



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

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

**(NO FEE REQUIRED)**

For the fiscal year ended December 31, 2002

OR

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

**[NO FEE REQUIRED]**

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

Commission File Number 0-24000

**ERIE INDEMNITY COMPANY**

*(Exact name of registrant as specified in its charter)*

**Pennsylvania**

**25-0466020**

*(State or other jurisdiction  
of incorporation or organization)*

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

**100 Erie Insurance Place, Erie, Pennsylvania**

**16530**

*(Address of principal executive offices)*

*(Zip code)*

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 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 an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes       No

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 the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date: 64,061,106 Class A shares and 2,890 Class B shares of Common Stock outstanding on February 28, 2003.

**DOCUMENTS INCORPORATED BY REFERENCE:**

1. Portions of the Registrant's Annual Report to Shareholders for the fiscal year ended December 31, 2002 (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 29, 2003 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 (the “Company”) is a Pennsylvania corporation which operates predominantly as a provider of sales, underwriting and policy issuance services to the Erie Insurance Exchange (the “Exchange”). The Company has served since 1925 as attorney-in-fact for the policyholders of the Exchange. Management fees earned in the capacity as attorney-in-fact comprised 77% of total Company revenue in 2002. The Company also operates as a property and 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 and casualty subsidiary, Flagship City Insurance Company (“Flagship”), and the Company’s three property and casualty subsidiaries (collectively, the “Property and Casualty Group”) write personal and commercial lines property and casualty coverages exclusively through over 8,400 independent agents and pool their underwriting results. 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”.

The Property and Casualty Group underwrites a broad line of personal and commercial coverages. Insurance products are marketed primarily in the Midwest, Mid-Atlantic and Southeast regions through independent agents comprising approximately 1,800 insurance agencies. The Property and Casualty Group is licensed to do business in sixteen states and in the District of Columbia and at December 31, 2002, operated in eleven states and the District of Columbia. Twenty-three branch offices are maintained throughout the eleven contiguous states in which the Property and Casualty Group does business. The Property and Casualty Group also underwrites voluntary assumed reinsurance business.

As of December 31, 2002, the Company had over 4,000 full-time employees, of which 1,978 provide claims specific services exclusively for the Property and Casualty Group and 145 perform general services exclusively for EFL. Both the Exchange and EFL reimburse the Company monthly for the cost of these services. None of the Company’s employees is covered by a collective bargaining agreement. As evidenced by a recently completed culture survey completed by an international human resources consulting firm, the Company’s relationship with its employees continues to be good.

### Information About Business Segments

Reference is made to Note 15 of the “Notes to the Consolidated Financial Statements” included in the Annual Report for information as to total revenue and net income attributable to the three business segments (management operations, insurance underwriting operations and investment operations) in which the Company is engaged.

### Management Operations

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 the services required to be performed, including sales, underwriting and policy issuance activities, but currently such fees are not paid to the Company by the Exchange until it collects the premiums. Historically, due to policy renewal and sales patterns, management fees earned 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, where the Property and Casualty Group operates. Management fees recorded from the Exchange account for approximately 77% of the Company’s revenues in 2002.

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The management fee rate charged to the Exchange is set by the Company's Board of Directors. The Company's Board of Directors may change the management fee rate at its discretion. However, the maximum fee level which can be charged the Exchange, is limited by the agreement between each policyholder of the Exchange and the Company to 25% of the affiliated assumed premiums (the Property and Casualty Group, excluding the Exchange) and direct premiums written by the Exchange. The Board considers several factors in determining the management fee rate, including the relative financial position of the Exchange and the Company and the long-term capital needs of the Exchange to ensure its continued growth, competitiveness, and superior financial strength. From 1999 through December 31, 2002, the management fee rate charged the Exchange has been at its maximum permitted level of 25%. In December 2002, the Board voted to lower the management fee rate to 24% beginning January 1, 2003.

All premiums collected, less the management fee paid to the Company, are retained by the Exchange for the purpose of paying losses, loss adjustment expenses, investment expenses and other miscellaneous expenses including insurance-related taxes, licenses and fees, certain information technology costs covered under a technology cost-sharing agreement, and for other purposes that are to the benefit of the policyholders.

The Company receives a service agreement fee from the Exchange, at the rate of 7% of voluntary assumed written premium as compensation for the management and administration of its voluntary assumed reinsurance business from non-affiliated insurers. Service agreement revenue is earned when reinsurance premiums are earned because the services required to be performed by the Company are completed over the terms of the related treaties. The Company's Board of Directors approved a reduction in the service fee rate from 7% to 6% beginning January 1, 2003.

The Company also collects service charges from Policyholders for providing extended payment terms 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 when each additional billing is rendered to the policyholder.

Both the service charges and service agreement fees are included in service agreement revenue in the Consolidated Statements of Operations.

The cost of management operations includes all independent agent commission expenses as well as personnel and benefit costs, underwriting and policy issuance costs and other administrative expenses of the Company.

The largest component of the cost of management operations is the cost of independent agent commissions and other incentive programs for the Company's independent agents. Included in commission costs is the cost of scheduled commissions earned on premiums written, agency contingency awards based on the three-year average underwriting profitability of the business written with the Property & Casualty Group, accelerated commissions earned by start-up agencies and promotional incentives to agents.

Personnel and benefit costs related to the sales, underwriting and issuance of policies and the administrative staff of the Company are the second largest component of the cost of management operations. Expenses other than personnel and benefit costs related to the underwriting and issuance of new business vary with the number of new policies. Underwriting reports, printing, postage and other cost of materials necessary for the underwriting and issuance of policies are included in the cost of management operations.

Additional costs are incurred for general administrative expenses of the Company including the cost of office facilities, travel, telephone and communication costs, the cost of data processing and information technology and

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other miscellaneous expenses. Beginning in 2001, Erie Insurance Group initiated the eCommerce program and committed to new information technology infrastructure expenditures as part of the program. The Company's share of these eCommerce infrastructure expenditures are included in the cost of management operations. Non-infrastructure costs of the eCommerce program which are subject to the technology cost-sharing agreement are included in the insurance underwriting operations segment.

The Company's management operations are affected by factors such as competition, insurance industry market conditions and changes in insurance distribution systems as well as general economic and investment conditions.

### **Insurance Underwriting Operations**

The Company's property and casualty insurance subsidiaries participate in the underwriting results of the Exchange via a pooling arrangement under which the Exchange has a 94.5% participation in the underwriting results of the Property and Casualty Group. The Company's property and casualty insurance subsidiaries, the Erie Insurance Company and the Erie Insurance Company of New York, have a 5.5% participation. As such, the Company has an interest in the underwriting profitability of the business written as well as the volume of premium written. An excess of loss reinsurance agreement between the Exchange, Erie Insurance Company and Erie Insurance Company of New York limits the amount of sustained ultimate net losses in any applicable accident year for the Erie Insurance Company and the Erie Insurance Company of New York. The excess of loss reinsurance agreement is excluded from the pooling arrangement.

### **Industry**

One of the distinguishing features of the property and casualty insurance industry is that in general its products are priced before its costs are known, as premium rates are generally determined before losses are reported. Current prices must be established from forecasts of the ultimate costs expected to arise from exposures underwritten during the coverage period when the rates are applied. Changes in statutory, "regulatory" and case law can significantly affect the liabilities associated with known risks after the insurance contract is in place. Property and casualty insurance companies' ability to increase prices in response to declines in profitability are limited by the large number of competitors and the similarity of products offered, as well as regulatory constraints.

The profitability of the property and casualty insurance business is influenced by many external factors some of which include rate competition, the severity and frequency of claims, terrorist actions, natural disasters, state regulation of premium rates, and other areas of competition, defaults of reinsurers, investment market conditions, general business conditions, court decisions that define and may expand the extent of coverage and the amount of compensation due for injuries and losses.

Inflation also affects the loss costs of property and casualty insurers and, as a consequence, insurance rates. 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.

### **Lines of Business**

The Property and Casualty Group underwrites direct insurance business as well as assumed reinsurance business. The Property and Casualty Group underwrites a broad range of insurance. In 2002, personal lines comprised 70.5% of direct written premium revenue of the Property & Casualty Group while commercial lines constituted the remaining 29.5%. The core products in the

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personal lines are private passenger automobile (74.6%) and homeowners (22.3%) while the core commercial lines consist principally of multi-peril (38.7%), automobile (28.9%) and workers' compensation (29.2%). In 2002, property lines comprised 94.7% of the assumed written premium revenue of the Property and Casualty Group while liability lines constituted the remaining 5.3%.

