennsylvania	45.9%	46.3%	46.6%
Maryland	12.6	12.4	12.0
Virginia	8.7	8.3	8.2
Ohio	8.2	8.6	8.8
North Carolina	6.0	5.8	5.9
West Virginia	4.8	4.8	4.7
Indiana	4.1	4.3	4.4
New York	3.9	3.8	3.8
Illinois	2.4	2.5	2.5
Tennessee	2.0	1.9	1.9
Wisconsin	1.0	0.9	0.8
District of Columbia	0.4	0.4	0.4
Total direct premiums written	100.0%	100.0%	100.0%
Premiums written by line of business:			
Personal			
Automobile	48.6%	49.7%	51.1%
Homeowners	18.6	18.4	16.8
Other	2.5	2.4	2.3
Total personal	69.7%	70.5%	70.2%
Commercial			
Commercial multi-peril	11.3%	10.9%	10.9%
Workers' compensation	8.8	8.6	8.8
Automobile	8.3	8.2	8.4
Other	1.9	1.8	1.7
Total commercial	30.3%	29.5%	29.8%

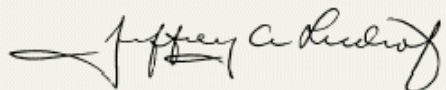
The growth rate of policies in force and policy retention trends can impact the Company's management and insurance operating segments. Below is a summary of each by line of business for the Property and Casualty Group business.

	Years ended December 31		
	2005	2004	2003
<i>(amounts in thousands)</i>			
Policies in force:			
Personal lines	3,281	3,297	3,273
Commercial lines	479	474	470
Total policies in force	3,760	3,771	3,743
Policy retention percentages:			
Personal policy retention percentages	89.1%	88.8%	90.5%
Commercial policy retention percentages	85.2	85.1	87.3
Total policy retention percentages	88.6	88.4	90.2

Report of Management on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting of Erie Indemnity Company, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of Erie Indemnity Company's internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control—Integrated Framework, management has concluded that Erie Indemnity Company's internal control over financial reporting was effective as of December 31, 2005.

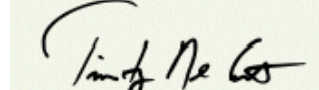
Management's assessment of the effectiveness of Erie Indemnity Company's internal control over financial reporting as of December 31, 2005, has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.



Jeffrey A. Ludrof
President and
Chief Executive Officer
February 16, 2006



Philip A. Garcia
Executive Vice President and
Chief Financial Officer
February 16, 2006



Timothy G. NeCastro
Senior Vice President and
Controller
February 16, 2006

Report of Independent Registered Public Accounting Firm on Effectiveness of Internal Control Over Financial Reporting

To the Board of Directors and Shareholders
Erie Indemnity Company
Erie, Pennsylvania

We have audited management's assessment, included in the accompanying Report of Management on Internal Control Over Financial Reporting, that Erie Indemnity Company maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Erie Indemnity Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained

in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

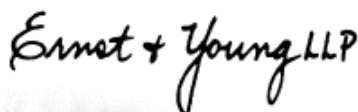
A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely

detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Erie Indemnity Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Erie Indemnity Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial position of Erie Indemnity Company as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005, of Erie Indemnity Company and our report dated February 16, 2006, (except Note 11, as to which the date is February 21, 2006) expressed an unqualified opinion thereon.



Cleveland, Ohio
February 16, 2006

Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements

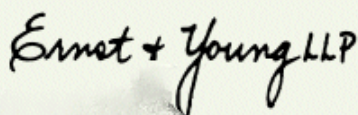
To the Board of Directors and Shareholders
Erie Indemnity Company
Erie, Pennsylvania

We have audited the accompanying consolidated statements of financial position of Erie Indemnity Company and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Erie Indemnity Company and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the Standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Erie Indemnity Company's internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control —Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 16, 2006, expressed an unqualified opinion thereon.



Cleveland, Ohio
February 16, 2006,
except for Note 11, as to which the date is
February 21, 2006,

Consolidated Statements of Operations

(dollars in thousands, except per share data)	Years ended December 31		
	2005	2004	2003
Operating revenue			
Management fee revenue, net	\$ 888,558	\$ 893,087	\$ 830,069
Premiums earned	215,824	208,202	191,592
Service agreement revenue	20,568	21,855	27,127
Total operating revenue	1,124,950	1,123,144	1,048,788
Operating expenses			
Cost of management operations	710,237	684,491	616,382
Losses and loss adjustment expenses incurred	140,385	153,220	152,984
Policy acquisition and other underwriting expenses	50,109	47,205	51,112
Total operating expenses	900,731	884,916	820,478
Investment income—unaffiliated			
Investment income, net of expenses	61,555	60,988	58,298
Net realized gains on investments	15,620	18,476	10,445
Equity in earnings (losses) of limited partnerships	38,062	8,655	(2,000)
Total investment income—unaffiliated	115,237	88,119	66,743
Income before income taxes and equity in earnings of Erie Family Life Insurance	339,456	326,347	295,053
Provision for income taxes	(111,733)	(105,140)	(102,237)
Equity in earnings of Erie Family Life Insurance, net of tax	3,381	5,206	6,909
Net income	\$ 231,104	\$ 226,413	\$ 199,725
Net income per share—basic			
Class A common stock	\$ 3.69	\$ 3.54	\$ 3.09
Class B common stock	\$ 558.34	\$ 539.88	\$ 474.19
Net income per share—diluted	\$ 3.34	\$ 3.21	\$ 2.81
Weighted average shares outstanding			
Basic :			
Class A common stock	62,392,860	63,508,873	64,075,506
Class B common stock	2,843	2,877	2,884
Diluted shares	69,293,649	70,492,292	71,094,167

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Financial Position

(dollars in thousands, except per share data)

	As of December 31	
	2005	2004
Assets		
Investments		
Fixed maturities at fair value (amortized cost of \$962,320 and \$939,280, respectively)	\$ 972,210	\$ 974,512
Equity securities at fair value (cost of \$249,440 and \$175,860, respectively)	266,334	202,694
Limited partnerships (cost of \$141,405 and \$116,097, respectively)	153,159	130,464
Real estate mortgage loans	4,885	5,044
Total investments	1,396,588	1,312,714
Cash and cash equivalents	31,666	50,061
Accrued investment income	13,131	12,480
Premiums receivable from policyholders	267,632	275,721
Federal income taxes recoverable	15,170	3,331
Reinsurance recoverable from Erie Insurance Exchange on unpaid losses	827,126	764,950
Ceded unearned premiums to Erie Insurance Exchange	125,579	128,187
Notes receivable from Erie Family Life Insurance	25,000	40,000
Other receivables from Erie Insurance Exchange and affiliates	198,714	211,488
Reinsurance recoverable from non-affiliates	1,321	964
Deferred policy acquisition costs	16,436	17,112
Equity in Erie Family Life Insurance	55,843	58,728
Securities lending collateral	30,831	0
Prepaid pension costs	38,720	50,860
Other assets	57,504	56,208
Total assets	\$3,101,261	\$2,982,804
Liabilities and shareholders' equity		
Liabilities		
Unpaid losses and loss adjustment expenses	\$1,019,459	\$ 943,034
Unearned premiums	454,409	472,553
Commissions payable and accrued	200,459	179,284
Securities lending collateral	30,831	0
Accounts payable and accrued expenses	34,885	33,016
Deferred executive compensation	24,447	19,069
Deferred income taxes	6,538	24,122
Dividends payable	22,172	20,612
Employee benefit obligations	29,459	24,233
Total liabilities	1,822,659	1,715,923
Shareholders' equity		
Capital stock:		
Class A common, stated value \$.0292 per share; authorized 74,996,930 shares; 67,600,800 and 67,540,800 shares issued, respectively; 61,162,682 and 62,992,841 shares outstanding, respectively	1,972	1,970
Class B common, convertible at a rate of 2,400 Class A shares for one Class B share; stated value \$70 per share; 2,833 and 2,858 shares authorized, issued and outstanding, respectively	198	200
Additional paid-in capital	7,830	7,830
Accumulated other comprehensive income	21,681	58,611
Retained earnings	1,501,798	1,354,181
Total contributed capital and retained earnings	1,533,479	1,422,792
Treasury stock, at cost, 6,438,118 and 4,547,959 shares respectively	(254,877)	(155,911)
Total shareholders' equity	1,278,602	1,266,881
Total liabilities and shareholders' equity	\$3,101,261	\$2,982,804

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(dollars in thousands)

	Years ended December 31		
	2005	2004	2003
Cash flows from operating activities			
Management fee received	\$ 891,965	\$ 882,893	\$ 813,963
Service agreement fee received	20,334	21,789	26,427
Premiums collected	214,592	189,904	193,443
Settlement of commutation received from Exchange	3,031	0	0
Net investment income received	66,274	64,268	62,370
Limited partnership distributions	71,718	37,165	21,266
Dividends received from Erie Family Life Insurance	1,799	1,799	1,717
Salaries and wages paid	(95,408)	(83,263)	(78,586)
Pension funding and employee benefits paid	(10,184)	(21,250)	(30,624)
Commissions paid to agents	(471,492)	(480,685)	(438,699)
Agents bonuses paid	(46,883)	(24,163)	(18,436)
General operating expenses paid	(85,333)	(80,211)	(70,971)
Losses and loss adjustment expenses paid	(126,314)	(133,466)	(134,365)
Other underwriting and acquisition costs paid	(8,269)	(8,908)	(11,196)
Income taxes paid	(124,749)	(108,127)	(89,692)
Net cash provided by operating activities	301,081	257,745	246,617
Cash flows from investing activities			
Purchase of investments:			
Fixed maturities	(372,979)	(363,232)	(503,859)
Equity securities	(155,141)	(135,386)	(32,860)
Limited partnerships	(75,279)	(41,352)	(36,659)
Sales/maturities of investments:			
Fixed maturity sales	232,617	140,745	207,008
Fixed maturity calls/maturities	115,422	122,661	152,001
Equity securities	95,676	124,008	52,043
Return on limited partnerships	6,164	2,396	1,848
Purchase of property and equipment	(2,003)	(2,689)	(2,658)
Net collections on agent loans	1,942	2,023	1,057
Net cash used in investing activities	(153,581)	(150,826)	(162,079)
Cash flows from financing activities			
Increase (decrease) in collateral from securities lending	30,831	(34,879)	(9,037)
Redemption of securities lending collateral	(30,831)	34,879	9,037
Dividends paid to shareholders	(81,929)	(55,120)	(49,021)
Payment of note from Erie Family Life Insurance	15,000	0	0
Issuance of note to Erie Family Life Insurance	0	0	(25,000)
Purchase of treasury stock	(98,966)	(54,051)	0
Net cash used in financing activities	(165,895)	(109,171)	(74,021)
Net (decrease) increase in cash and cash equivalents	(18,395)	(2,252)	10,517
Cash and cash equivalents at beginning of year	50,061	52,313	41,796
Cash and cash equivalents at end of year	\$ 31,666	\$ 50,061	\$ 52,313

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Shareholders' Equity

(dollars in thousands, except per share data)

	Total shareholders' equity	Comprehensive income	Retained earnings	Accumulated other comprehensive income	Class A common stock	Class B common stock	Additional paid-in capital	Treasury stock
Balance, January 1, 2003	\$ 987,372		\$ 1,040,547	\$ 38,685	\$ 1,967	\$ 203	\$ 7,830	\$ (101,860)
Comprehensive income:								
Net income	199,725	\$ 199,725	199,725					
Unrealized appreciation of investments, net of tax	27,732	27,732		27,732				
Minimum pension liability adjustment, net of tax	(15)	(15)		(15)				
Comprehensive income		<u>\$ 227,442</u>						
Conversion of Class B shares to Class A shares	—				2	(2)		
Dividends declared:								
Class A \$.785 per share	(50,304)		(50,304)					
Class B \$117.75 per share	(340)		(340)					
Balance, December 31, 2003	1,164,170		1,189,628	66,402	1,969	201	7,830	(101,860)
Comprehensive income:								
Net income	226,413	\$ 226,413	226,413					
Unrealized depreciation of investments, net of tax	(7,793)	(7,793)		(7,793)				
Minimum pension liability adjustment, net of tax	2	2		2				
Comprehensive income		<u>\$ 218,622</u>						
Purchase of treasury stock	(54,051)							(54,051)
Conversion of Class B shares to Class A shares	—				1	(1)		
Dividends declared:								
Class A \$.97 per share	(61,442)		(61,442)					
Class B \$145.50 per share	(418)		(418)					
Balance, December 31, 2004	1,266,881		1,354,181	58,611	1,970	200	7,830	(155,911)
Comprehensive income:								
Net income	231,104	\$ 231,104	231,104					
Unrealized depreciation of investments, net of tax	(36,933)	(36,933)		(36,933)				
Minimum pension liability adjustment, net of tax	3	3		3				
Comprehensive income		<u>\$ 194,174</u>						
Purchase of treasury stock	(98,966)							(98,966)
Conversion of Class B shares to Class A shares	—				2	(2)		
Dividends declared:								
Class A \$1.335 per share	(82,918)		(82,918)					
Class B \$200.25 per share	(569)		(569)					
Balance, December 31, 2005	\$ 1,278,602		\$ 1,501,798	\$ 21,681	\$ 1,972	\$ 198	\$ 7,830	\$ (254,877)

See accompanying notes to Consolidated Financial Statements.