See "Selected Segment Information" contained in the Annual Report, for the distribution of direct premiums written by the Property and Casualty Group.

## Reinsurance

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 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 catastrophic 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 hurricanes, earthquakes, tornadoes, wind and hail storms, fires and explosions. Since 1993, the Property and Casualty Group had not purchased catastrophe reinsurance because Company management concluded the benefits of such coverage were outweighed by the costs of the coverage in light of the Exchange's substantial surplus position and its ratio of net premiums written to surplus. The lower surplus levels of the Exchange, along with increasing catastrophe risk exposure as a result of accelerating policy growth, have resulted in management's decision to purchase catastrophe reinsurance coverage. Effective January 1, 2003, the Property and Casualty Group entered into a reinsurance treaty to mitigate the future potential catastrophe loss exposure. The agreement is a property catastrophe reinsurance treaty that provides coverage of up to 95% of a loss of \$415 million in excess of the Property and Casualty Group's loss retention of \$115 million per occurrence.

Reference is also made to Note 12 of the "Notes to Consolidated Financial Statements" contained in the Annual Report for the year ended December 31, 2002, incorporated herein by reference, for a complete discussion of reinsurance transactions.

## Combined Ratios

The combined ratio is a standard industry measurement of the results of property and casualty insurance underwriting operations. The statutory combined ratio is the sum of the ratio of incurred losses and loss adjustment expenses to net premiums earned ("loss ratio"), the ratio of underwriting expenses incurred to net premiums written ("expense ratio") and, the ratio of dividends to policyholders to net premiums earned ("dividend ratio"). The generally accepted accounting principles ("GAAP") combined ratio is calculated in the same manner except that it is based on GAAP reported amounts and the denominator for each component is net premiums earned. A combined ratio under 100% generally indicates an underwriting profit; a combined ratio over 100% generally indicates an underwriting loss before contemplation of the time value of money. Investment income, federal income taxes and other non-underwriting income or expense are not reflected in the combined ratio. The profitability of the Property and Casualty Group is a function of income and expense from both its underwriting and investment operations.

The ratios shown in the table below for the Company's property and casualty insurance subsidiaries Erie Insurance Company and Erie Insurance Company of New York, are prepared in accordance with GAAP and with the National Association of Insurance Commissioners (NAIC) Codified Statutory Accounting Practices ("SAP"). The NAIC Codified SAP contain a provision allowing for prescribed or permitted accounting practices to be determined by each states'

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insurance commissioner. Accordingly, such discretion will continue to allow prescribed or permitted accounting practices that may differ from state to state.

	Combined Ratios		
	Year Ended December 31,		
	2002	2001	2000
GAAP Combined Ratio	116.5%	114.9%	108.4%
Statutory operating ratios:			
Loss ratio	83.8	84.5	80.1
Expense and dividend ratio	30.9	30.1	28.2
Statutory Combined Ratio	114.7%	114.6%	108.3%

The 2002 loss ratio reflected continued prior accident year adverse loss development. In 2002, fourth quarter adjustments to strengthen reserves and increases in catastrophe losses on direct business were offset slightly by the effect of premium rate increases. The increased loss ratio in 2001 compared to 2000 resulted from increased loss severity in the Company's private passenger automobile and workers' compensation lines of business, combined with unaffiliated assumed voluntary reinsurance losses from the September 11th terrorist attack on the World Trade Center. The 2002 and 2001 expense and dividend ratio includes the Company's share of expenses related to the eCommerce initiative, which account for 2.4 points and 1.0 points, respectively.

### Investment Operations

The Company's primary invested assets include fixed maturities, equity securities and limited partnerships that constitute 30.0%, 8.2% and 3.9%, of total assets, respectively. Investment operations include investment income and realized gains and losses generated by those assets of the Company's management and insurance underwriting operations. Investment operations performance is evaluated based on appreciation of assets and overall rate of return. Reference is made to Note 3 of the "Notes to Consolidated Financial Statements" contained in the Annual Report for the year ended December 31, 2002, incorporated herein by reference for a complete discussion of investment operations.

### Financial Condition—Investments

The Company's investment strategy takes a long-term perspective emphasizing investment quality, diversification and investment returns providing for liquidity to meet the short and long-term commitments of the Company. Investments are managed on a total return approach that focuses on current income and capital appreciation. The Company's investment portfolio, at market value, increased to \$998.8 million at December 31, 2002, which represents 42.4% of total assets. Investment income reflected on the Consolidated Statements of Operations is affected by shifts in the types of investments in the portfolio, changes in interest rates and other factors. Net investment income was \$55.4 million in 2002 compared to \$49.9 million in 2001 and \$48.4 million in 2000.

The Company reviews the investment portfolio to evaluate positions that might have incurred other-than-temporary declines in value. For all investment holdings, general economic conditions and/or conditions specifically affecting the underlying issuer or its industry are considered in evaluating impairment in value. In addition to specific factors, the primary 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. Reference is made to the Financial Condition section of the "Management's Discussion and Analysis" contained in the Annual Report for the year ended December 31, 2002 incorporated

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herein by reference, for a complete discussion of the investment impairment policy.

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. Management believes its investment valuation philosophy and accounting practices result in appropriate and timely measurement of value and recognition of impairment.

The Company also has a 21.6% common stock interest in EFL of \$48.5 million at December 31, 2002, which is accounted for under the equity method of accounting. EFL, which was organized in 1967 as a Pennsylvania-domiciled life insurance company, has an A.M. Best and Company Inc. ("A.M. Best") rating of A+ (Superior). EFL is primarily engaged in the business of underwriting and selling non-participating individual and group life insurance policies, including universal life, disability income and individual and group annuity products in ten states and the District of Columbia.

Reference is made to the Financial Condition section of the "Management's Discussion and Analysis" contained in the Annual Report for the year ended December 31, 2002 incorporated herein by reference, for a complete discussion of investments.

### **Financial Ratings**

The financial status of the Company is not rated, however, its property/casualty insurance subsidiaries are rated by rating agencies. Insurance companies are rated by rating agencies to provide insurance consumers and investors with meaningful information on specific insurance companies. 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.

Each member of the Property and Casualty Group currently has an A++ ("Superior") rating from A.M. Best. A++ is the highest rating that A.M. Best gives to insurance companies, and represents a superior ability to meet ongoing obligations to policyholders. In evaluating an insurer's financial and operating performance, A.M. Best reviews the insurer's profitability, leverage and liquidity as well as the insurer's book of business, the adequacy and soundness of its reinsurance, the quality and estimated market value of its assets, the adequacy of its loss reserves and the experience and competency of its management. Each member of the Property and Casualty Group also has a rating of Api ("Strong") from Standard & Poors. A rating of "A" means that the insurer has strong financial security characteristics. The subscript "pi" means the rating was based on publicly available information of the Exchange. Management believes that financial ratings are among many important factors in marketing the Property and Casualty Group's insurance to its agents and customers.

### **Competition**

The markets in which the Property and Casualty Group operates are highly competitive. 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. In addition, because the insurance products of the Property and Casualty Group are marketed exclusively through independent insurance agents, these agents have the opportunity to represent more than one company. The Property and Casualty Group, thus, potentially faces competition within its appointed agencies based on product, price and service relationships.

Market competition bears directly on the price charged for insurance products and services subject to the regulatory limitations. Growth is driven by

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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 Property and Casualty Group has been able to raise prices or maintain current premium rates to gain competitive advantage in the insurance marketplace as a result of the current favorable market conditions in both commercial and personal property and casualty lines, which are generally referred to within the industry as "hard market conditions." Hard market conditions are characterized by increasing premium rates, more stringent underwriting standards and a need for additional capital in the industry.

The Erie Insurance Group, has followed several strategies which management believes will result in long-term underwriting performance which exceeds those of the property and casualty industry in general. First, the Erie Insurance Group employs an underwriting philosophy and product mix targeted to produce a Property and Casualty Group-wide underwriting profit, i.e., a combined ratio of less than 100% 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.

Second, Erie Insurance Group's management focuses on consistently providing superior service to policyholders and agents that is reflected in its policy retention and new policy growth rates. Policy retention (the percentage of existing policyholders who renew their policies) remained excellent at 91.2%, 90.9% and 91.0% for the years ended December 31, 2002, 2001 and 2000, respectively, for all lines of business combined. Continued improvement in new policy growth drove the gains experienced in the Property and Casualty Group's direct written premium. Policies in force increased 12.8% to 3.5 million in 2002 from 3.1 million in 2001 and 8.5% in 2001 from 2.9 million in 2000. See "Selected Segment Information" contained in the Annual Report for policy in force counts and retention rates for the Property and Casualty Group.