Note 1.**Nature of business**

Erie Indemnity Company (Company), formed in 1925, is the attorney-in-fact for the subscribers of Erie Insurance Exchange (Exchange), a reciprocal insurance exchange. The Company performs certain services for the Exchange relating to the sales, underwriting and issuance of policies on behalf of the Exchange and earns a management fee for these services. The Exchange is a Pennsylvania-domiciled property/ casualty insurer rated A+ (Superior) by A.M. Best. The Exchange is the 23rd largest property/casualty insurer in the United States based on 2004 net premiums written for all lines of business. The Exchange and its wholly-owned subsidiary, Flagship City Insurance Company (Flagship) and the Company's wholly-owned subsidiaries, Erie Insurance Company (EIC), Erie Insurance Company of New York (EINY) and the Erie Insurance Property and Casualty Company (EIPC), comprise the Property and Casualty Group. The Property and Casualty Group is a regional insurance group operating in 11 midwestern, mid-Atlantic, and southeastern states and the District of Columbia. The Property and Casualty Group primarily writes personal auto insurance, which comprises 48.5% of its direct premiums. The Company also owns 21.6% of the common stock of the Erie Family Life Insurance Company (EFL), an affiliated life insurance company. The Company, together with the Property and Casualty Group and EFL, operate collectively as the Erie Insurance Group (the Group).

Note 2.**Recent accounting pronouncements**

In November 2005, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments." This FSP nullifies the requirements of measurement and recognition in paragraphs 10-18 of Emerging Issues Task Force (EITF) Issue 03-1, of the same name, carries forward the disclosure requirements included in Issue 03-1 and references existing other-than-temporary impairment guidance. This final FSP is effective for fiscal years beginning after December 15, 2005. The Company had previously adopted the disclosure requirements of EITF 03-1, which were unchanged by this final FSP. Management does not anticipate a change in policy that would significantly impact the Company's financial condition or results of operations.

The Accounting Standards Executive Committee issued Statement of Position (SOP) 05-1, "Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts," in September 2005, which is effective for fiscal years beginning after December 15,

2006, with earlier adoption encouraged. The SOP provides guidance on accounting for deferred acquisition costs on internal replacements of insurance contracts that are modifications to product features that occur by the exchange of a contract for a new contract. Insurance contracts issued by the Property and Casualty Group include nonintegrated contract features as defined in the SOP, or those that provide coverage that is underwritten and priced only for that incremental insurance coverage and do not result in reunderwriting or repricing of other components of the contract. Nonintegrated contract features do not change the existing base contract and do not require further evaluation under the SOP. This SOP has no impact on the Company's financial condition or results of operations.

In December 2004, the FASB issued Statement of Financial Accounting Standards (FAS) No. 123(R), "Share-Based Payment, an amendment of FASB Statements No. 123 and 95." FAS 123(R) addresses the accounting for transactions in which an enterprise exchanges its valuable equity instruments for employee services. It also addresses transactions in which an enterprise incurs liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of those equity instruments in exchange for employee services. The cost of employee services received in exchange for equity instruments would be measured based on the grant-date fair value of those instruments. That cost would be recognized as compensation expense over the requisite service period (often the vesting period). For employees that become eligible to retire during an explicit service period, compensation cost would be recognized over the period through the date that the employee first becomes eligible to retire and is no longer required to provide service to earn the award. If vesting of share-based payments accelerates upon an employee's retirement, this should be accrued at the date of retirement. Alternatively, an award may continue to vest after retirement, even though the employee no longer is providing services to the employer. FAS 123(R) is effective for periods beginning after June 15, 2005. The implementation of FAS 123(R) will have minimal impact on the Company's financial position, results of operations or cash flows, as the Company does not settle the cost of employee services through the issuance of equity instruments.

Note 3.**Significant accounting policies****Basis of presentation**

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) that differ from statutory accounting practices prescribed or permitted for insurance companies by regulatory authorities. See also Note 17.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The 21.6% equity ownership of EFL is not consolidated but accounted for under the equity method of accounting.

Reclassifications

Certain amounts reported in prior years have been reclassified to conform to the current year's financial statement presentation.

Use of estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investments and cash equivalents

Fixed maturities consist of bonds, notes and redeemable preferred stock. Fixed maturities are classified as available for sale and are reported at fair value, with unrealized investment gains and losses, net of income taxes, charged or credited directly to shareholders' equity in accumulated other comprehensive income. Market value of fixed maturities are determined based upon quoted market prices or dealer quotes. If quoted market prices or dealer quotes are not available, valuation is based on discounted expected cash flows using market rates commensurate with the credit quality and maturity of the investment. Also included in fixed maturities are mortgage-backed securities, which are amortized using the constant effective yield method based on anticipated prepayments and the estimated economic life of the securities. If actual prepayments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments. The net investment in the security is adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the security, with the corresponding adjustment included as part of investment income.

Equity securities, which include common and nonredeemable preferred stocks, are classified as available for sale and carried at fair value based on quoted market prices. Changes in fair values of equity securities, net of income tax, are charged or credited directly to shareholders' equity in accumulated other comprehensive income.

Limited partnerships include U.S. and foreign private equity, real estate and mezzanine debt investments. The private equity limited partnerships invest primarily in small- to medium-sized companies. Limited partnerships are recorded using the equity method, which is the Company's share of the reported value of the partnership.

Realized gains and losses on sales of investments are recognized in income based upon specific identification of the investments sold on the trade date. Interest and dividend income is recorded as earned. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to lowest yield. Such amortization is included in investment income.

All investments are evaluated monthly for other-than-temporary impairment loss. Some factors considered in evaluating whether or not a decline in fair value is other-than-temporary include:

- the extent and duration to which fair value is less than cost;
- historical operating performance and financial condition of the issuer;
- near term prospects of the issuer and its industry based on analysts recommendations;
- specific events that occurred affecting the issuer, including a ratings downgrade; and
- the Company's ability and intent to hold the investment for a period of time sufficient to allow for a recovery in value.

An investment that is deemed impaired is written down to its estimated net realizable value. Impairment charges are included as realized losses in the Consolidated Statements of Operations.

Securities lending program

The Company engages in securities lending activities from which it generates investment income from the lending of certain of its investments to other institutions for short periods of time. The Company receives marketable securities as collateral equal to at least 102% of the market value of the loaned securities. The Company maintains full ownership rights to the securities loaned and, accordingly, the loaned securities remain classified as investments of the Company.

The Company shares a portion of the interest charged on lent securities with the third party custodian and the borrowing institution. In accordance with FAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," the Company recognizes the receipt of the collateral held by the third party custodian and the obligation to return the collateral on its Consolidated Statements of Financial Position.

Deferred policy acquisition costs

Amounts which vary with, and are primarily related to, the production of new and renewal insurance policies, primarily commissions, are deferred and amortized pro rata over the policy periods in which the related premiums are earned. Deferred acquisition costs are reviewed to determine if they are recoverable from future income, and if not, are charged to expense. Future investment income attributable to related premiums is taken into account in measuring the recoverability of the carrying value of this asset. Amortization expense, included in policy acquisition and other underwriting expenses, was \$34.2 million, \$34.3 million and \$38.6 million in 2005, 2004 and 2003, respectively.

Insurance liabilities

The liability for losses and loss adjustment expenses represent estimated provisions for both reported and unreported claims and related expenses. The reserves are adjusted regularly based on experience. Reserve estimates are based on management's assessment of known facts and circumstances, review of historical settlement patterns, estimates of trends in claims severity, frequency, legal theories of liability and other factors. Multiple estimation methods are employed for each product line, which results in a range of reasonable estimates for each product line. Loss reserves are set at full expected cost except for workers' compensation loss reserves, which have been discounted using an interest rate of 2.5%. Unpaid losses and loss adjustment expenses in the Consolidated Statements of Financial Position were reduced by \$4.6 million and \$4.1 million at December 31, 2005 and 2004, respectively, due to discounting. The reserves for losses and loss adjustment expenses are reported net of receivables for salvage and subrogation of \$6.7 million at both December 31, 2005 and 2004.

The reserve for losses and loss adjustment expenses is necessarily based on estimates and, while management believes the amount is appropriate, the ultimate liability may be more or less than the amounts provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed. The effects of changes in such estimated reserves are included in the results of operations in the period in which the estimates are changed. Changes in the estimated reserves recorded as of period end may be material to the result of operations and financial condition in future periods.

Reinsurance

Premiums earned and losses and loss adjustment expenses incurred are presented net of reinsurance activities in the Consolidated Statements of Operations. Reinsurance premiums are recognized as revenue on a pro-rata basis over the policy term. Gross losses and expenses incurred are reduced for amounts expected to be recovered under reinsurance agreements. Estimated reinsurance recoverables and receivables for ceded unearned premiums are recorded as assets with liabilities recorded for related unpaid losses and expenses and unearned premiums in the Consolidated Statements of Financial Position. See the discussion of the intercompany reinsurance pooling arrangement in Note 13.

Recognition of management fee revenue

In exchange for providing sales, underwriting, and policy issuance services, the Company earns management fees from the Exchange. The management fee revenue is calculated as a percentage of the direct written premium of the Property and Casualty Group. The Exchange issues policies with annual terms only. Management fees are recorded as revenue upon policy issuance or renewal, as substantially all of the services required to be performed by the Company have been satisfied at that time. Certain activities are performed and related costs are incurred by the Company subsequent to policy issuance in connection with the services provided to the Exchange; however, these activities are deemed to be inconsequential and perfunctory.

Although the Company is not required to do so under the subscriber's agreement with the Exchange, it forgives the management fee charged the Exchange when mid-term policy cancellations occur. The Company estimates mid-term policy cancellations and records a related allowance which is adjusted quarterly. The effect of recording changes in this estimated allowance increased the Company's management fee revenue by \$5 million for the year ended December 31, 2005. Management fee revenue was reduced by \$4.1 million and \$3.0 million for the years ended December 31, 2004 and 2003, respectively, due to changes in the allowance.

Recognition of premium revenues and losses

Property and liability premiums are recognized as revenue on a pro-rata basis over the policy term. Unearned premiums represent the unexpired portion of premiums written. Losses and loss adjustment expenses are recorded as incurred. Premiums earned and losses and loss adjustment expenses incurred are reflected net of amounts ceded to the Exchange on the Consolidated Statements of Operations. See also Note 16.

Recognition of service agreement revenue

Included in service agreement revenue are service charges the Company collects from policyholders for providing multiple payment plans on policies written by the Property and Casualty Group. Service charges, which are flat dollar charges for each installment billed beyond the first installment, are recognized as revenue when each additional billing is rendered to the policyholder.

Prior to March 2005, service agreement revenue also included service income received from the Exchange as compensation for the management of voluntary assumed reinsurance from nonaffiliated insurers. The service fee revenue, calculated as 6% of nonaffiliated assumed reinsurance premiums written, was recognized in the period in which the related premium was earned since the Company's services extended to that same period. The Exchange exited the assumed reinsurance business effective December 31, 2003. The service agreement remained in effect while existing contracts expired throughout 2004 and was terminated effective March 31, 2005.

Agent bonus estimates

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 agent bonuses, which are based on the performance over 36 months, is modeled on a monthly basis using actual underwriting data by agency for the two prior years combined with the current year-to-date actual data and projected underwriting data for the remainder of the current year. At December 31 of each year, the Company uses actual data available and records an accrual based on expected payment amount. The estimated incurred agent bonus at December 31, 2005, is \$71.1 million. The 2004 and 2003 agent bonus amounts incurred were \$46.2 million and \$24.0 million, respectively. These costs are included in the cost of management operations in the Consolidated Statements of Operations.

Income taxes

Provisions for income taxes include deferred taxes resulting from changes in cumulative temporary differences between the tax basis and financial statement basis of assets and liabilities. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. In the fourth quarter of 2003, the Company recorded an adjustment to deferred income taxes to recognize future tax obligations which will arise when earnings from the Company's equity investment in

EFL are distributed. The deferred tax provision was computed assuming undistributed earnings of EFL in excess of the Company's basis would be distributed in the form of dividends. The one-time non-cash charge of \$3.2 million to record these deferred taxes reduced net income per share-diluted by \$.05 in 2003.

Stock-based compensation

The Company has a long-term incentive plan (LTIP) from which restricted stock awards are issued to executive management that are settled in Company stock. The Company does not issue stock, but instead purchases stock in the open market to settle these obligations. The Company currently applies the FAS 123, "Accounting for Stock-Based Compensation," fair value method of accounting for stock-based employee awards. Under this method, compensation cost is measured at the grant date based on the fair value of the award and recognized ratably over the three-year performance period. The fair value of the restricted stock is measured at the market price of a share of the Company's Class A common stock on the grant date. The effects of changes in the stock price are recognized as compensation expense over the performance period. The LTIP does not include an acceleration of vesting clause. Therefore, if an employee retired prior to the close of the plan's three-year performance period, vesting would cease at the end of the year in which they retire.

Note 4.

Earnings per share

Basic earnings per share is calculated under the two-class method which allocates earnings to each class of stock based on its dividend rights. Weighted average shares used in the Class A basic earnings per share calculation were 62.4 million in 2005, 63.5 million in 2004 and 64.1 million in 2003. Class B shares used in the basic earnings per share calculation were 2,843 shares, 2,877 shares and 2,884 shares in 2005, 2004 and 2003, respectively. Class B shares are convertible into Class A at a conversion ratio of 2,400 to 1. The computation of diluted earnings per share reflects the effect of potentially dilutive outstanding employee stock-based awards under the long-term incentive plan. See also Note 9. The total weighted average number of Class A equivalent shares outstanding (including conversion of Class B shares) was 69.3 million, 70.5 million and 71.1 million during 2005, 2004 and 2003, respectively.

The following table reconciles the numerators and denominators of the basic and diluted per-share computations for each of the years ended December 31. (See Note 9 for a description of the restricted stock awards not yet vested.)

(net income amounts in thousands)	For the years ended December 31		
	2005	2004	2003
Basic:			
Allocated net income—Class A	\$ 229,517	\$ 224,861	\$ 198,357
Class A shares of common stock	62,392,860	63,508,873	64,075,506
Class A earnings per share—basic	\$ 3.69	\$ 3.54	\$ 3.09
Allocated net income—Class B	\$ 1,587	\$ 1,552	\$ 1,368
Class B shares of common stock	2,843	2,877	2,884
Class B earnings per share—basic	\$ 558.34	\$ 539.88	\$ 474.19
Diluted:			
Net income	\$ 231,104	\$ 226,413	\$ 199,725
Class A shares of common stock	62,392,860	63,508,873	64,075,506
Assumed conversion of class B common stock and restricted stock awards	6,900,789	6,983,419	7,018,661
Class A shares of common and equivalent shares	69,293,649	70,492,292	71,094,167
Earnings per share—diluted	\$ 3.34	\$ 3.21	\$ 2.81

Note 5.

Investments

The following tables summarize the cost and market value of available-for-sale securities at December 31, 2005 and 2004:

(in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
December 31, 2005				
Fixed maturities				
U. S. treasuries and government agencies	\$ 9,583	\$ 204	\$ 52	\$ 9,735
States and political subdivisions	145,528	1,383	1,104	145,807
Special revenue	195,059	1,816	1,130	195,745
Public utilities	66,866	3,077	334	69,609
U. S. industrial and miscellaneous	353,843	5,889	4,013	355,719
Mortgage-backed securities	32,251	788	413	32,626
Asset-backed securities	22,117	43	443	21,717
Foreign	106,445	3,772	816	109,401
Total bonds	931,692	16,972	8,305	940,359
Redeemable preferred stock	30,628	1,340	117	31,851
Total fixed maturities	962,320	18,312	8,422	972,210
Equity securities				
Common stock:				
Public utilities	1,313	160	0	1,473
U. S. banks, trusts and insurance companies	10,783	1,528	286	12,025
U. S. industrial and miscellaneous	53,713	8,668	1,599	60,782
Foreign	18,950	2,712	381	21,281
Nonredeemable preferred stock:				
Public utilities	26,266	285	448	26,103
U. S. banks, trusts and insurance companies	64,632	2,432	228	66,836
U. S. industrial and miscellaneous	62,552	3,523	464	65,611
Foreign	11,231	1,033	41	12,223
Total equity securities	\$249,440	\$20,341	\$3,447	\$266,334

(in thousands)

December 31, 2004	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Fixed maturities				
U. S. treasuries and government agencies	\$ 11,850	\$ 412	\$ 69	\$ 12,193
States and political subdivisions	80,508	2,515	164	82,859
Special revenue	125,083	3,407	137	128,353
Public utilities	66,927	4,708	52	71,583
U. S. industrial and miscellaneous	429,793	14,953	1,669	443,077
Mortgage-backed securities	48,504	772	390	48,886
Asset-backed securities	21,596	76	286	21,386
Foreign	125,590	9,628	312	134,906
Total bonds	909,851	36,471	3,079	943,243
Redeemable preferred stock	29,429	1,949	109	31,269
Total fixed maturities	939,280	38,420	3,188	974,512
Equity securities				
Common stock:				
Public utilities	992	11	0	1,003
U. S. banks, trusts and insurance companies	6,197	2,334	50	8,481
U. S. industrial and miscellaneous	34,120	13,136	171	47,085
Foreign	2,245	57	28	2,274
Nonredeemable preferred stock:				
Public utilities	21,373	1,939	59	23,253
U. S. banks, trusts and insurance companies	43,605	3,401	2	47,004
U. S. industrial and miscellaneous	55,096	4,667	88	59,675
Foreign	12,232	1,730	43	13,919
Total equity securities	\$175,860	\$27,275	\$ 441	\$ 202,694

The amortized cost and estimated fair value of fixed maturities at December 31, 2005, by remaining contractual term to maturity, are shown below. Mortgage-backed securities are allocated based on their stated maturity dates. Actual cash flows may differ from those presented as a result of calls, prepayments or defaults.

(in thousands)	Amortized cost	Estimated fair value
Due in one year or less	\$ 88,040	\$ 87,857
Due after one year through five years	334,109	333,063
Due after five years through ten years	351,622	359,076
Due after ten years	188,549	192,214
Total fixed maturities	\$962,320	\$972,210

Fixed maturities and equity securities in a gross unrealized loss position are as follows. Data is provided by length of time securities were in a gross unrealized loss position:

	Less than 12 months		12 months or longer		Total		Number of holdings
(in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	
December 31, 2005							
Fixed maturities							
U.S. treasuries and government agencies	\$ 5,615	\$ 40	\$ 257	\$ 12	\$ 5,872	\$ 52	7
States and political subdivisions	88,553	907	5,035	197	93,588	1,104	40
Special revenue	108,565	992	6,284	138	114,849	1,130	52
Public utilities	20,215	220	2,877	114	23,092	334	13
U.S. industrial & miscellaneous	106,403	1,766	68,585	2,247	174,988	4,013	100
Mortgage-backed securities	6,889	92	12,194	321	19,083	413	15
Asset-backed securities	2,903	97	12,420	346	15,323	443	7
Foreign	21,103	398	13,973	418	35,076	816	17
Total bonds	360,246	4,512	121,625	3,793	481,871	8,305	251
Redeemable preferred stock	5,018	117	0	0	5,018	117	1
Total fixed maturities	365,264	4,629	121,625	3,793	486,889	8,422	252
Equity securities							
Common stock	20,858	2,095	2,280	171	23,138	2,266	84
Nonredeemable preferred stock	35,567	764	8,022	417	43,589	1,181	19
Total equity securities	56,425	2,859	10,302	588	66,727	3,447	103
Total fixed maturities and equity securities	\$421,689	\$ 7,488	\$131,927	\$ 4,381	\$553,616	\$11,869	355

	Less than 12 months		12 months or longer		Total		Number of holdings
(in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	
December 31, 2004							
Fixed maturities							
U.S. treasuries and government agencies	\$ 1,014	\$ 12	\$ 1,934	\$ 57	\$ 2,948	\$ 69	3
States and political subdivisions	15,798	131	1,467	33	17,265	164	8
Special revenue	19,098	137	0	0	19,098	137	7
Public utilities	11,828	52	0	0	11,828	52	5
U.S. industrial & miscellaneous	133,339	1,396	11,737	273	145,076	1,669	69
Mortgage-backed securities	13,879	200	7,021	190	20,900	390	13
Asset-backed securities	17,700	277	918	8	18,618	285	7
Foreign	26,156	215	1,865	98	28,021	313	13
Total bonds	238,812	2,420	24,942	659	263,754	3,079	125
Redeemable preferred stock	3,052	109	0	0	3,052	109	1
Total fixed maturities	241,864	2,529	24,942	659	266,806	3,188	126
Equity securities							
Common stock	12,985	249	0	0	12,985	249	66
Nonredeemable preferred stock	17,628	149	1,352	43	18,980	192	10
Total equity securities	30,613	398	1,352	43	31,965	441	76
Total fixed maturities and equity securities	\$272,477	\$ 2,927	\$26,294	\$ 702	\$298,771	\$ 3,629	202

The fixed maturity investments with continuous unrealized losses for less than 12 months were primarily due to the impact of higher market interest rates rather than a decline in credit quality of the specific issuers. Of the fixed maturities that are below amortized cost for less than 12 months, securities that were investment-grade had a fair value of \$357.7 million at December 31, 2005. These fixed maturities had unrealized losses as of December 31, 2005, of \$4.3 million.

The remaining fair value of fixed maturities below amortized cost for less than 12 months of \$7.6 million at December 31, 2005, were non-investment grade securities and had unrealized losses of \$4 million. Comprising this amount are three issuers, all of which were downgraded to non-investment grade credits in 2005. These three issuers are in the automotive and

auto financing industries. The Company is monitoring the financial condition of these three issuers. An impairment charge of \$.3 million was recorded for one of these securities to write it down to its estimated market value in 2005. It is possible that these securities may be further impaired resulting in realized losses in future periods.

There are \$121.6 million in investment-grade fixed maturity securities at fair value that at December 31, 2005, had been below amortized cost for 12 months or longer. These fixed maturities had unrealized losses as of December 31, 2005, of \$3.8 million. All of these securities were investment grade at December 31, 2005. These unrealized losses are due to higher market interest rates and greater spread requirements in the market in general and are not related to the credit quality of specific issuers.

Investment income net of expenses was generated from the following portfolios for the years ended December 31 as follows:

<i>(in thousands)</i>	2005	2004	2003
Fixed maturities	\$50,222	\$49,601	\$46,366
Equity securities	10,847	10,440	10,598
Cash equivalents and other	2,113	2,003	2,040
Total investment income	63,182	62,044	59,004
Less: investment expenses	1,627	1,056	706
Investment income, net of expenses	\$61,555	\$60,988	\$58,298

Following are the components of net realized gains on investments as reported in the Consolidated Statements of Operations. Included in 2005 gross realized losses are impairment charges of \$2.9 million and \$1.6 million related to fixed maturities and equity securities, respectively. The fixed maturity impairment charges related to bonds in the automotive industry. The equity securities that were impaired were in the consumer products, automotive and technology sectors. There were no impairment charges in 2004. Included in the 2003 gross realized losses are impairment charges of \$2.3 million and \$3.7 million related to fixed maturities and equity securities, respectively. The impairment charges related to bonds in the financial and retail sectors and charges related to equity securities were in the energy sector.

<i>(in thousands)</i>	Years ended December 31		
	2005	2004	2003
Fixed maturities			
Gross realized gains	\$ 7,231	\$ 6,855	\$15,589
Gross realized losses	(6,097)	(524)	(3,952)
Net realized gains	1,134	6,331	11,637
Equity securities			
Gross realized gains	19,517	14,175	4,602
Gross realized losses	(5,031)	(2,030)	(5,794)
Net realized gains (losses)	14,486	12,145	(1,192)
Net realized gains on investments	\$15,620	\$18,476	\$10,445

Change in difference between fair value and cost of investments:

<i>(in thousands)</i>	2005	Years ended December 31	
		2004	2003
Fixed maturities	\$ (25,342)	\$ (9,480)	\$ 12,520
Equity securities	(9,940)	(10,231)	18,580
	(35,282)	(19,711)	31,100
Deferred taxes on unrealized (losses) gains of fixed maturities and equity securities	12,349	6,899	(10,885)
Change in net unrealized (losses) gains	\$ (22,933)	\$ (12,812)	\$ 20,215

Limited partnerships are recorded using the equity method. The components of equity in earnings (losses) of limited partnerships as reported in the Consolidated Statements of Operations for the years ended December 31 are as follows:

<i>(in thousands)</i>	2005	2004	2003
Private equity	\$16,732	\$2,324	\$(3,983)
Real estate	7,657	4,350	3,349
Mezzanine debt	3,530	1,981	(1,366)
Valuation adjustments	10,143	0	0
Total equity in earnings (losses) of limited partnerships	\$38,062	\$8,655	\$(2,000)

During 2005, the Company made a correction to its treatment of unrealized gains and losses on limited partnerships. This correction resulted in an increase to second quarter 2005 pre-tax income of \$14.2 million, or an increase to net income per share-diluted of \$.13 to record changes in the fair value of limited partnerships to equity in earnings or losses of limited partnerships in the Consolidated Statement of Operations. The Company had previously reflected unrealized gains and losses on limited partnerships in shareholders' equity in accumulated other comprehensive income. Included in the pre-tax adjustment was \$9.4 million of unrealized gains related to 2004 and prior years, or \$.09 per share-diluted. While there was an earnings impact related to this adjustment, there was no impact on the Company's shareholders' equity.