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. These efforts have resulted in outstanding agency penetration and the ability to sustain long-term agency partnerships.

## **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 yet reported. The estimated loss reserve for reported claims is based primarily upon a case-by-case evaluation of the type of risk involved and knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss. Estimates of reserves for unreported claims and loss settlement

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expenses are determined on the basis of costs, trends and reviews of historical reserving results.

The Property and Casualty Group establishes loss and loss expense reserves for the Property and Casualty Group and for all states as a whole for various lines of business groupings. Bulk and incurred but not reported reserves are allocated to each company, state, and line of business. The Property and Casualty Group reviews the insurance laws of all states in which it operates, not just domiciliary states, to ensure that carried loss and loss adjustment expense reserves meet requirements. The statutory annual statements filed by the companies comprising the Property and Casualty Group contain actuarial opinions as to reserve adequacy as required by the states in which the Property and Casualty Group does business.

The loss and loss adjustment expense reserves are computed in accordance with accepted loss reserving standards and principles for the purpose of making a reasonable provision for all unpaid loss and loss expense obligations under the terms of the Property and Casualty Group's policies and agreements. However, the process of estimating the liability for unpaid losses and loss adjustment expenses is inherently judgmental and can be influenced by factors subject to variation. Possible sources of variation include claim frequency and severity, changing rates of inflation as well as changes in other economic conditions, judicial trends and legislative changes. It is unlikely that future losses and loss adjustment expenses will develop exactly as projected. The Property and Casualty Group continually refines reserves as experience develops and new information becomes known. The Property and Casualty Group reflects adjustments to reserves in the results of operations in the periods in which the estimates are changed. With the exception of reserves relating to certain workers' compensation cases, which have been discounted at 2.5% in 2002 and 2001, loss reserves are not discounted.

Adverse development of losses from prior accident years results in higher calendar year loss ratios and reduced calendar year underwriting results. To the extent prior year reserve deficiencies are indicative of deteriorating underlying loss trends and are material, the Property and Casualty Group's pricing of affected lines of business would be increased to the extent permitted by state departments of insurance. Management also reviews trends in loss developments in order to determine if adjustments, such as reserve strengthening, are appropriate. Any adjustments considered necessary are reflected in current results of operations.

The Company is addressing loss trends by controlling exposure growth, improving underwriting risk selection, instituting programs to control loss severity and obtaining additional premium on risks through rate increases. Pricing actions have been taken since 2001 to increase premiums charged to Property and Casualty Group policyholders. The Property and Casualty Group has also issued and is implementing more restrictive underwriting standards, the criteria under which policyholders are selected or renewed and premium rates are determined. Restricting underwriting standards will affect the number of new policyholders eligible for coverage with the Property and Casualty Group as well as the number eligible to renew and the terms of renewal. Taken together, pricing actions and restricting underwriting standards are designed to improve the overall underwriting result of the Property and Casualty Group. These actions will also reduce the growth rate of the Property and Casualty Group's new and renewal premium and could adversely affect policy retention rates currently experienced by the Property and Casualty Group. To the extent the premium growth rate of the Property and Casualty Group direct written premiums is impacted by these actions, the growth in the Company's management fee revenue will be proportionately affected.

For a reconciliation of beginning and ending property and casualty unpaid losses and loss adjustment expense reserves for each of the last three

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years, see Note 9 of the “Notes to Consolidated Financial Statements” contained in the Annual Report for the year ended December 31, 2002, incorporated herein by reference.

The following table sets forth the development of the Company’s property and casualty subsidiaries’ reserves for unpaid losses and loss adjustment expenses from 1993 through 2002.

**Property and Casualty Subsidiaries of Erie Indemnity Company**

**Reserves for Unpaid Losses and Loss Adjustment Expenses**

(amounts in millions)	At December 31,									
	2002	2001	2000	1999	1998	1997	1996	1995	1994	1993
Net liability for unpaid losses and loss adjustment expense (“LAE”)	\$139.1	\$118.7	\$102.3	\$ 95.0	\$ 91.4	\$ 89.5	\$ 84.9	\$ 79.0	\$ 68.9	\$ 65.4
<i>Net liability re-estimated as of:</i>										
One year later		126.9	110.4	103.0	91.3	88.9	87.2	78.4	65.7	61.8
Two years later			114.9	103.9	93.2	85.3	86.6	79.4	65.3	58.5
Three years later				107.1	94.1	87.6	83.4	80.2	68.6	60.1
Four years later					97.2	87.5	84.4	78.2	69.4	65.7
Five years later						90.1	84.5	78.9	68.2	67.3
Six years later							86.2	79.8	68.8	68.8
Seven years later								80.0	69.7	68.2
Eight years later									69.8	69.3
Nine years later										65.4
Cumulative (deficiency) redundancy		(8.2)	(12.6)	(12.1)	(5.8)	(0.6)	(1.3)	(1.0)	(0.9)	(0.0)
Net liability for unpaid losses and LAE	\$139.1	\$118.7	\$102.3	\$ 95.0	\$ 91.4	\$ 89.5	\$ 84.9	\$ 79.0	\$ 68.9	\$ 65.4
Reinsurance recoverable on unpaid losses	577.9	438.6	375.6	337.9	334.8	323.9	301.5	278.3	275.9	288.5
Gross liability for unpaid losses and LAE	\$717.0	\$557.3	\$477.9	\$432.9	\$426.2	\$413.4	\$386.4	\$357.3	\$344.8	\$353.9
<i>Gross re-estimated liability as of:</i>										
One year later		\$627.8	\$500.4	\$463.2	\$414.3	\$410.6	\$394.2	\$351.0	\$327.3	\$323.2
Two years later			548.2	464.9	429.0	398.4	398.2	362.3	332.7	322.8
Three years later				497.9	426.9	406.0	388.0	373.0	351.6	332.7
Four years later					449.8	402.4	391.3	367.7	364.0	358.2
Five years later						424.6	389.3	370.8	361.8	371.8
Six years later							408.0	368.6	365.0	370.3
Seven years later								385.6	363.0	374.9
Eight years later									379.3	373.4
Nine years later										393.4
Cumulative (deficiency) redundancy		(70.5)	(70.3)	(65.0)	(23.6)	(11.2)	(21.6)	(28.3)	(34.5)	(39.5)



**Reserves for Unpaid Losses and Loss Adjustment Expenses  
(Continued)**

(amounts in millions)	Through December 31,									
	2002	2001	2000	1999	1998	1997	1996	1995	1994	1993
<i>Cumulative amount of net liability paid through:</i>										
One year later		\$ 47.3	\$ 41.2	\$ 38.9	\$ 33.6	\$ 31.3	\$ 32.6	\$ 29.3	\$ 22.1	\$ 24.2
Two years later			64.9	59.2	52.4	48.3	48.7	44.7	36.2	34.9
Three years later				73.5	63.9	59.2	57.8	53.9	44.7	42.2
Four years later					71.3	65.5	63.5	59.4	49.8	46.5
Five years later						70.0	67.4	62.5	53.2	49.1
Six years later							70.1	64.8	55.0	51.3
Seven years later								66.3	56.5	52.6
Eight years later									57.7	53.7
Nine years later										54.6
<i>Cumulative amount of gross liability paid through:</i>										
One year later		\$194.3	\$174.4	\$158.9	\$145.4	\$136.9	\$141.3	\$131.9	\$134.0	\$140.6
Two years later			270.9	244.9	228.2	211.5	212.2	199.2	199.9	214.7
Three years later				297.6	274.9	256.8	250.0	235.7	233.4	247.2
Four years later					300.9	280.5	271.6	256.0	253.4	264.4
Five years later						295.9	285.9	267.7	265.0	275.3
Six years later							295.0	276.1	272.3	282.8
Seven years later								280.9	277.6	288.1
Eight years later									281.2	292.5
Nine years later										295.6

Additional information with respect to the reserve activity of the Company's property and casualty subsidiaries may be found at Note 9 of the "Notes to Consolidated Financial Statements" contained in the Annual Report for the year ended December 31, 2002, incorporated herein by reference.