Impairment charges in which the decline in value of limited partnerships is considered other-than-temporary by management are included in the related category in the table above. Included in the private equity partnership net earnings or losses are impairment charges of \$1.2 million and \$5.0 million for 2004 and 2003, respectively. Included in the 2003 mezzanine debt partnership losses is an impairment charge of \$2.5 million from partnerships concentrated in the facility resources, textile and food and beverage industries.

See also Note 19 for investment commitments related to partnerships.

The Company participates in a program whereby marketable securities from its investment portfolio are lent to independent brokers or dealers based on, among other things, their creditworthiness in exchange for collateral initially equal to at least 102% of the value of the securities on loan and is thereafter maintained at a minimum of 100% of the market value of the securities loaned. The market value of the securities on loan to each borrower is monitored daily by the third party custodian and the borrower is required to deliver additional collateral if the market value of the collateral falls below 100% of the market value of the securities on loan.

The Company had loaned securities included as part of its invested assets with a market value of \$30.0 million at December 31, 2005. The Company had no loaned securities at December 31, 2004. The Company has incurred no losses on the securities lending program since the program's inception.

Cash equivalents are principally comprised of investments in bank money market funds and approximate fair value.

Note 6.

Comprehensive income

The components of changes to comprehensive income follow for the years ended December 31:

<i>(in thousands)</i>	2005	2004	2003
Unrealized holding (losses) gains on securities arising during period	\$(41,199)	\$ 6,487	\$ 53,110
Less: gains included in net income	(15,620)	(18,476)	(10,445)
Net unrealized holding (losses) gains arising during period	(56,819)	(11,989)	42,665
Income tax benefit (liability) related to unrealized gains or losses	19,886	4,196	(14,933)
Net (depreciation) appreciation of investments	(36,933)	(7,793)	27,732
Minimum pension liability adjustment (See Note 8)	4	3	(23)
Income tax (liability) benefit related to pension adjustment	(1)	(1)	8
Net minimum pension liability adjustment	3	2	(15)
Change in other comprehensive income, net of tax	\$(36,930)	\$ (7,791)	\$(27,717)

The components of accumulated other comprehensive income, net of tax, as of December 31 are as follows:

<i>(in thousands)</i>	2005	2004
Accumulated net appreciation of investments	\$21,720	\$58,653
Accumulated minimum pension liability adjustment	(39)	(42)
Accumulated other comprehensive income	\$21,681	\$58,611

Note 7.

Equity in Erie Family Life Insurance

The Company owns 21.6% of EFL's common shares outstanding, which is accounted for using the equity method of accounting. EFL is a Pennsylvania-domiciled life insurance company operating in 10 states and the District of Columbia. EFL's undistributed earnings accounted for under the equity method and included in the Company's retained earnings as of December 31, 2005 and 2004, are \$51.6 million and \$49.9 million, respectively.

The following represents condensed financial information for EFL on a U.S. GAAP basis:

<i>(in thousands)</i>	Years ended December 31		
	2005	2004	2003
Revenues	\$148,876	\$149,833	\$149,973
Benefits and expenses	124,561	104,541	102,668
Income before income taxes	24,315	45,292	47,305
Net income	16,539	29,632	32,487
Comprehensive (loss) income	(7,242)	24,281	46,313
Dividends paid to shareholders	8,316	8,222	7,938

<i>(in thousands)</i>	As of December 31	
	2005	2004
Investments	\$1,498,099	\$1,466,579
Total assets	1,776,360	1,661,440
Liabilities	1,520,390	1,389,912
Accumulated other comprehensive income	15,471	39,252
Total shareholders' equity	255,970	271,528

The Company's share of EFL's unrealized appreciation of investments, net of tax, reflected in EFL's shareholders' equity, is \$3.3 million and \$8.5 million at December 31, 2005 and 2004, respectively. Dividends paid to the Company totaled \$1.8 million for the years ended December 31, 2005 and 2004, and \$1.7 million for the year ended December 31, 2003.

Note 8.**Benefit plans**

The liabilities for the plans described in this note are presented in total for all employees of the Group, before allocations to related entities. The gross liability for the pension and postretirement benefit plans is presented in the Consolidated Statements of Financial Position as employee benefit obligations with amounts expected to be recovered from the Company's affiliates included in other assets. The remaining liabilities not separately presented in this note are presented in the Consolidated Statements of Financial Position as accounts payable and accrued expenses.

The Company's pension plans consist of: 1) a noncontributory defined benefit pension plan covering substantially all employees of the Company, 2) an unfunded supplemental employee retirement plan (SERP) for its executive and senior management and 3) an unfunded pension plan for certain of its outside directors. The pension plans provide benefits to covered individuals satisfying certain age and service requirements. The defined benefit pension plan and SERP provide benefits through a final average earnings formula and a percent of average monthly compensation formula, respectively. The benefit provided under the pension plan for outside directors

equals the annual retainer fee at the date of retirement. The outside directors' plan has been frozen since 1997.

The Company also provides postretirement health benefits in the form of medical and pharmacy health plans for eligible retired employees and eligible dependents. To be eligible for benefits, an employee must be at least 60 years old when separating from service and have 15 years of continuous full-time service. The benefits are provided from retirement date to age 65. Actuarially determined costs are recognized over the period the employee provides service to the Company.

The Company pays the obligations when due for those benefit plans that are unfunded.

The following tables summarize the funded status, obligations and amounts recognized in the Consolidated Statements of Financial Position for the Company's plans. The Company uses a December 31 measurement date for its pension and postretirement health benefit plans. The projected benefit obligation is presented below for the pension plans and the accumulated benefit obligation is presented for the postretirement health benefit plan.

The accumulated benefit obligation of the Company's pension plans was \$181.3 million and \$150.4 million at December 31, 2005 and 2004, respectively.

(in thousands)	Pension plans		Postretirement health benefit plan	
	2005	2004	2005	2004
Change in benefit obligation				
Benefit obligation at January 1	\$241,641	\$212,713	\$ 12,628	\$ 11,367
Service cost	14,564	13,236	1,259	968
Interest cost	14,576	12,949	968	708
Amendments	221	296	(290)	(730)
Actuarial loss	15,603	3,512	6,108	566
Benefits paid	(1,628)	(1,065)	(638)	(251)
Benefit obligation at December 31	\$284,977	\$241,641	\$ 20,035	\$ 12,628
Change in plan assets				
Fair value of plan assets at January 1	\$203,071	\$181,714	\$ —	\$ —
Actual return on plan assets	18,996	14,673	—	—
Employer contributions	70	7,749	—	—
Benefits paid	(1,628)	(1,065)	—	—
Fair value of plan assets at December 31	\$220,509	\$203,071	\$ —	\$ —
Reconciliation of funded status				
Funded status at December 31	\$ (64,468)	\$ (38,570)	\$ (20,035)	\$ (12,628)
Unrecognized net actuarial loss	82,699	72,305	9,055	3,273
Unrecognized prior service cost	3,463	3,942	(1,253)	(1,071)
Net amount recognized	\$ 21,694	\$ 37,677	\$ (12,233)	\$ (10,426)
Amounts recognized in the Consolidated Statements of Financial Position consist of				
Prepaid benefit cost (defined benefit plan)	\$ 38,720	\$ 50,860	\$ —	\$ —
Accrued benefit liability	(17,226)	(13,807)	(12,233)	(10,426)
Intangible asset	140	560	—	—
Accumulated other comprehensive income	60	64	—	—
Net amount recognized	\$ 21,694	\$ 37,677	\$ (12,233)	\$ (10,426)
Accrued benefit liability	17,226	13,807	12,233	10,426
Reimbursements from affiliates included in other assets	(7,845)	(6,309)	(6,576)	(5,424)
Net accrued benefit liability	\$ 9,381	\$ 7,498	\$ 5,657	\$ 5,002

The 2005 actuarial loss in the pension plan was due to a change in the discount rate assumption used to estimate the benefit obligation from 6.00% in 2004 to 5.75% in 2005. The postretirement health benefit plan's actuarial loss was principally due to changes in the mortality and discount rate assumptions, offset by actual plan experience that was better than the experience used to estimate 2005 expense.

Previously, a single health care plan was offered for all employees. Effective January 1, 2005, two alternative health plan options were offered to employees which required increased employee cost-sharing. This plan change resulted in a decrease in the per-capita medical costs under the postretirement health benefit plan.

For pension plans with an accumulated benefit obligation in excess of plan assets (SERP and the plan for outside directors), the aggregate projected benefit obligation and the aggregate accumulated benefit obligation were \$30.4 million and \$17.2 million, respectively, at

December 31, 2005, and \$26.5 million and \$13.8 million, respectively, at December 31, 2004. As these plans are unfunded, consequently, there are no plan assets.

The accrued benefit liability of \$17.2 million and \$13.8 million at December 31, 2005 and 2004, respectively, relates principally to the SERP plan. The intangible asset relates entirely to the SERP plan.

The Company's funding policy regarding the employee pension plan is to contribute amounts sufficient to meet ERISA funding requirements plus such additional amounts as may be determined to be appropriate, subject to IRS funding limits. In 2005, the Company's contribution to the pension plan was limited by IRS funding limits. The Company expects to contribute approximately \$7.5 million to the employee pension plan in 2006. The following table summarizes the components of net benefit expense recognized in the Consolidated Statements of Operations for the years ended December 31:

(in thousands)	Pension plans			Postretirement health benefit plan		
	2005	2004	2003	2005	2004	2003
Net periodic benefit cost						
Service cost	\$ 14,564	\$ 13,236	\$ 10,045	\$ 1,259	\$ 968	\$ 715
Interest cost	14,576	12,949	11,096	968	708	595
Expected return on plan assets	(17,382)	(16,996)	(16,553)	—	—	—
Amortization of prior service cost	700	901	885	(108)	(53)	(50)
Recognized net actuarial loss	3,595	3,205	811	326	154	54
Amortization of unrecognized initial net asset	0	0	(234)	—	—	—
Net periodic benefit cost	\$ 16,053	\$ 13,295	\$ 6,050	\$ 2,445	\$ 1,777	\$ 1,314

A portion of the net periodic benefit cost for the pension plans and the postretirement health benefit plan is borne by the Exchange and EFL. The Company was reimbursed approximately 51% from the Exchange and EFL during 2005 and approximately 50% in both 2004 and 2003.

Assumptions and health care cost trend rate sensitivity

	2005	2004
Assumptions used to determine benefit obligations		
Employee pension plan:		
Discount rate	5.75%	6.00%
Expected return on plan assets	8.25	8.25
Rate of compensation increase	4.75*	5.00
SERP:		
Discount rate	5.75%	6.00%
Rate of compensation increase	6.00-7.25	6.00-7.25
Postretirement health benefit plan:		
Discount rate	5.75%	6.00%

* Rate of compensation increase is age-graded. An equivalent single compensation increase rate of 4.75% would produce similar results.

	2005	2004
Assumptions used to determine net periodic benefit cost		
Employee pension plan:		
Discount rate	6.00%	6.00%
Expected return on plan assets	8.25	8.25
Rate of compensation increase	4.75*	5.00
SERP:		
Discount rate	6.00%	6.00%
Rate of compensation increase	6.00-7.25	6.00-7.25
Postretirement health benefit plan:		
Discount rate	6.00%	6.00%
Assumed health care cost trend rates		
Health care cost trend rate assumed for next year	10.0%	9.0%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2011	2009

The discount rate used to determine net periodic pension and postretirement benefit costs for 2006 will be 5.75% compared to 6.00% used for 2005. The rate was modeled by management in a bond-matching study that compared projected pension plan benefit flows to the cash flows from a comparable portfolio of fixed maturity instruments which yielded approximately 5.75%. The employee pension plan's expected long-term rate of return on assets is based on historical long-term returns for the asset classes included in the employee pension plan's target asset allocation. In 2005, the Company's consulting pension actuarial firm completed an experience study which supported the use of an age-graded scale for the rate of compensation increase, which correlates a participant's age to their rate of compensation increase.

The December 31, 2005, accumulated postretirement health benefit obligation was based on a 9.0% increase in the cost of covered health care benefits during 2005. Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 100-basis point change in assumed health care cost trend rates would have the following effects:

<i>(in thousands)</i>	100-basis point increase	100-basis point decrease
Effect on total of service and interest cost	\$ 387	\$ (322)
Effect on postretirement health benefit obligation	2,970	(2,520)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

<i>(in thousands)</i>	Pension benefits	Postretirement health benefits
2006	\$ 2,425	\$ 410
2007	3,164	482
2008	4,087	542
2009	5,039	759
2010	6,216	1,001
Years 2011-2015	53,062	7,662

Pension plan assets

The SERP and pension plan for outside directors are unfunded. The employee pension plan is a funded plan with asset allocation by asset category as follows:

Asset category	Plan assets at December 31	
	2005	2004
Equity securities	62.5%	58.9%
Debt securities		
Due beyond one year	35.9%	34.3%
Due within one year	.8%	6.2%
Other	.8%	.6%
Total	100.0%	100.0%

Equity securities included 60,000 shares of Company Class A common stock, with market values of \$3.2 million (1.5% of total plan assets), at both December 31, 2005 and 2004. Dividends paid on these shares were less than \$.1 million for 2005 and 2004.

Also included in equity securities are 69,750 shares of EFL common stock at December 31, 2005 and 2004, with market values of \$1.9 million (.9% of total plan assets) and \$2.2 million (1.0% of total plan assets), respectively. Dividends paid on these shares were less than \$.1 million for 2005 and 2004.

The employee pension plan's investment strategy is based on an understanding that:

- equity investments are expected to outperform debt investments over the long term;
- the potential volatility of short-term returns from equities is acceptable in exchange for the larger expected long-term returns;
- a portfolio structured across investment styles and markets (both domestic and foreign) reduces volatility.

As a result, the employee pension plan's asset allocation will include a broadly diversified allocation among equity, debt and other investments. The target percentage range for asset categories is:

Asset category	2005 target allocation
Equity securities	40% — 65%
Debt securities	35% — 60%
Other	0% — 5%

Employee savings plan

The Company has a qualified 401(k) savings plan for its employees. Eligible participants are permitted to make contributions to the plan up to the Internal Revenue Service limit. The Company match is 100% of the participant contributions up to 3% of compensation and 50% of participant contributions over 3% and up to 5% of compensation. All full-time and regular part-time employees are eligible to participate in the plan. The Company's matching contributions to the plan were \$7.7 million, \$7.2 million and \$6.6 million in 2005, 2004, and 2003, respectively, before reimbursements from affiliates. The Company's matching contributions after reimbursements from affiliates were \$3.2 million, \$2.9 million, and \$2.6 million in 2005, 2004, and 2003, respectively. Employees are only permitted to invest employer-matching contributions in the Class A common stock of the Company. The plan acquires shares in the open market necessary to meet the obligations of the plan. Plan participants held .1 million Company Class A shares at December 31, 2005, 2004 and 2003.

Health and dental benefits

The Company has self-funded health care plans for all of its employees and eligible dependents. Estimated unpaid claims incurred are accrued as a liability at December 31, 2005 and 2004. Operations were charged \$30.9 million, \$32.1 million and \$28.3 million in 2005, 2004 and 2003, respectively, for the cost of health and dental care provided under these plans before reimbursements from affiliates. Beginning January 1, 2005, the Company offered new health plan alternatives which increased employee cost-sharing. The charges after reimbursement from affiliates were \$14.1 million in 2005 and 2004, and \$12.5 million in 2003.

Note 9.

Incentive plans and deferred compensation

The Company has separate annual and long-term incentive plans for executive and senior management and regional vice presidents of the Company. The Company also makes available several deferred compensation plans for executive and senior management and certain outside directors.

Annual incentive plan

The annual incentive plan is a bonus plan that annually pays cash bonuses to executive, senior and regional vice presidents of the Company.

Pre-2004 Plan—Prior to 2004, incentives under the annual incentive plan were based on growth in written premiums and the underwriting results of the Property and Casualty Group compared to a peer group of property/casualty companies that wrote predominately personal lines insurance and were rated A++ by A.M. Best.

Post-2004 Plans—Beginning in 2004, the incentives under the plan are based on the achievement of certain predetermined performance targets. These targets are established by the Executive Compensation and Development Committee of the Board and can include various financial measures. The 2005 incentives were based on the adjusted operating ratio and the growth in direct written premiums of the Property and Casualty Group.

The cost of the plan is charged to operations as the compensation is earned over the performance period of one year. The amount charged to expense for the annual incentive plan bonus before reimbursement from affiliates was \$4.1 million, \$4.4 million and \$1.8 million for 2005, 2004 and 2003, respectively. After reimbursements from affiliates, the Company's expense was \$2.8 million, \$2.9 million and \$1.2 million for 2005, 2004 and 2003, respectively.

Long-term incentive plan

The long-term incentive plan (LTIP) of the Company is a restricted stock award plan designed to reward executive, senior and regional vice presidents who can have a significant impact on the performance of the Company with long-term compensation that is settled in Company stock.

Pre-2004 Plan—Prior to 2004, awards were determined based on the achievement of predetermined Company financial performance goals compared to the actual growth in retained earnings of the Company.

Post-2004 Plans—Beginning in 2004, the award is based on the level of achievement of objective measures of performance over a three-year period as compared to a peer group of property/casualty companies that write predominately personal lines insurance. The 2005 award was based on the adjusted combined ratio and the growth in direct written premiums and total return on invested assets of the adjusted property/casualty operations of the Erie Insurance Group compared to a peer group of companies. Because the award is based on a comparison to results of a peer group over a three-year period, the estimated award is based on estimates of results for the remaining performance period. This estimate is subject to variability if the results of the Company or peer group are substantially different than those results projected by the Company.

The Company cannot issue new stock or stock from treasury to settle the compensation award obligations under the LTIP, but instead must purchase Company stock on the open market. The restricted stock awards are granted at the beginning of a three-year performance period. The maximum number of shares which may be earned under the post-2004 LTIP plan by any single participant during any one calendar year is limited to .25 million shares. The aggregate number of Class A common stock that may be issued pursuant to awards granted under the LTIP is 1.0 million shares. A liability is recorded and compensation expense is recognized ratably over the performance period. For performance periods beginning before 2004, the stock awards vest ratably over a three-year vesting period subsequent to the three-year performance period. For performance periods beginning in 2004, stock awards are considered vested at the end of the performance period.

At December 31, 2005, 2004 and 2003, the unvested outstanding restricted shares under the LTIP totaled 73,471 shares, 75,399 shares and 68,176 shares, respectively, with average grant prices of \$52.65, \$46.83 and \$39.47, respectively. The change in market value of stock from the date of award under the LTIP and the balance sheet date is charged or credited to operations. The compensation cost charged to operations for these restricted stock awards after corporate federal income tax, was \$3.9 million,

\$2.1 million, and \$1.6 million for the years ending December 31, 2005, 2004 and 2003, respectively, after reimbursements from affiliates.

The following table shows the number of shares awarded and not yet vested at December 31, 2005. There were no forfeitures in any of the performance periods presented.

Long-term incentive plan	Weighted average grant price	Number of shares
2001-2003		
Performance period		
Awarded	\$ 39.47	33,859
Shares vested		23,284
Shares not yet vested		10,575
2002-2004		
Performance period		
Awarded	\$ 46.84	40,517
Shares vested		15,230
Shares not yet vested		25,287
2003-2005		
Performance period		
Awarded	\$ 51.15	39,870
Shares vested		2,261
Shares not yet vested		37,609
Restricted shares not yet vested at December 31, 2005		
		73,471

Deferred compensation plans

The deferred compensation plans are arrangements for executive and senior vice presidents of the Company whereby the participants can elect to defer a portion of their compensation until separation from services to the Company. Those participating in the plans select hypothetical investment funds for their deferrals and are credited with the hypothetical returns generated. The deferred compensation plan for directors allows them to defer director and meeting fees. Directors participating in the plan select hypothetical investment funds for their deferrals and are credited with the hypothetical returns generated. The Company does not match any deferrals to the director plan.

The awards, payments, deferrals and liabilities under the deferred compensation, annual and long-term incentive plans for officers and directors, were as follows for the years ended December 31. The gross liabilities are presented separately in the Consolidated Statements of Financial Position, while reimbursements from affiliates are included in other assets.

(in thousands)	2005	2004	2003
Plan awards, employer match and hypothetical earnings			
Long-term incentive plan awards	\$ 5,814	\$ 3,039	\$ 2,036
Annual incentive plan awards	4,145	4,394	1,703
Deferred compensation plan, employer match and hypothetical earnings	1,188	1,718	1,154
Total plan awards and earnings	\$11,147	\$ 9,151	\$ 4,893
Total plan awards paid	\$ 6,088	\$ 3,108	\$ 4,572
Compensation deferred under the plans	\$ 496	\$ 551	\$ 842
Distributions from the deferred compensation plans	\$ (177)	\$ (458)	\$ (309)
Gross incentive plan and deferred compensation liabilities	\$24,447	\$19,069	\$12,933
Reimbursements from affiliates	3,958	3,091	1,722
Net incentive plan and deferred compensation liabilities	\$20,489	\$15,978	\$11,211

Stock compensation plan for outside directors

The Company has a stock compensation plan for its outside directors. The purpose of this plan is to further align the interests of directors with shareholders by providing for a portion of annual compensation for the directors' services in shares of the Company's Class A common stock. Each director vests in the grant 25% every three months over the course of a year. Dividends paid by the Company are reinvested into each director's account with additional shares of the Company's Class A common stock. The Company accounts for grants under the stock compensation plan for outside directors under the fair value method as defined in FAS 123, "Accounting for Stock-Based Compensation." The annual charge related to this plan, net of reimbursement, totaled \$.3 million for each of the years 2005, 2004 and 2003. The implementation of FAS 123(R), "Share Based Compensation," will have minimal impact on the Company's financial position or results of operations.

Note 10.**Income taxes**

The provision for income taxes consists of the following for the years ended December 31:

<i>(in thousands)</i>	2005	2004	2003
Federal income taxes:			
Currently due	\$112,655	\$104,274	\$101,288
Deferred	(922)	866	949
Total	\$111,733	\$105,140	\$102,237

A reconciliation of the provision for income taxes with amounts determined by applying the statutory federal income tax rates to pretax income is as follows:

<i>(in thousands)</i>	2005	2004	2003
Income tax at statutory rates	\$118,810	\$114,222	\$103,269
Tax-exempt interest	(4,013)	(2,726)	(2,601)
Dividends received deduction	(2,727)	(2,636)	(3,010)
Other	(337)	(3,720)	4,579
Provision for income taxes	\$111,733	\$105,140	\$102,237

Temporary differences and carryforwards, which give rise to deferred tax assets and liabilities, are as follows for the years ended December 31:

<i>(in thousands)</i>	2005	2004
Deferred tax assets		
Loss reserve discount	\$ 5,630	\$ 5,504
Unearned premiums	7,490	7,607
Net allowance for service fees and premium cancellations	2,923	2,872
Other employee benefits	8,277	6,525
Alternative minimum tax carryforwards	0	1,761
Write-downs of impaired securities	1,393	1,592
Limited partnerships	4,027	3,847
Other	1,659	1,481
Total deferred tax assets	\$31,399	\$31,189
Deferred tax liabilities		
Deferred policy acquisition costs	\$ 5,752	\$ 5,989
Unrealized gains on investments	9,354	26,432
Pension and other benefits	10,164	15,467
Equity interest in EFL	3,619	3,490
Limited partnerships	3,550	0
Depreciation	2,241	976
Other	3,257	2,957
Total deferred tax liabilities	37,937	55,311
Net deferred income tax liability	\$ 6,538	\$24,122

The Company, as a corporate attorney-in-fact for a reciprocal insurer, is not subject to state corporate taxes, as the Property and Casualty Group pays gross premium taxes. In 2004, the Company underwent an audit by the Internal Revenue Service (IRS) for the years 2002 and 2001. The Company recorded a reduction in income tax expense of \$3.1 million as a result of related audit adjustments, the most significant of which was an additional deduction related to the pension plan that had a favorable impact on the Company's tax position. The adjustment was recorded as part of the current tax position and had a \$.04 benefit to net income per share—diluted in the fourth quarter of 2004.

Note 11.**Capital stock****Class A and B shares**

Holders of Class B shares may, at their option, convert their shares into Class A shares at the rate of 2,400 Class A shares for each Class B share. During the year 2005, a total of 25 Class B shares were converted to 60,000 Class A shares. In 2004, 20 Class B shares were converted to 48,000 Class A shares. There is no provision for conversion of Class A shares to Class B shares and Class B shares surrendered for conversion cannot be reissued. Each share of Class A common stock outstanding at the time of the declaration of any dividend upon shares of Class B common stock shall be entitled to a dividend payable at the same time, at the same record date, and in an amount at least equal to 2/3 of 1.0% of any dividend declared on each share of Class B common stock. The Company may declare and pay a dividend in respect to Class A common stock without any requirement that any dividend be declared and paid in respect to Class B common stock. Sole voting power is vested in Class B common stock except insofar as any applicable law shall permit Class A common stock to vote as a class in regards to any changes in the rights, preferences and privileges attaching to Class A common stock.