The top line shows the estimated liability that was recorded at the end of each of the indicated years for all current and prior year unpaid losses and loss expenses. The upper portion of the table shows re-estimations of the original recorded reserve as of the end of each successive year. The estimate is increased or decreased as payments are made and more information becomes known about the development of remaining unpaid claims. The lower portion of the table shows the cumulative amount paid in succeeding years for losses incurred prior to the Statements of Financial Position date. The cumulative deficiency or redundancy represents the aggregate amount by which original estimates of reserves as of that year-end have changed in subsequent years. The deficiency in reserves means that the reserves established in prior years were less than actual losses and loss adjustment expenses or were reevaluated at more than the originally reserved amount.

The Property and Casualty Group does not discount reserves except for workers' compensation reserves which are discounted on a non-tabular basis. The workers' compensation reserves are discounted at a risk-adjusted 2.5% interest rate as permitted 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

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loss adjustment expenses reserve, as a result of this discounting, was reduced by \$2.7 million and \$2.4 million at December 31, 2002 and 2001, respectively.

The 2002 unpaid losses and loss adjustment expenses reserve of \$717.0 million includes an adjustment to strengthen loss reserves made during the fourth quarter of 2002. The Property and Casualty Group increased losses and loss adjustment expense reserves by \$184.1 million, of which the Company's 5.5% share amounted to \$10.1 million. During 2002, the Property and Casualty Group experienced continued adverse development of the loss reserves for prior accident years, principally in certain private passenger and commercial automobile coverages.

The 2001 unpaid losses and loss adjustment expenses reserve of \$557.3 million includes the Property and Casualty Group's share of estimated incurred losses from the unaffiliated reinsurance business stemming from the September 11th attack on the World Trade Center. Incurred losses are the total losses sustained by an insurer or reinsurer under its policies or contracts, whether paid or unpaid, and include a provision for incurred but not reported losses. The portion of World Trade Center losses recorded by the Company's property and casualty subsidiaries after giving effect to recoveries from the excess of loss agreement with the Exchange was \$5.8 million, or \$0.06 per share, after taxes. The Property and Casualty Group is exposed to both direct and reinsurance losses arising from possible future terrorist actions.

Adverse development on loss reserves established for the year ended December 31, 2000 was the result of an increase in loss costs experienced by the Property and Casualty Group's direct business related to its automobile liability and workers' compensation lines of business. The development for the personal and commercial automobile liability lines of business has been above expected due to changes in claims handling procedures, which makes the extrapolation of future development from historical patterns very difficult. Development has also been above expected on uninsured motorist bodily injury and underinsured motorist bodily injury coverages due to precedents set by unfavorable court decisions and an evolving arbitration system. The increase in claims development costs for the workers' compensation line of business has been above expected largely because of the reevaluation of known claims in which the claimants suffered catastrophic injuries.

### **Government Regulation**

The Company is subject to the corporate governance standards set forth in the recently enacted Sarbanes-Oxley Act of 2002 and other recent changes to the federal securities laws, as well as any rules or regulations that may be promulgated by the Securities and Exchange Commission or the Nasdaq Stock Market<sup>SM</sup>. Compliance with these standards, rules and regulations, as well as with accelerated filing requirements that have recently been enacted, impose additional administrative costs and burdens on the Company.

The Sarbanes-Oxley Act of 2002 (Act) was designed to better protect investors by improving the accuracy and reliability of public company disclosures. Some requirements of the Act were effective immediately while others are scheduled to become effective throughout 2003. Management has initiated the appropriate process both within the Company and with the Board of Directors to ensure timely compliance with the requirements. New requirements introduced by the Act are projected to become effective in 2003.

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 which delegate regulatory, supervisory and administrative authority to state insurance departments. Accordingly, the authority of the state insurance departments

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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 and 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 may be required, under the solvency or guaranty laws of the various states in which it is licensed, to pay assessments to fund policyholder losses or liabilities of insolvent insurance companies. Depending on state law, insurers can be assessed an amount that is generally equal to between 1% and 2% of premiums written for the relevant lines of insurance in that state each year to pay the claims of an insolvent insurer. Certain states permit these assessments, or a portion thereof, to be recorded as an offset to future premium taxes. The members of the Property and Casualty Group have made accruals for their portion of assessments related to such insolvencies based upon the most current information furnished by the guaranty associations. Reference is made to the Critical Accounting Estimates section of the "Management's Discussion and Analysis" contained in the Annual Report for the year ended December 31, 2002 for a complete discussion of the liability for guaranty funds.

The Property and Casualty Group is also required to participate in various involuntary insurance programs for automobile insurance, as well as other property and 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; however, the impact of these involuntary programs on the Property and Casualty Group has been immaterial.

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.

## Financial Regulation

The Company is subject to the filing requirements of the Securities and Exchange Commission (SEC). The financial information in these filings are prepared in accordance with generally accepted accounting principles (GAAP) and SEC guidelines. The Company's property and casualty insurance subsidiaries are required to file financial statements prepared using SAP with state regulatory authorities. The adjustments necessary to reconcile the Company's property and casualty insurance subsidiaries' net income and shareholders' equity prepared in accordance with SAP to net income and shareholders' equity prepared in accordance with GAAP are as follows:

	Net Income		
	Year Ended December 31,		
	2002	2001	2000
	(in thousands)		
SAP amounts	\$(10,679)	\$(4,929)	\$5,091
Adjustments:			
Deferred policy acquisition costs	4,695	3,816	1,798
Deferred income taxes	664	1,392	32
Federal alternative minimum tax credit recoverable	0	0	188
Salvage and subrogation	833	312	221
Incurred premium adjustment	(3,270)	(1,816)	(798)
Other	(104)	83	10
GAAP amounts	\$ (7,861)	\$(1,142)	\$6,542
	Shareholders' Equity		
	As of December 31,		
	2002	2001	2000
	(in thousands)		
SAP amounts	\$ 82,549	\$ 92,128	\$ 89,637
Adjustments:			
Deferred policy acquisition costs	21,713	17,018	13,202
Difference between GAAP and SAP deferred income taxes	(2,450)	(354)	3,569
Salvage and subrogation	4,493	3,661	3,349
Statutory reserves	0	0	865
Incurred premium adjustment	(17,288)	(14,018)	(12,202)
Unrealized gains net of deferred taxes	9,602	4,722	2,331
Other	362	223	7
GAAP amounts	\$ 98,981	\$103,380	\$100,758

Effective January 1, 2001, the NAIC adopted the Codification of Statutory Accounting Practices (Codification) as the NAIC-supported basis of accounting. Codification resulted in changes to the SAP-based financial statements of the Company's property and casualty subsidiaries, the most significant of which was the recording of statutory deferred taxes for certain of the Company's property and casualty insurance subsidiaries. The total cumulative adjustment increased the surplus of the Company's property and casualty insurance subsidiaries by \$4.4 million as of January 1, 2001.

Pennsylvania regulations limit the amount of dividends EFL can pay its shareholders and limit the amount of dividends the Company's property and casualty

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insurance subsidiaries the Erie Insurance Company and the Erie Insurance Property and Casualty Company can pay to the Company. New York state regulates the amount of dividends the Erie Insurance Company of New York can pay to the Erie Insurance Company. The limitations are fully described and reference is made herein to Note 13 of the “Notes to Consolidated Financial Statements” contained in the Annual Report for the year ended December 31, 2002, incorporated by reference.

The NAIC has adopted risk-based capital (“RBC”) standards that require insurance companies to calculate and, report statutory capital and surplus needs based on a formula measuring underwriting, investment and other business risks inherent in an individual company’s operations. These RBC standards have not affected the operation of the Company’s property and casualty insurance subsidiaries and affiliates because each of them has statutory capital and surplus in excess of RBC requirements.

**“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 2002 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 2. Properties**

The Company and its subsidiaries, the Exchange and its subsidiary, Flagship, and EFL share a corporate home office complex in Erie, Pennsylvania which contains 488,997 square feet and is owned by the Exchange. At December 31, 2002 in addition to the Erie branch office, the Company also operated 22 field offices in 11 states. Of these sites, 17 provide both agency support and claims services and are referred to as "Branch Offices", while the remaining 5 provide only claims services and are considered "Claims Offices".

The Company owns three of its field offices. Three field offices are owned by and leased from the Exchange. The annual rent expense incurred by the Company for the field offices and home office complex totaled \$11.3 million in 2002. One office is owned by and leased from EFL at an annual rental in 2002 of \$0.3 million. The remaining 14 offices are leased from various unaffiliated parties at an aggregate annual rental in 2002 of approximately \$2.0 million.

Total rent and operating expenses for all office space occupied by the Company in 2002 was \$19.8 million. This amount was reduced by allocations to the Property and Casualty Group of \$12.8 million for claims operations. The net amount after allocations is reflected in the cost of management operations.