In 2004, the Company increased both its Class A and Class B quarterly dividends by 51%. The annualized dividends increased the Company's payout for 2005 by approximately \$27 million. The increase in quarterly shareholder dividends beginning in January 2006 was 10.8% for both Class A and Class B shareholders.

Stock repurchase plan

The current stock repurchase program allows the Company to repurchase up to \$250 million of its outstanding Class A common stock from January 1, 2004, through December 31, 2006. Treasury shares are recorded in the Consolidated Statements of Financial Position at cost. Shares repurchased during 2005 totaled 1.9 million at a total cost of \$99.0 million. Cumulative shares repurchased under the currently authorized repurchase plan through 2005 totaled 3.0 million at a total cost of \$153.0 million, or \$50.41 per share.

On February 21, 2006, the Board of Directors approved a continuation of the current stock repurchase program allowing an additional \$250 million of Company Class A Common stock to be repurchased through December 31, 2009.

Note 12.**Unpaid losses and loss adjustment expenses**

The following table provides a reconciliation of beginning and ending loss and loss adjustment expense liability balances for the Company's wholly-owned property/casualty insurance subsidiaries:

<i>(in thousands)</i>	2005	2004	2003
Total unpaid losses and loss adjustment expenses at January 1, gross	\$ 943,034	\$845,536	\$717,015
Less reinsurance recoverables	765,563	687,819	577,917
Net balance at January 1	177,471	157,717	139,098
Incurred related to:			
Current accident year	146,312	153,563	154,816
Prior accident years	(5,927)	(343)	(1,832)
Total incurred	140,385	153,220	152,984
Paid related to:			
Current accident year	72,352	75,371	83,043
Prior accident years	53,962	58,095	51,322
Total paid	126,314	133,466	134,365
Net balance at December 31	191,542	177,471	157,717
Plus reinsurance recoverables	827,917	765,563	687,819
Total unpaid losses and loss adjustment expenses at December 31, gross	\$1,019,459	\$943,034	\$845,536

The 2005 net incurred losses and loss adjustment expenses of \$5.9 million related to prior accident years are the result of positive development of personal auto and commercial multi-peril attributable to an improvement in actual claims severity compared to historical trends.

Note 13.**Related party transactions****Management fee**

A management fee is charged to the Exchange for services provided by the Company under subscriber's agreements with policyholders of the Exchange. The fee is a percentage of direct written premium of the Property and Casualty Group. This percentage rate is adjusted periodically by the Company's Board of Directors but cannot exceed 25%. The management rate charged the Exchange was 23.75% in 2005. In 2004, the management fee rate charged the Exchange was 23.5% in the first half of 2004 and 24% during the second half of 2004. The management fee rate was 24% during 2003. The Board of Directors elected to set the fee at 24.75% beginning January 1, 2006.

There is no provision for termination of the Company's appointment as attorney-in-fact and the appointment is not affected by a policyholder's disability or incapacity.

Service agreement revenue

Service agreement revenue previously included service income received from the Exchange as compensation for the management of voluntary assumed reinsurance from nonaffiliated insurers. Service agreement fee revenue amounted to \$.8 million and \$.7 million in 2004 and 2003, respectively.

Intercompany reinsurance pooling agreement

EIC, EIPC, Flagship and EINY have an intercompany reinsurance pooling agreement with the Exchange, whereby these companies cede all of their direct property/casualty insurance to the Exchange, except for the annual premium under the all-lines aggregate excess-of-loss reinsurance agreement discussed below. EIC and EINY then assume 5% and 0.5%, respectively, of the total of the Exchange's insurance business (including the business assumed from EIC and EINY). The participation percentages are determined by the Board of Directors. Intercompany accounts are settled by payment within 30 days after the end of each quarterly accounting period. The purpose of the pooling agreement is to spread the risks of the members of the Property and Casualty Group by the different lines of business they underwrite and geographic regions in which each operates. This agreement may be terminated by any party as of the end of any calendar year by providing not less than 90 days advance written notice.

Aggregate excess-of-loss reinsurance agreement

Through 2005, EIC and EINY had in effect an all-lines aggregate excess-of-loss reinsurance agreement with the Exchange. The purpose of the excess-of-loss reinsurance agreement was to reduce the variability of earnings and thereby reduce the adverse effects on the results of operations of EIC and EINY in a given year if the frequency or severity of claims were substantially higher than historical averages. The excess-of-loss reinsurance agreement was not renewed for the 2006 accident year due to the proposed pricing for the coverage as well as the loss profile of the Property and Casualty Group. The Property and Casualty Group maintains sufficient property catastrophe coverage from unaffiliated reinsurers and no longer participates in the assumed reinsurance business.

This excess-of-loss reinsurance agreement limited EIC's and EINY's retained share of ultimate net losses in any applicable accident year. The excess-of-loss agreement provided that once EIC and EINY sustained ultimate net losses, excluding losses from terrorism, nuclear, biological and chemical events, in any applicable accident year that exceeded an amount equal to 72.5% of EIC's and EINY's net premium earned in that period, the Exchange would be liable for 95% of the amount of such excess, up to but not exceeding, an amount equal to 95% of 15% of EIC and EINY's net premium

earned. Losses equal to 5% of the net ultimate net loss in excess of the retention under the contract were retained net by EIC and EINY. The contract permitted loss recoverables only when claims were paid. The contract also required that any unpaid loss recoverables be commuted 60 months after an annual period expired. This reinsurance treaty was excluded from the intercompany pooling agreement. The annual premium was subject to a minimum premium of \$3.0 million in 2005. The annual premium paid to the Exchange for the agreement totaled \$3.3 million, \$3.6 million and \$2.5 million in 2005, 2004 and 2003, respectively.

Included in the 2005 net charges of \$2.2 million are charges under the agreement of \$1.5 million plus net charges of \$0.7 million related to the commutations of the 1999 and 2000 accident year. The unpaid loss recoverable related to the 1999 accident year of \$3.4 million was settled in March 2005. The present value of the estimated losses from the 1999 accident year, or \$3.0 million, was settled with the Exchange and cash payment made by the Company's property/ casualty insurance subsidiaries resulting in a charge to the Company of \$0.4 million. The \$2.0 million unpaid loss recoverable related to the 2000 accident year was settled in December 2005. The present value of these estimated losses from the 2000 accident year, or \$1.7 million, was settled with the Exchange by the Company's property/casualty insurance subsidiaries resulting in a charge to the Company of \$0.3 million. The cash will be paid for settlement of the 2000 accident year in the first quarter of 2006.

(in thousands)	Accident year	
	1999	2000
Loss recoverables	\$ 3,419	\$ 2,038
Settlement of loss recoverables at present value	(3,033)	(1,710)
Net charge related to commutation	\$ 386	\$ 328

Total charges of \$7.7 million were recorded under the excess-of-loss reinsurance agreement during 2004, of which \$6.0 million related to the reversal of previously recorded recoverables for the 2003 accident year. Recoveries recorded during 2003 totaled \$6.5 million.

While the excess-of-loss agreement was not renewed for 2006, the remaining open accident years under the agreement, 2001 through 2005, will be settled and losses will be commuted as the 60 months expire.

eCommerce program and related information technology infrastructure

The Erie Insurance Group undertook a series of initiatives to develop its capabilities to transact business electronically, which began in 2001. In connection with this program, referred to as eCommerce, the Company and the Property and Casualty Group entered into a Cost Sharing Agreement for Information Technology Development (Agreement). The Agreement describes how member companies of the Erie Insurance Group will share the costs to be incurred for the development

and maintenance of new Internet-enabled property/ casualty agency interface, policy administration and customer relationship management systems (ERIEConnection® system).

The Agreement provides that the development cost of the application systems and the directly related enabling technology costs, such as required infrastructure and architectural tools, will be shared among the Property and Casualty Group in a manner consistent with the sharing of insurance transactions under the existing intercompany pooling agreement. Certain other costs of the eCommerce program are related to information technology hardware, networks and upgrades to technology platforms and are not included under the Agreement. These costs are included in the cost of management operations in the Consolidated Statements of Operations. The amounts incurred by the property/casualty subsidiaries of the Company have not been material.

Expense allocations

The claims handling services of the Exchange are performed by personnel who are entirely dedicated to and paid for by the Exchange from its own policyholder revenues. The Exchange's claims function and its management and administration are exclusively the responsibility of the Exchange and not a part of the service the Company provides under the subscriber's agreement. Likewise, personnel who perform activities within the life insurance operations of EFL are paid for by EFL from its own policyholder revenues. However, the Company is the legal entity that employs personnel on behalf of the Exchange and EFL and functions as a common paymaster for all employees. Common overhead expenses included in the expenses paid for by the Company are allocated based on appropriate utilization statistics (employee count, square footage, vehicle count, project hours, etc.) specifically measured to accomplish proportional allocations. Executive compensation is allocated based on each executive's primary responsibilities (management services, property/casualty claims operations, EFL operations and investment operations). Management believes the methods used to allocate common overhead expenses among the affiliated entities are reasonable.

Payments on behalf of related entities

The Company makes certain payments for the account of the Group's related entities. The Company, in making these payments, is acting as the common paymaster. Cash transfers are settled monthly.

The amounts of these cash settlements for Company payments made for the account of related entities were as follows for the years ended December 31:

(in thousands)	2005	2004	2003
Erie Insurance Exchange	\$265,359	\$237,842	\$217,794
Erie Family Life Insurance	35,556	28,925	26,081
Total cash settlements	\$300,915	\$266,767	\$243,875

Office leases

The Company occupies certain office facilities owned by the Exchange and EFL. The Company leases office space on a year-to-year basis from the Exchange. Rent expenses under these leases totaled \$10.3 million, \$11.4 million and \$11.8 million in 2005, 2004 and 2003, respectively. The Company has a lease commitment until 2008 with EFL for a branch office. Rentals paid to EFL under this lease totaled \$3 million in each of the years 2005, 2004 and 2003, respectively.

Notes receivable from EFL

The Company is due \$25 million from EFL in the form of a surplus note that was issued in 2003. The note may be repaid only out of unassigned surplus of EFL. Both principal and interest payments are subject to prior approval by the Pennsylvania Insurance Commissioner. The note bears an annual interest rate of 6.70% and will be payable on demand on or after December 31, 2018, with interest scheduled to be paid semi-annually. EFL paid interest to the Company totaling \$1.7 million in 2005 and 2004 and \$.6 million in 2003.

On December 30, 2005, EFL repaid its \$15 million surplus note that was payable to the Company on December 31, 2005. Prior approval was received from the Pennsylvania Insurance Commissioner authorizing repayment of the surplus note. EFL paid interest on this note to the Company totaling \$1.0 million in each of the years 2005, 2004 and 2003, respectively.

Note 14.

Receivables from Erie Insurance Exchange and concentrations of credit risk

Financial instruments could potentially expose the Company to concentrations of credit risk, including unsecured receivables from the Exchange. A large majority of the Company's revenue and receivables are from the Exchange and affiliates. See also Note 15.

The Company has a receivable due from the Exchange for reinsurance recoverable from unpaid losses and loss adjustment expenses and unearned premium balances ceded under the intercompany pooling arrangement totaling \$952.7 million and \$893.1 million at December 31, 2005 and 2004, respectively. Management fee and expense allocation amounts due from the Exchange were \$194.8 million and \$207.2 million at December 31, 2005 and 2004, respectively. The receivable from EFL for expense allocations totaled \$3.9 million at December 31, 2005, compared to \$4.3 million at December 31, 2004.

Premiums due from policyholders of the Company's wholly-owned property/casualty insurance subsidiaries equaled \$267.6 million and \$275.7 million at December 31, 2005 and 2004, respectively. A significant amount of these receivables are ceded to the Exchange as part of the intercompany pooling agreement and are included in reinsurance recoverables on the Consolidated Statements of Financial Position. See also Note 16.

Note 15.

Variable interest entity

The Exchange is a variable interest entity because of the absence of decision-making capabilities by the equity owners (subscribers) of the Exchange. The Company holds a variable interest in the Exchange, however, the Company does not qualify as the primary beneficiary under Financial Accounting Standards Interpretation 46, "Consolidation of Variable Interest Entities." The Company has a significant interest in the financial condition of the Exchange because management fee revenues, which accounted for 71.6% of the Company's 2005 total revenues, are based on the direct written premiums of the Exchange and the other members of the Property and Casualty Group. Additionally, the Company participates in the underwriting results of the Exchange through the pooling arrangement in which the Company's insurance subsidiaries have a 5.5% participation. Finally, a concentration of credit risk exists related to the unsecured receivables due from the Exchange for certain fees, costs and reimbursements.