The Company, through its insurance subsidiaries, recorded \$0.9 million in rental expense in policy acquisition and other underwriting expenses. This represents the Company's 5.5% share of the total rental expense of the Property and Casualty Group.

**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 29, 2003 to be filed with the Securities and Exchange Commission within 120 days of December 31, 2002 (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 2002.

## PART II

### Item 5. Market for Registrant's Common Stock and Related Shareholder Matters

Reference is made to "Market Price of and Dividends on the Common Stock and Related Shareholder Matters" in the Annual Report for the year ended December 31, 2002, incorporated herein by reference, for information regarding the high and low sales prices for the Company's stock and additional information regarding such stock of the Company.

As of February 28, 2003, there were approximately 1,063 beneficial shareholders of record of the Company's Class A non-voting common stock and 28 beneficial shareholders of record of the Company's Class B voting common stock.

Of the 64,061,106 shares of the Company's Class A common stock outstanding as of February 28, 2003, approximately 26,102,491 shares are freely transferable without restriction or further registration under the Securities Act of 1933 (the Act), as amended unless purchased by affiliates of the Company as that term is defined in Rule 144 under the Act. The 37,958,615 remaining outstanding shares of Class A common stock (the Restricted Shares) are held by the Company's directors, executive officers and their affiliates and are restricted securities that are eligible to be sold publicly pursuant to an effective registration statement under the Act or in accordance with the applicable exemption, including Rule 144, from the registration requirements under the Act. The Company is unable to estimate the amount of Restricted Shares that may be sold under Rule 144 since this amount will depend in part on the price for the Class A common stock, the personal circumstances of the sellers and other factors. Sales of a substantial number of Restricted Shares in the public market, or the availability of such shares, could adversely affect the price of the Class A common stock.

In general, under Rule 144 as currently in effect, a person (or persons whose shares are aggregated for purposes of Rule 144) who beneficially has owned Restricted Shares for at least two years, including affiliates of the Company, is entitled to sell within any three-month period a number of shares that does not exceed the greater of: (1) one percent of the number of shares of Class A common stock then outstanding, or (2) the average weekly trading volume of the Class A common stock in The NASDAQ Stock Market<sup>SM</sup> during the four calendar weeks preceding the date on which notice of sale is filed with the SEC. Sales under Rule 144 are also subject to certain manner of sale provisions, notice requirements and the availability of current public information about the Company. However, a person (or persons whose shares are aggregated for purposes of Rule 144) who is deemed not to have been an affiliate of the Company at any time during the 90 days preceding a sale, and who beneficially has owned the Restricted Shares for at least three years at the time of sale, would be entitled to sell such shares under Rule 144(k) without regard to the aforesaid limitations.

### Item 6. Selected Consolidated Financial Data

Reference is made to "Selected Consolidated Financial Data" in the Annual Report for the year ended December 31, 2002, incorporated herein by reference.

### 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 Annual Report for the year ended December 31, 2002, incorporated herein by reference.

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### **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 Annual Report for the year ended December 31, 2002, incorporated herein by reference.

### **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 Annual Report for the year ended December 31, 2002, incorporated herein by reference.

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

On September 10, 2002, the Audit Committee of Erie Indemnity Company (Company) appointed Ernst & Young LLP as the Company’s independent auditors for 2003. Malin, Bergquist & Company, LLP (M, B&C) were the Company’s independent auditors for 2002. On March 28, 2003, Ernst & Young, LLP was engaged as the Company’s independent auditors. On March 27, 2003, M, B&C was dismissed as the Company’s independent auditors.

The Audit Committee of the Company annually considers the selection of the Company’s independent auditors. In previous years, the Audit Committee would recommend the appointment of the independent auditors to the Company’s Board of Directors for shareholder ratification. At its meeting of September 9, 2002, the Company’s Board of Directors amended the Bylaws of the Company consistent with the provisions of the Sarbanes-Oxley Act of 2002, to give the Audit Committee sole authority to engage the Company’s independent auditors.

M, B&C’s reports on the Company’s consolidated financial statements for the past two years did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles.

During the Company’s two most recent fiscal years and through the date of this Form 10-K, there were no disagreements with M, B&C on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure which, if not resolved to M, B&C’s satisfaction, would have caused them to make reference to the subject matter in connection with their report on the Company’s consolidated financial statements for such years; and there were no reportable events, as listed in Item 304(a)(1)(v) of Regulation S-K.

The Company provided M, B&C with a copy of the foregoing disclosures and requested M, B&C furnish the Company with a letter to update the letter previously provided pursuant to Item 304(a)(3) of Regulation S-K, which was included as Exhibit 16 to the Company’s Form 8-K dated September 13, 2002. The updated letter is included as Exhibit 16 to this Form 10-K.

During the Company’s two most recent fiscal years and through the date of this Form 10-K, the Company did not consult Ernst & Young, LLP with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company’s consolidated financial statements, or any other matters or reportable events listed in Items 304 (a) (2) (i) and (ii) of Regulation S-K.

On October 23, 2002, Ernst & Young LLP was engaged by the Company, with concurrence by the Audit Committee to consult with Company management and with M, B&C regarding the registration of its class A common stock on Form S-3. Such consultation was limited to providing assistance in responding to accounting comments in the Securities and Exchange Commission (SEC) staff comment letters to preliminary S-3 filings. The registration became effective January 22, 2003.

The consultation included:

- Participation in discussions with the Company and representatives of M, B&C;
- Review and discussion of applicable accounting literature and SEC comments and,
- Assistance in drafting responses to SEC comments.

Ernst & Young LLP provided oral viewpoints, none of which created a material change in application of accounting principles or disclosure matters. There were also no disagreements between M, B&C, Ernst & Young LLP and Company management on the application of accounting principles to the Company’s financial statements or transactions.

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

Directors are elected to one year terms at the Company's annual meeting of Shareholders. Following are the Company's officers and directors:

(a) Certain information as to the Directors of the Company is as follows:

<u>Name</u>	<u>Age as of 12/31/02</u>	<u>Present Principal Position with Erie Indemnity Company and Other Material Positions Held During the Last Five Years</u>
Samuel P. Black, III <sup>1,3,4,6</sup>	60	Director since 1997. President, Treasurer and Secretary, Samuel P. Black & Associates, Inc.—insurance agency; Director—the Company, Erie Insurance Company, Flagship City Insurance Company, Erie Insurance Property & Casualty Company and Erie Family Life Insurance Company.
J. Ralph Borneman, Jr. <sup>3,4</sup>	64	Director since 1992. President and Chief Executive Officer, Body-Borneman Associates, Inc., insurance agency. President, Body-Borneman, Ltd. and Body-Borneman, Inc., insurance agencies. Director—the Company, Erie Insurance Company, Erie Family Life Insurance Company, Erie Insurance Company of New York and National Penn Bancshares.
Patricia Garrison-Corbin <sup>2,4,5C</sup>	55	Director since 2000. President, P.G. Corbin & Company 1986 — Present. Director—the Company, Erie Insurance Company and Erie Family Life Insurance Company.
Susan Hirt Hagen <sup>1,6C</sup>	67	Director since 1980. Co-Trustee of H.O. Hirt Trust; Retired Managing Partner, Hagen, Herr & Peppin, Group Relations Consultants; Director—the Company, Erie Insurance Company and Erie Family Life Insurance Company.