The financial statements of the Exchange are prepared in accordance with Statutory Accounting Principles (SAP) required by the National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual*, as modified to include prescribed or permitted practices of the Commonwealth of Pennsylvania. The Exchange does not, nor is it required to, prepare financial statements in accordance with Generally Accepted Accounting Principles (GAAP). Financial statements prepared under SAP generally provide a more conservative approach than under GAAP. Under SAP, the principle focus is on the solvency of the insurer in order to protect the interests of the policyholders. Some significant differences between SAP and GAAP include the following:

- * Fixed maturities and short-term investments are valued at amortized cost or the lower of amortized cost or market under SAP. The SAP valuations are dependent upon the ERIE designation prescribed to the investment by the NAIC. GAAP requires these securities be valued at fair value;
- * SAP recognizes expenses when incurred and does not allow for the establishment of deferred policy acquisition cost assets;
- * Statutory deferred tax calculations limit the amount of deferred tax assets that can be recorded and deferred taxes are direct charges or credits to surplus;
- * GAAP requires the establishment of an asset for the estimated salvage and subrogation that will be recovered in the future. Under SAP, a company may establish this recoverable, but is not required to do so. The Exchange does not establish estimated salvage and subrogation recoveries;
- * As prescribed by the Insurance Department of the Commonwealth of Pennsylvania, the Exchange records in its statutory basis financial statements,

unearned subscriber fees (fees to attorney-in-fact) as deductions from unearned premium reserve and charges current operations on a pro-rata basis over the periods covered by the policies.

The selected financial data below is derived from the Exchange's financial statements prepared in accordance with SAP. In the opinion of management, all adjustments consisting only of normal recurring accruals, considered necessary for a fair presentation, have been included. The condensed financial data set forth below represents the Exchange's share of underwriting results after accounting for intercompany pool transactions.

Selected financial data of the Exchange

Condensed statutory statements of operations

(in thousands)	Years ended December 31		
	2005	2004	2003
Premiums earned	\$3,762,260	\$3,672,486	\$3,372,308
Losses and loss adjustment expenses	2,371,660	2,502,313	2,772,940
Insurance underwriting and other expenses*	996,357	1,013,846	955,377
Dividends to policyholders	25,004	14,692	16,788
Other expense	12,778	13,305	11,189
Total underwriting operations expenses	3,405,799	3,544,156	3,756,294
Net underwriting gain (loss)	356,461	128,330	(383,986)
Net investment income	370,977	282,388	232,677
Net realized gains	438,487	162,905	734,848
Total investment income	809,464	445,293	967,525
Net income before federal income tax	1,165,925	573,623	583,539
Federal income tax expense	379,563	180,824	142,106
Net income	\$ 786,362	\$ 392,799	\$ 441,433

* Includes management fees and service fees paid or accrued to the Company

Condensed statutory statements of financial position

(in thousands)	As of December 31	
	2005	2004
Assets		
Fixed maturities	\$4,534,116	\$4,399,458
Equity securities:		
Common stock	1,736,538	1,508,664
Preferred stock	648,301	550,090
Limited partnerships	599,745	567,089
Real estate mortgage loans	10,533	10,859
Real estate	35,277	36,305
Cash and cash equivalents	299,160	125,933
Surplus note from EFL	20,000	0
Other assets	33,945	1,049
Total invested assets	7,917,615	7,199,447
Premiums receivable	981,844	1,002,818
Federal income taxes recoverable	76,217	0
Deferred income taxes	17,518	0
Other assets	77,069	67,497
Total assets	\$9,070,263	\$8,269,762
Liabilities		
Loss and LAE reserves	\$3,549,128	\$3,436,246
Unearned premium reserves	1,509,636	1,536,890
Accrued liabilities	629,749	400,375
Deferred income taxes	0	92,193
Total liabilities	5,688,513	5,465,704
Total policyholders' surplus	3,381,750	2,804,058
Total liabilities and policyholders' surplus	\$9,070,263	\$8,269,762

The Exchange's Policyholders' surplus increased 20.6% during 2005, primarily as a result of improved underwriting results and increased net investment income.

Common equity securities represent a significant portion of the Exchange's investment portfolio and surplus and are exposed to price risk, volatility of the capital markets and general economic conditions. Common stock investments made up approximately 51% and 54% of the Exchange's statutory surplus at December 31, 2005 and 2004, respectively. The common stock portfolio has been diversified and all of the portfolio is now managed by external equity managers.

The Exchange had realized and unrealized capital gains on its common stock portfolio of \$105.2 million and \$60 million for the years ended December 31, 2005 and 2004, respectively. Net proceeds from the sale of common stock investments were \$969.9 million in 2005, which included \$447.5 million in realized capital gains compared to proceeds of \$381.4 million in 2004, which included \$137.4 million in realized capital gains.

The weighted average current price to 12-months earnings ratio of the Exchange's common stock portfolio was 21.08 and 20.85 at December 31, 2005 and 2004, respectively. The Standard & Poors composite price to trailing 12-months earnings ratio was 17.39 at December 31, 2005, and 20.24 at December 31, 2004.

If the surplus of the Exchange were to decline significantly from its current level, the Property and Casualty Group could find it more difficult to retain its existing business and attract new business. A decline in the business of the Property and Casualty Group would have an adverse effect on the amount of the management fees the Company receives and the underwriting results of the Property and Casualty Group in which the Company has a 5.5% participation. In addition, a decline in the surplus of the Exchange from its current level would make it more likely that the management fee rate received by the Company would be reduced.

Condensed statutory statements of cash flows

(in thousands)	Years ended December 31		
	2005	2004	2003
Cash flows from operating activities			
Premiums collected net of reinsurance	\$ 3,754,392	\$ 3,748,540	\$ 3,473,030
Net investment income received	385,153	293,517	236,656
Miscellaneous expense	(12,778)	(13,305)	(11,188)
Losses paid	(1,929,867)	(1,993,342)	(2,029,696)
Management fee and expenses paid	(1,336,369)	(1,325,798)	(1,237,829)
Dividends to policyholders	(22,652)	(16,409)	(13,892)
Income taxes (paid) recovered	(477,469)	(313,840)	171,881
Net cash provided by operating activities	360,410	379,363	588,962
Cash flows from investing activities			
Proceeds from investment sales and maturities	3,316,424	2,032,622	4,370,411
Purchases of investments	(3,748,296)	(2,797,488)	(4,501,440)
Net cash used in investing activities	(431,872)	(764,866)	(131,029)
Cash flows from financing activities			
Payments on borrowings	0	(55)	(53)
Other cash provided (applied)	244,689	(101,480)	(341,711)
Net cash provided by (used in) financing activities	244,689	(101,535)	(341,764)
Net increase (decrease) in cash and cash equivalents	173,227	(487,038)	116,169
Cash and cash equivalents at beginning of year	125,933	612,971	496,802
Cash and cash equivalents at end of year	\$ 299,160	\$ 125,933	\$ 612,971

Note 16.**Reinsurance**

Reinsurance contracts do not relieve the Property and Casualty Group from its primary obligations to policyholders. A contingent liability exists with respect to reinsurance recoverables in the event reinsurers are unable to meet their obligations under the reinsurance agreements.

During 2003, the Property and Casualty Group replaced coverage previously provided by individual facultative contracts with reinsurance treaties. One of the agreements was a property risk excess-of-loss reinsurance treaty on commercial property risks that provided coverage of 100% of a loss of \$20 million in excess of the Property and Casualty Group's loss retention of \$5 million per risk. There was a limit of \$40 million per any one loss occurrence. This agreement was terminated as of December 31, 2003. Since January 1, 2004, the Property and Casualty Group has acquired facultative reinsurance on all risks in excess of \$25 million in property limits.

The Company maintains an umbrella excess-of-loss reinsurance treaty covering commercial and personal catastrophe liability risks. In 2005, this treaty provided coverage of 60% of a specified loss amount in excess of the loss retention of \$1 million per occurrence. The specified maximum loss amount for the commercial and personal catastrophe liability was \$9 million and \$4 million, respectively. This treaty was renewed, effective January 1, 2006, at coverage of 90%, all other limits remaining the same. The specified maximum loss amounts remained the same for commercial and personal catastrophe liabilities.

The Property and Casualty Group maintains a property catastrophe treaty to mitigate future potential catastrophe loss exposure. During 2005, this reinsurance treaty provided coverage of up to 95% of a loss of \$400 million in excess of the Property and Casualty Group's loss retention of \$200 million per occurrence. This agreement was renewed for 2006 to provide coverage of up to 95% of a loss of \$400 million in excess of the Property and Casualty Group's loss retention of \$300 million per occurrence.

The Property and Casualty Group exited the assumed reinsurance business effective December 31, 2003. While certain expenses will continue to be incurred until all related claims are settled, only nominal premiums were generated in 2004 and 2005. Loss reserves for unaffiliated assumed reinsurance of the Property and Casualty Group was \$177 million at December 31, 2005.

The following tables summarize insurance and reinsurance activities of the Company's property/casualty insurance subsidiaries. See also Note 13 for a discussion of the intercompany reinsurance pooling agreement with the Exchange.

(in thousands)	Years ended December 31		
	2005	2004	2003
Premiums earned			
Direct	\$ 704,366	\$ 699,533	\$ 644,286
Assumed from nonaffiliates and intercompany pool	226,245	225,905	202,147
Ceded to Erie Insurance Exchange	(714,787)	(717,236)	(654,841)
Assumed from Erie Insurance Exchange	215,824	208,202	191,592
Losses and loss adjustment expenses incurred			
Direct	\$ 499,262	\$ 510,260	\$ 512,740
Assumed from nonaffiliates and intercompany pool	152,534	169,870	175,360
Ceded to Erie Insurance Exchange	(511,411)	(526,910)	(535,116)
Assumed from Erie Insurance Exchange	140,385	153,220	152,984

Note 17.**Statutory information**

Accounting principles used to prepare statutory financial statements differ from those used to prepare financial statements under U.S. GAAP. The statutory financial statements of EIPC and EIC are prepared in accordance with accounting practices prescribed and permitted by the Pennsylvania Insurance Department. EINY prepares its statutory financial statements in accordance with accounting practices prescribed and permitted by the New York Insurance Department. Prescribed SAP include state laws, regulations and general administration rules, as well as a variety of publications from the NAIC.

Consolidated shareholders' equity, including amounts reported by the Company's property/casualty insurance subsidiaries on the statutory basis, was \$1.3 billion at both December 31, 2005 and 2004. Consolidated net income, including amounts reported by the Company's property/casualty insurance subsidiaries on a statutory basis, was \$233.4 million, \$228.6 million and \$200.0 million for 2005, 2004 and 2003, respectively.

The minimum statutory capital and surplus requirements under Pennsylvania and New York law for the Company's stock property/casualty subsidiaries amounts to \$10.0 million. The Company's subsidiaries total statutory capital and surplus significantly exceed these minimum requirements, totaling, \$184.4 million at December 31, 2005. The Company's subsidiaries risk-based capital levels significantly exceed the minimum requirements.

Cash and securities with carrying values of \$3.6 million were deposited by the Company's property/casualty insurance subsidiaries with regulatory authorities under statutory requirements as of December 31, 2005 and 2004.

The amount of dividends the Company's Pennsylvania-domiciled property/casualty subsidiaries, EIC and EIPC, can pay without the prior approval of the Pennsylvania Insurance Commissioner is limited by Pennsylvania regulation to not more than the greater of: (a) 10% of its statutory surplus as reported on its last annual statement, or (b) the net income as reported on its last annual statement. The amount of dividends that the Erie Insurance Company's New York-domiciled property/casualty subsidiary, EINY, can pay without the prior approval of the New York Superintendent of Insurance is limited to the lesser of: (a) 10% of its statutory surplus as reported on its last annual statement, or (b) 100% of its adjusted net investment income during such period. At December 31, 2005, the maximum dividend the Company could receive from its property/casualty insurance subsidiaries was \$25.2 million. No dividends were paid to the Company from its property/casualty insurance subsidiaries in 2005, 2004 or 2003.

The amount of dividends EFL, a Pennsylvania-domiciled life insurer, can pay to its shareholders without the prior approval of the Pennsylvania Insurance Commissioner is limited by statute to the greater of: (a) 10% of its statutory surplus as regards policyholders as shown on its last annual statement on file with the commissioner, or (b) the net income as reported for the period covered by such annual statement, but shall not include pro-rata distribution of any class of the insurer's own securities. Accordingly, the Company's share of the maximum dividend payout which may be made in 2006 without prior Pennsylvania Commissioner approval is \$4.0 million. Dividends declared to the Company totaled \$1.8 million in 2005.

Note 18.