1 Member of Executive Committee

2 Member of Audit Committee

3 Member of Executive Compensation Committee

4 Member of Nominating Committee

5 Member of Investment Committee

6 Member of Charitable Giving Committee

C Committee Chairperson

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Name	Age as of 12/31/02	Present Principal Position with Erie Indemnity Company and Other Material Positions Held During the Last Five Years
F. William Hirt <sup>1C,6</sup>	77	Director since 1965. Co-Trustee of H.O. Hirt Trust; Chairman of the Board of the Company, Erie Insurance Company, Erie Family Life Insurance Company, Erie Insurance Property & Casualty Company and Flagship City Insurance Company since September 1993; Chairman of the Board of Erie Insurance Company of New York since April 1994. Chairman of the Executive Committee of the Company and the Erie Family Life Insurance Company since November 1990; Interim President and Chief Executive Officer of the Company, Erie Family Life Insurance Company, Erie Insurance Company, Erie Insurance Property & Casualty Company, Flagship City Insurance Company and Erie Insurance Company of New York from January 1, 1996 to February 12, 1996; Chairman of the Board, Chief Executive Officer and Chairman of the Executive Committee of the Company, Erie Family Life Insurance Company and Erie Insurance Company for more than five years prior thereto; Director—the Company, Erie Insurance Company, Flagship City Insurance Company, Erie Family Life Insurance Company, Erie Insurance Property & Casualty Company and Erie Insurance Company of New York.
Samuel P. Katz <sup>2,3</sup>	53	Director since 2000. Chief Executive Officer, Greater Philadelphia First, July 2000 — January 2003; Managing Partner, Wynnefield Capital Advisors, Inc., 1997 — Present; President, Entersport Capital Advisors, Inc., 1997 — Present; Partner, Stafford Capital Partners, L.P. 1994 — 1997; Co-Chief Executive Officer, Public Financial Management, Inc., 1980 — 1994; Director— the Company, Erie Insurance Company and Erie Family Life Insurance Company.
Claude C. Lilly, III <sup>2</sup>	56	Director since 2000. Dean, Belk College of Business Administration, University of North Carolina at Charlotte 1997 — Present; Professor, Florida State University 1978 — 1997; Director— the Company, Erie Insurance Company and Erie Family Life Insurance Company.

1 Member of Executive Committee

2 Member of Audit Committee

3 Member of Executive Compensation Committee

6 Member of Charitable Giving Committee

C Committee Chairperson

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Name	Age as of 12/31/02	Present Principal Position with Erie Indemnity Company and Other Material Positions Held During the Last Five Years
Jeffrey A. Ludrof <sup>1,5</sup>	43	Director since July 23, 2002, of the Company, Erie Insurance Company, Erie Insurance Company of New York, Erie Insurance Property & Casualty Company, Flagship City Insurance Company and Erie Family Life Insurance Company. President and Chief Executive Officer of the Company, Erie Family Life Insurance Company, Erie Insurance Company, Flagship City Insurance Company, Erie Insurance Company of New York and Erie Insurance Property and Casualty Company since May 8, 2002; Executive Vice President-Insurance Operations of the Company 1999 to May 8, 2002; Senior Vice President of the Company 1994 — 1999.
Henry N. Nassau <sup>1,5</sup>	48	Director since 2000. Managing Director and Chief Operating Officer, Internet Capital Group 1999 — Present; Partner, Dechert, Price & Rhoades 1987 — 1999; Director—the Company, Erie Insurance Company and Erie Family Life Insurance Company.
John M. Petersen <sup>1,4C</sup>	74	Director since 1979. Retired; President and Chief Executive Officer of the Company, Erie Family Life Insurance Company, Erie Insurance Company, Flagship City Insurance Company and Erie Insurance Property & Casualty Company 1993 — 1995 and Erie Insurance Company of New York 1994 — 1995; Director—the Company, Erie Insurance Company, Flagship City Insurance Company, Erie Family Life Insurance Company, Erie Insurance Property & Casualty Company, Erie Insurance Company of New York, and Spectrum Control.

- 1 Member of Executive Committee
- 4 Member of Nominating Committee
- 5 Member of Investment Committee
- C Committee Chairperson

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Name	Age as of 12/31/02	Present Principal Position with Erie Indemnity Company and Other Material Positions Held During the Last Five Years
Jan R. Van Gorder <sup>5</sup>	55	Director since 1990. Senior Executive Vice President, Secretary and General Counsel of the Company, Erie Family Life Insurance Company and Erie Insurance Company since 1990 and of Flagship City Insurance Company and Erie Insurance Property & Casualty Company since 1992 and 1993, respectively and of Erie Insurance Company of New York since 1994. Acting President and Chief Executive Officer of the Company, Erie Insurance Company, Erie Family Life Insurance Company, Flagship City Insurance Company, Erie Insurance Property and Casualty Company and Erie Insurance Company of New York January 19, 2002 — May 8, 2002. Director—the Company, Erie Insurance Company, Flagship City Insurance Company, Erie Insurance Property & Casualty Company, Erie Insurance Company of New York and Erie Family Life Insurance Company.
Robert C. Wilburn <sup>2C,3C,4,5</sup>	59	Director since 1999. President and Chief Executive Officer, The Gettysburg National Battlefield Museum Foundation since 2000; Distinguished Service Professor, Carnegie Mellon University since 1999; Retired, President and Chief Executive Officer, Colonial Williamsburg Foundation, 1992 — 1999; Director — the Company, Erie Insurance Company and Erie Family Life Insurance Company.

- 2 Member of Audit Committee
- 3 Member of Executive Compensation Committee
- 4 Member of Nominating Committee
- 5 Member of Investment Committee
- C Committee Chairperson

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

<u>Name</u>	<u>Age as of 12/31/02</u>	<u>Principal Occupation for Past Five Years and Positions with Erie Insurance Group</u>
<u>President &amp; Chief Executive Officer</u>		
Jeffrey A. Ludrof	43	President and Chief Executive Officer of the Company, Erie Family Life Insurance Company, Erie Insurance Company, Flagship City Insurance Company, Erie Insurance Company of New York, and Erie Insurance Property and Casualty Company since May 8, 2002. Executive Vice President-Insurance Operations of the Company, Erie Insurance Co., Flagship, Erie P&C, and Erie NY 1999 to May 8, 2002; Senior Vice President of the Company 1994 — 1999.
<u>Executive Vice Presidents</u>		
Jan R. Van Gorder, Esq.	55	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, the Company, EFL, Erie Insurance Co., Erie NY, Flagship and Erie P&C.
Philip A. Garcia	46	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	49	Executive Vice President — Human Development and Leadership since January 2003; Senior Vice President 1999 — December 2002; Vice President 1994 — 1999.
Thomas B. Morgan	39	Executive Vice President — Insurance Operations since January 2003; Senior Vice President October 2001 to December 2003; Assistant Vice President and Branch Manager 1997 — October 2001; Independent Insurance Agent 1998 — 1997.

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<u>Name</u>	<u>Age as of 12/31/02</u>	<u>Principal Occupation for Past Five Years and Positions with Erie Insurance Group</u>
<u>Senior Vice Presidents</u>		
Eugene C. Connell	48	Senior Vice President since 1990.
George R. Lucore	52	Senior Vice President since 1995; Regional Vice President 1993 — 1995.
Eric D. Root	34	Senior Vice President since January 2003; Regional Vice President April 2000 — December 2002; Branch Manager 1996 — April 2000.
Timothy G. NeCastro	42	Senior Vice President and Controller since 1997; Department Manager — Internal Audit November 1996 — 1997.
James R. Roehm	54	Senior Vice President since 1991.
John P. Sommerwerck	52	Senior Vice President and Chief Information Officer since May 2000.
Barry P. Stiles	53	Senior Vice President since 1999; Vice President 1993 — 1999.
Michael S. Zavasky	50	Senior Vice President since 1998; Vice President and Managing Director of Reinsurance 1990 — 1998.
Douglas F. Ziegler	52	Senior Vice President, Treasurer and Chief Investment Officer since 1993.
<u>Regional Vice Presidents</u>		
George D. Dufala	31	Regional Vice President since April 2000; Assistant Vice President 1993 — April 2000.
Terry L. Hamman	48	Regional Vice President since 1995; Assistant Vice President 1993 — 1995.
Jeffrey W. Brinling	34	Regional Vice President since January 2003; Marketing Department Manager November 2002 — December 2002; Branch Manager January 1999 — November 2002; Branch Sales Manager May 1993 — January 1999.

**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 29, 2003, except for the Performance Graph, which has not been incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management**

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 29, 2003 to be filed with the Securities and Exchange Commission within 120 days of December 31, 2002.

The Company does not have a compensation plan for its employees or directors under which equity securities of the Company are authorized for issuance.

**Item 13. Certain Relationships and Related Transactions**

The Company operates predominantly as a provider of sales, underwriting and policy issuance services to the Exchange. Since the formation of the Company and the Exchange in 1925, the Company has served as the attorney-in-fact for the policyholders of the Exchange. 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 10 of the "Notes to Consolidated Financial Statements" in the Annual Report for the year ended December 31, 2002, incorporated herein by reference, 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 29, 2003 to be filed with the Securities and Exchange Commission within 120 days of December 31, 2002.

**Item 14. Controls and Procedures**

Within 90 days prior to the date of filing of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Chief Executive Officer and its Chief Financial Officer, of the design and operation of the Company's disclosure controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective for gathering, analyzing and disclosing the information the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect disclosure controls subsequent to the date of this evaluation.