Supplementary data on cash flows

A reconciliation of net income to net cash provided by operating activities as presented in the Consolidated Statements of Cash Flows is as follows:

	Years ended December 31		
(in thousands)	2005	2004	2003
Cash flows from operating activities			
Net income	\$231,104	\$ 226,413	\$ 199,725
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	36,855	37,317	41,816
Deferred income tax (benefit) expense	(922)	866	949
Realized gain on investments	(15,620)	(18,476)	(10,445)
Equity in (earnings) losses from limited partnerships	(38,062)	(8,655)	2,000
Net amortization of bond premium	2,742	1,664	1,124
Undistributed earnings of Erie Family Life Insurance	(1,837)	(3,800)	(5,712)
Deferred compensation	4,631	2,987	1,392
Limited partnership distributions	71,718	37,165	21,266
Increase in receivables from the Exchange and reinsurance recoverable	(39,062)	(129,726)	(182,598)
Increase in prepaid expenses and other assets	(37,201)	(38,984)	(34,017)
Increase in accounts payable and accrued expenses	28,454	30,530	26,081
Increase in loss reserves	76,425	97,498	128,521
(Decrease) increase in unearned premiums	(18,144)	22,946	56,515
Net cash provided by operating activities	\$301,081	\$ 257,745	\$ 246,617

Note 19.**Commitments**

The Company has contractual commitments to invest up to \$243.2 million related to its limited partnership investments at December 31, 2005. These commitments will be funded as required by the partnerships' agreements which principally expire in 2010. At December 31, 2005, the total remaining commitment to fund limited partnerships that invest in private equity securities is \$86.5 million, real estate activities is \$108.7 million and mezzanine debt securities is \$48.0 million. The Company expects to have sufficient cash flows from operations to meet these partnership commitments.

The Company is involved in litigation arising in the ordinary course of business. In the opinion of management, the effects, if any, of such litigation are not expected to be material to the Company's consolidated financial condition, cash flows or operations.

Note 20.**Segment information**

The Company operates its business as three reportable segments—management operations, insurance underwriting operations and investment operations. Accounting policies for segments are the same as those described in the summary of significant accounting policies, with the exception of the management fee revenues received from the property/casualty insurance subsidiaries. These revenues are not eliminated in the segment detail below, as management bases its decisions on the segment presentation. See also Note 3. Assets are not allocated to the segments but rather are reviewed in total by management for purposes of decision-making. No single customer or agent provides 10% or more of revenues for the Property and Casualty Group.

The Company's principal operations consist of serving as attorney-in-fact for the Exchange, which constitute its management operations. The Company operates in this capacity solely for the Exchange. The Company's insurance underwriting operations arise through direct business of its property/casualty insurance subsidiaries and by virtue of the pooling agreement between its subsidiaries and the Exchange, which includes assumed reinsurance from nonaffiliated domestic and foreign sources. The Exchange exited the assumed reinsurance business effective December 31, 2003, and therefore reinsurance-nonaffiliates includes only run-off activity of the assumed reinsurance business in 2004 and 2005. Insurance provided in the insurance underwriting operations consists of personal and commercial lines and is sold by independent agents. Personal lines are marketed to individuals and commercial lines are marketed to small- and medium-sized businesses. The performance of the personal lines and commercial lines is evaluated based upon the underwriting results as determined under SAP for the total pooled business of the Property and Casualty Group.

Company management evaluates profitability of its management operations segment principally on the gross margin from management operations, while profitability of the insurance underwriting operations segment is evaluated principally based on the combined ratio. Investment operations performance is evaluated by Company management based on appreciation of assets, rate of return and overall return.

Summarized financial information for these operations is presented below.

<i>(in thousands)</i>	Years ended December 31		
	2005	2004	2003
Management operations			
<i>Operating revenue</i>			
Management fee revenue	\$940,274	\$945,066	\$878,380
Service agreement revenue	20,568	21,855	27,127
Total operating revenue	960,842	966,921	905,507
Cost of management operations	751,573	724,329	652,256
Income before income taxes	\$209,269	\$242,592	\$253,251
Net income from management operations	\$140,388	\$164,436	\$165,495
Insurance underwriting operations			
<i>Operating revenue</i>			
Premiums earned:			
Personal lines	\$153,859	\$148,935	\$132,093
Commercial lines	65,605	62,647	56,248
Reinsurance—nonaffiliates	(378)	250	5,781
Reinsurance—affiliate	(3,262)	(3,630)	(2,530)
Total premiums earned	215,824	208,202	191,592
<i>Operating expenses</i>			
Losses and expenses:			
Personal lines	144,953	143,458	147,927
Commercial lines	56,732	59,726	67,413
Reinsurance—nonaffiliates	(3,037)	1,642	7,654
Reinsurance—affiliate	2,226	7,740	(6,461)
Total losses and expenses	200,874	212,566	216,533
Income (loss) before income taxes	\$ 14,950	\$ (4,364)	\$ (24,941)
Net income (loss) from insurance underwriting operations	\$ 10,029	\$ (2,958)	\$ (16,296)

<i>(in thousands)</i>	Years ended December 31		
	2005	2004	2003
Investment operations			
Investment income, net of expenses	\$ 61,555	\$ 60,988	\$ 58,298
Net realized gains on investments	15,620	18,476	10,445
Equity in earnings (losses) of limited partnerships	38,062	8,655	(2,000)
Income before income taxes and before equity in earnings of EFL	\$ 115,237	\$ 88,119	\$ 66,743
Net income from investment operations	\$ 77,306	\$ 59,729	\$ 43,617
Equity in earnings of EFL, net of tax	\$ 3,381	\$ 5,206	\$ 6,909
Reconciliation of reportable segment revenues and operating expenses to the Consolidated Statements of Operations			
Segment revenues	\$1,176,666	\$1,175,123	\$1,097,099
Elimination of intersegment management fee revenues	(51,716)	(51,979)	(48,311)
Total operating revenue	\$1,124,950	\$1,123,144	\$1,048,788
Segment operating expenses	\$ 952,447	\$ 936,895	\$ 868,789
Elimination of intersegment management fee expenses	(51,716)	(51,979)	(48,311)
Total operating expenses	\$ 900,731	\$ 884,916	\$ 820,478

The intersegment revenues and expenses that are eliminated in the Consolidated Statements of Operations relate to the Company's property/casualty insurance subsidiaries 5.5% share of the management fees paid to the Company.

Note 21.**Quarterly results of operations (unaudited)**

<i>(in thousands, except per share data)</i>	First quarter	Second quarter	Third quarter	Fourth quarter
2005				
Operating revenue	\$ 276,171	\$ 299,915	\$ 287,551	\$ 261,313
Operating expenses	(212,461)	(233,373)	(233,688)	(221,209)
Investment income—unaffiliated	22,076	45,775	24,552	22,834
Income before income taxes and equity in earnings of EFL	\$ 85,786	\$ 112,317	\$ 78,415	\$ 62,938
Net income	\$ 57,771	\$ 76,168	\$ 53,005	\$ 44,160
Net income per share: (*)				
Class A—basic	\$.91	\$ 1.21	\$.84	\$.72
Class B—basic	138.84	183.89	128.01	107.45
Diluted	.83	1.10	.76	.66
Comprehensive income	37,455	73,969	42,250	40,500
2004				
Operating revenue	\$ 265,911	\$ 298,326	\$ 291,083	\$ 267,824
Operating expenses	(211,176)	(234,556)	(224,414)	(214,770)
Investment income—unaffiliated	17,957	20,100	19,499	30,563
Income before income taxes and equity in earnings of EFL	\$ 72,692	\$ 83,870	\$ 86,168	\$ 83,617
Net income	\$ 49,572	\$ 56,955	\$ 58,566	\$ 61,320
Net income per share: (*)				
Class A—basic	\$.77	\$.89	\$.92	\$.96
Class B—basic	117.87	135.81	139.84	146.36
Diluted	.70	.81	.83	.87
Comprehensive income	62,630	23,878	73,689	58,425

(*) The cumulative sum of quarterly basic and diluted net income per share amounts may not equal total basic and diluted net income per share for the year due to differences in weighted average shares and equivalent shares outstanding for each of the periods presented.

2005

Includes a \$14.2 million second quarter correction to record unrealized gains and losses on limited partnerships to equity in earnings or losses of limited partnerships in the Consolidated Statements of Operations. This correction increased net income per share-diluted by \$.13, of which \$.09 per share-diluted related to 2004 and prior years.

2004

Includes a \$5.2 million fourth quarter adjustment to recognize reduced commercial commission rates to be paid in 2005 on premiums yet to be collected at December 31, 2004.

Reflects a fourth quarter adjustment of \$3.1 million to record a tax benefit as a result of an IRS audit of 2002 and 2001.

Market Price of, and Dividends on, Common Stock and Related Shareholder Matters

Common stock prices

The Class A non-voting common stock of the Company trades on the NASDAQ Stock Market under the symbol "ERIE." The following sets forth the range of closing high and low trading prices by quarter as reported by the NASDAQ Stock Market.

Class A trading price

	2005		2004	
	Low	High	Low	High
First quarter	\$51.33	\$54.39	\$41.75	\$48.26
Second quarter	50.15	54.83	43.92	49.29
Third quarter	52.14	54.66	45.32	51.29
Fourth quarter	51.79	53.34	47.79	53.00

No established trading market exists for the Class B voting common stock.

The Company's 401(k) plan for employees permits participants to invest a portion of the Company's contributions to the plan in shares of Erie Indemnity Class A common stock. The plan's trustee is authorized to buy Erie Indemnity Company Class A common stock on behalf of 401(k) plan participants. Plan participants held 126,451 and 112,698 Company Class A shares at December 31, 2005 and 2004, respectively.

The Company has a stock repurchase plan that was authorized at the end of 2003, allowing the Company to repurchase up to \$250 million of its outstanding Class A common stock through December 31, 2006. The Company may purchase the shares from time to time in the open market or through privately negotiated transactions, depending on prevailing market conditions and alternative uses of the Company's capital. Shares repurchased during 2005 totaled 1,890,159 at a total cost of \$99.0 million. Cumulative shares repurchased under the plan since inception was 3,035,224 at a total cost of \$153.0 million.

On February 21, 2006, the Company's Board of Directors reauthorized a \$250 million stock repurchase program. The reauthorized stock repurchase program is effective once the available funds from the current repurchase program are expended, and continues through December 31, 2009.

Common stock dividends

The Company historically has declared and paid cash dividends on a quarterly basis at the discretion of the Board of Directors. The payment and amount of future dividends on the common stock will be determined by the Board of Directors and will depend on, among other things, earnings, financial condition and cash requirements of the Company at the time such payment is considered, and on the ability of the Company to receive dividends from its subsidiaries, the amount of which is subject to regulatory limitations. Dividends declared for each class of stock during 2005 and 2004 are as follows:

Dividends declared:

	Class A share	Class B share
2005		
First quarter	\$.325	\$ 48.75
Second quarter	.325	48.75
Third quarter	.325	48.75
Fourth quarter	.360	54.00
Total	\$1.335	\$200.25

	Class A share	Class B share
2004		
First quarter	\$.215	\$ 32.25
Second quarter	.215	32.25
Third quarter	.215	32.25
Fourth quarter	.325	48.75
Total	\$.970	\$145.50

American Stock Transfer & Trust Company serves as the Company's transfer agent and registrar.

SUBSIDIARIES OF REGISTRANT

Registrant owns 100% of the outstanding stock of the following companies:

<u>Name</u>	<u>State of Formation</u>
Erie Insurance Property & Casualty Company	Pennsylvania
Erie Insurance Company	Pennsylvania
EI Holding Corp.	Delaware
EI Service Corp.	Pennsylvania
Erie Insurance Company of New York - Wholly owned by Erie Insurance Company	New York

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Erie Indemnity Company of our report dated February 16, 2006 (except Note 11, as to which the date is February 21, 2006), included in the 2005 Annual Report to Shareholders of Erie Indemnity Company.

Our audit also included the 2005 and 2004 financial statement schedules of Erie Indemnity Company listed in Item 15(a). These schedules are the responsibility of the Erie Indemnity Company's management. Our responsibility is to express an opinion based on our audits. In our opinion the consolidated financial statement schedules when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ Ernst & Young, LLP

February 21, 2006
Cleveland, Ohio

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

I, Jeffrey A. Ludrof, certify that:

1. I have reviewed this annual report on Form 10-K of Erie Indemnity Company for the year ended December 31, 2005;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting or caused such internal control over financial reporting to be designated under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 22, 2006

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

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

I, Philip A. Garcia, certify that:

1. I have reviewed this annual report on Form 10-K of Erie Indemnity Company for the year ended December 31, 2005;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting or caused such internal control over financial reporting to be designated under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 22, 2006

/s/ Philip A. Garcia

Philip A. Garcia, Executive Vice President & CFO

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

We, Jeffrey A. Ludrof, Chief Executive Officer of the Erie Indemnity Company (Company), and Philip A. Garcia, Chief Financial Officer of the Company, certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. § 1350, that:

- (1) The Annual Report on Form 10-K of the Company for the annual period December 31, 2005 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jeffrey A. Ludrof

Jeffrey A. Ludrof
President & Chief Executive Officer

/s/ Philip A. Garcia

Philip A. Garcia
Executive VP & Chief Financial Officer

February 22, 2006

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Erie Indemnity Company and will be retained by Erie Indemnity Company and furnished to the Securities and Exchange Commission or its staff upon request.