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**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

	<b>Page*</b>
Erie Indemnity Company and Subsidiaries:	
Independent Auditors' Report on the Consolidated Financial Statements	38
Consolidated Statements of Operations for the three years ended December 31, 2002, 2001 and 2000	39
Consolidated Statements of Financial Position as of December 31, 2002 and 2001	40
Consolidated Statements of Cash Flows for the three years ended December 31, 2002, 2001 and 2000	41
Consolidated Statements of Shareholders' Equity for the three years ended December 31, 2002, 2001 and 2000	42
Notes to Consolidated Financial Statements	43

(2) Financial Statement Schedules

	<b>Page</b>
Erie Indemnity Company and Subsidiaries:	
Report of Independent Auditors on Schedules	32
Schedule I. Summary of Investments — Other than Investments in Related Parties	33
Schedule IV. Reinsurance	34
Schedule VI. Supplemental Information Concerning Property/Casualty Insurance Operations	35

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 2002 Annual Report to Shareholders. The "Consolidated Financial Statements" and "Notes to Consolidated Financial Statements and Auditors' Report" thereon on pages 38 to 61 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 and 8, 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.

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(3) Exhibits

See Exhibit Index on page 37 hereof.

(b) Reports on Form 8-K:

On December 11, 2002 the Company filed a report on Form 8-K, reporting under Item 5, that at the regular meeting of the Board of Directors of the Company, the Board approved an increase in shareholders' dividends. The Board also set the management fee rate and service fee rate charged to the Erie Insurance Exchange for 2003.

On December 23, 2002 the Company filed a report on Form 8-K, reporting under Item 5, that the Property and Casualty Group would increase loss and loss adjustment expense reserves in the fourth quarter of 2002. The Company also reported its expected losses due to recent storms.

**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.

Date: March 11, 2003

ERIE INDEMNITY COMPANY  
(Registrant)

**Principal Officers**

/s/ Jeffrey A. Ludrof

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Jeffrey A. Ludrof, President and CEO

/s/ Jan R. Van Gorder

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

/s/ Philip A. Garcia

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Philip A. Garcia, Executive Vice President & CFO

/s/ Timothy G. NeCastro

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Timothy G. NeCastro, Senior Vice President & Controller

**Board of Directors**

/s/ Claude C. Lilly, III

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Samuel P. Black, III

---

Claude C. Lilly, III

/s/ J. Ralph Borneman, Jr.

---

/s/ Jeffrey A. Ludrof

---

J. Ralph Borneman, Jr.

---

Jeffrey A. Ludrof

/s/ Patricia Garrison-Corbin

---

/s/ Henry N. Nassau

---

Patricia Garrison-Corbin

---

Henry N. Nassau

/s/ Susan Hirt Hagen

---

/s/ John M. Petersen

---

Susan Hirt Hagen

---

John M. Petersen

/s/ F. William Hirt

---

/s/ Jan R. Van Gorder

---

F. William Hirt

---

Jan R. Van Gorder

/s/ Samuel P. Katz

---

/s/ Robert C. Wilburn

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Samuel P. Katz

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Robert C. Wilburn

## CERTIFICATIONS

I, Jeffrey A. Ludrof, certify that:

1. I have reviewed this annual report on Form 10-K of Erie Indemnity Company;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures 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 annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 27, 2003

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

## CERTIFICATIONS

I, Philip A. Garcia, certify that:

1. I have reviewed this annual report on Form 10-K of Erie Indemnity Company;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures 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 annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 27, 2003

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

**INDEPENDENT AUDITORS' REPORT**

To The Board of Directors and Shareholders  
Erie Indemnity Company

We have audited the consolidated statements of financial position of Erie Indemnity Company and subsidiaries (Company) as of December 31, 2002 and 2001 and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2002, as contained in the 2002 annual report, incorporated by reference in the annual report on Form 10-K for the year ended December 31, 2002. In connection with our audits of the financial statements, we also have audited the financial statement schedules, as listed in the accompanying index. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 that 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, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related 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/ Malin, Bergquist & Company, LLP  
Malin, Bergquist & Company, LLP

Erie, Pennsylvania  
February 7, 2003

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

December 31, 2002

Type of Investment	Cost or Amortized Cost	Fair Value	Amount at which Shown in the Consolidated Statements of Financial Position
(In Thousands)			
Available-for-sale securities:			
Fixed maturities:			
U.S. treasuries & government agencies	\$ 6,788	\$ 7,311	\$ 7,311
States & political subdivisions	48,394	51,334	51,334
Special revenue	95,854	100,764	100,764
Public utilities	45,076	46,535	46,535
U.S. industrial & miscellaneous	398,791	418,127	418,127
Foreign	60,920	62,978	62,978
Redeemable preferred stock	20,053	21,019	21,019
Equity securities:			
Common stock:			
U.S. banks, trusts & insurance companies	1,030	1,413	1,413
U.S. industrial & miscellaneous	20,478	34,403	34,403
Foreign	417	699	699
Non-redeemable preferred stock:			
Public utilities	18,902	19,366	19,366
U.S. banks, trusts & insurance companies	21,713	22,948	22,948
U.S. industrial & miscellaneous	89,628	90,524	90,524
Foreign	23,425	24,725	24,725
Total available-for-sale securities	\$851,469	\$902,146	\$902,146
Real estate mortgage loans	\$ 5,567	\$ 5,567	\$ 5,567
Limited partnerships	94,194	91,046	91,046
Total investments	\$951,230	\$998,759	\$998,759

## SCHEDULE IV — REINSURANCE

	Direct	Ceded to Other Companies	Assumed From Other Companies	Net Amount	Percentage of Amount Assumed to Net
December 31, 2002 Premiums for the year Property and Liability Insurance	\$531,479,346	\$541,888,482	\$174,366,780	\$163,957,644	106.3%
December 31, 2001 Premiums for the year Property and Liability Insurance	\$432,306,939	\$439,697,934	\$145,039,248	\$137,648,253	105.4%
December 31, 2000 Premiums for the year Property and Liability Insurance	\$377,569,981	\$382,394,388	\$128,532,601	\$123,708,194	103.9%

**SCHEDULE VI — SUPPLEMENTAL INFORMATION CONCERNING PROPERTY/CASUALTY INSURANCE OPERATIONS**

	Deferred Policy Acquisition Costs	Reserves for Unpaid Loss & LAE Expenses	Discount, if any deducted from reserves*	Unearned Premiums
(In Thousands)				
@ 12/31/02				
Consolidated P&C Entities	\$21,713	\$717,015	\$2,655	\$393,091
Unconsolidated P&C Entities	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0
Total	\$21,713	\$717,015	\$2,655	\$393,091
@ 12/31/01				
Consolidated P&C Entities	\$17,018	\$557,278	\$2,390	\$311,969
Unconsolidated P&C Entities	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0
Total	\$17,018	\$557,278	\$2,390	\$311,969
@ 12/31/00				
Consolidated P&C Entities	\$13,202	\$477,879	\$1,509	\$263,855
Unconsolidated P&C Entities	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0
Total	\$13,202	\$477,879	\$1,509	\$263,855

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

[Table of Contents](#)**SCHEDULE VI — SUPPLEMENTAL INFORMATION CONCERNING PROPERTY/CASUALTY INSURANCE OPERATIONS (CONTINUED)**

	<u>Earned Premiums</u>	<u>Net Investment Income</u>	<u>Loss and Loss Incurred (1) Current Year</u>	<u>Adjustment Expense Related to (2) Prior Years</u>	<u>Amortization of Deferred Policy Acquisition Costs</u>	<u>Net Loss &amp; LAE Paid</u>	<u>Premiums Written</u>
<b>(In Thousands)</b>							
<b>@ 12/31/02</b>							
Consolidated P&C Entities	\$163,958	\$13,289	\$133,787	\$5,438	\$29,928	\$118,800	\$181,013
Unconsolidated P&C Entities	0	0	0	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0	0	0	0
<b>Total</b>	<b>\$163,958</b>	<b>\$13,289</b>	<b>\$133,787</b>	<b>\$5,438</b>	<b>\$29,928</b>	<b>\$118,800</b>	<b>\$181,013</b>
<b>@ 12/31/01</b>							
Consolidated P&C Entities	\$137,648	\$17,071	\$111,258	\$5,943	\$24,276	\$100,840	\$146,936
Unconsolidated P&C Entities	0	0	0	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0	0	0	0
<b>Total</b>	<b>\$137,648</b>	<b>\$17,071</b>	<b>\$111,258</b>	<b>\$5,943</b>	<b>\$24,276</b>	<b>\$100,840</b>	<b>\$146,936</b>
<b>@ 12/31/00</b>							
Consolidated P&C Entities	\$123,708	\$18,381	\$93,416	\$6,148	\$22,793	\$92,236	\$128,044
Unconsolidated P&C Entities	0	0	0	0	0	0	0
Proportionate share of registrant & subsidiaries	0	0	0	0	0	0	0
<b>Total</b>	<b>\$123,708</b>	<b>\$18,381</b>	<b>\$93,416</b>	<b>\$6,148</b>	<b>\$22,793</b>	<b>\$92,236</b>	<b>\$128,044</b>

**EXHIBIT INDEX****(Pursuant to Item 601 of Regulation S-K)**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>	<b>Sequentially Numbered Page</b>
3.1*	Articles of Incorporation of Registrant	
3.2**	Amended and Restated By-laws of Registrant	
3.3##	Amended and Restated By-laws of Registrant dated March 9, 1999	
3.4@	Amended and Restated By-laws of Registrant effective September 9, 2002	
4A*	Form of Registrant's Class A Common Stock certificate	
4B*	Form of Registrant's Class B Common Stock certificate	
10.1***	Retirement Plan for Employees of Erie Insurance Group, effective as of December 31, 1989	
10.2***	Restatement of Supplemental Retirement Plan for Certain Members of the Erie Insurance Group Retirement Plan for Employees, effective as of January 1, 1990	
10.3***	Deferred Compensation Plan of Registrant	
10.4***	Retirement Plan for Outside Directors of Registrant, effective as of January 1, 1991	
10.5***	Employee Savings Plan of Erie Insurance Group, effective as of April 1, 1992	
10.6***	Amendment to Employee Savings Plan of Erie Insurance Group	
10.7***	Supplemental 401(k) Plan of Erie Insurance Group effective as of January 1, 1994	
10.8***	Service Agreement dated January 1, 1989 between Registrant and Erie Insurance Company	
10.9***	Service Agreement dated June 21, 1993 between Registrant and Erie Insurance Property & Casualty Company	
10.10***	Service Agreement dated June 21, 1993 between Registrant and Flagship City Insurance Company	
10.11***	Reinsurance Pooling Agreement dated January 1, 1992 between Erie Insurance Company and Erie Insurance Exchange	

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<u>Exhibit Number</u>	<u>Description of Exhibit</u>	<u>Sequentially Numbered Page</u>
10.12***	Form of Subscriber's Agreement whereby policyholders of Erie Insurance Exchange appoint Registrant as their Attorney-in-Fact	
10.13*	Stock Redemption Plan of Registrant dated December 14, 1989	
10.14*	Stock Purchase Agreement dated December 20, 1991, between Registrant and Erie Insurance Exchange relating to the capital stock of Erie Insurance Company	
10.15**	Property Catastrophe Excess of Loss Reinsurance Agreement dated January 1, 1994 between Erie Insurance Exchange and Erie Insurance Co.	
10.16****	Stock Redemption Plan of Registrant restated as of December 12, 1995	
10.17****	Property Catastrophe Excess of Loss Reinsurance Agreement dated January 1, 1995 between Erie Insurance Exchange and Erie Insurance Company of New York	
10.18****	Service Agreement dated January 1, 1995 between Registrant and Erie Insurance Company of New York	
10.19*****	Consulting Agreement for Investing Services dated January 2, 1996 between Erie Indemnity Company and John M. Petersen	
10.20*****	Agreement dated April 29, 1994 between Erie Indemnity Company and Thomas M. Sider	
10.21*****	Aggregate Excess of Loss Reinsurance Agreement effective January 1, 1997 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	
10.22#	1997 Annual Incentive Plan of Erie Indemnity Company	
10.23#	Erie Indemnity Company Long-Term Incentive Plan	
10.24#	Employment Agreement dated December 16, 1997 by and between Erie Indemnity Company and Stephen A. Milne	
10.25#	Employment Agreement dated December 16, 1997 by and between Erie Indemnity Company and Jan R. Van Gorder	

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<u>Exhibit Number</u>	<u>Description of Exhibit</u>	<u>Sequentially Numbered Page</u>
10.26#	Employment Agreement dated December 16, 1997 by and between Erie Indemnity Company and Philip A. Garcia	
10.27#	Employment Agreement effective December 16, 1997 by and between Erie Indemnity Company and John J. Brinling, Jr.	
10.28###	Employment Agreement effective June 30, 1999 by and between Erie Indemnity Company and Jeffrey A. Ludrof	
10.29###	Employment Agreement effective December 15, 1999 By and between Erie Indemnity Company and Douglas F. Ziegler	
10.30###	Addendum to Employment Agreement effective December 15, 1999 by and between Erie Indemnity Company and Stephen A. Milne	
10.31###	Addendum to Employment Agreement effective December 15, 1999 by and between Erie Indemnity Company and Jan R. Van Gorder	
10.32###	Addendum to Employment Agreement effective December 15, 1999 by and between Erie Indemnity Company and Philip A. Garcia	
10.33###	Addendum to Employment Agreement effective December 15, 1999 by and between Erie Indemnity Company and John J. Brinling, Jr.	
10.34###	Addendum to Employment Agreement effective December 15, 1999 by and between Erie Indemnity Company and Jeffrey A. Ludrof	
10.35&	Addendum to Employment Agreement effective December 15, 2000 by and between Erie Indemnity Company and Stephen A. Milne	
10.36&	Addendum to Employment Agreement effective December 15, 2000 by and between Erie Indemnity Company and Jan R. Van Gorder	
10.37&	Addendum to Employment Agreement effective December 15, 2000 by and between Erie Indemnity Company and Philip A. Garcia	
10.38&	Addendum to Employment Agreement effective December 15, 2000 by and between Erie Indemnity Company and John J. Brinling, Jr.	
10.39&	Addendum to Employment Agreement effective December 15, 2000 by and between Erie Indemnity Company and Jeffrey A. Ludrof	
10.40&	Addendum to Employment Agreement effective December 15, 2000 by and between Erie Indemnity Company and Douglas F. Ziegler	

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<u>Exhibit Number</u>	<u>Description of Exhibit</u>	<u>Sequentially Numbered Page</u>
10.41&&	Cost Sharing Agreement for Information Technology Development dated March 14, 2001 between Registrant and member companies of the Erie Insurance Group	
10.42&&&	Addendum to Employment Agreement effective December 12, 2001 by and between Erie Indemnity Company and Stephen A. Milne	
10.43&&&	Addendum to Employment Agreement effective December 12, 2001 by and between Erie Indemnity Company and Jan R. Van Gorder	
10.44&&&	Addendum to Employment Agreement effective December 12, 2001 by and between Erie Indemnity Company and Philip A. Garcia	
10.45&&&	Addendum to Employment Agreement effective December 12, 2001 by and between Erie Indemnity Company and John J. Brinling, Jr.	
10.46&&&	Addendum to Employment Agreement effective December 12, 2001 by and between Erie Indemnity Company and Jeffrey A. Ludrof	
10.47&&&	Addendum to Employment Agreement effective December 12, 2001 by and between Erie Indemnity Company and Douglas F. Ziegler	
10.48&&&	Summary of termination benefits provided under the Employment Agreement effective January 18, 2002 by and and between Erie Indemnity Company and Stephen A. Milne	
10.49@	Amended and Restated Service Agreement between Registrant and Erie Insurance Company effective January 1, 1992	
10.50@	Amended and Restated Supplemental Retirement Plan for Certain Members of the Erie Insurance Group Retirement Plan for Employees, effective December 31, 1995	
10.51@	Amended and Restated Reinsurance Pooling Agreement effective January 1, 1995 between Erie Insurance Company and its wholly-owned subsidiary Erie Insurance Company of New York and Erie Insurance Exchange	
10.52@	Amended and Restated Aggregate Excess of Loss Reinsurance Contract effective January 1, 1998 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	
10.53@	Amended and Restated Retirement Plan for Employees of Erie Insurance Group, effective December 31, 2000	

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<b>Exhibit Number</b>	<b>Description of Exhibit</b>	<b>Sequentially Numbered Page</b>
10.54@	Amended and Restated Deferred Compensation Plan from Outside Directors of Registrant, effective January 1, 2001	
10.55@	Amended and Restated Employee Savings Plan of Erie Insurance Group, effective January 1, 2001	
10.56@	First Amendment and Restatement to Employee Savings Plan of Erie Insurance Group effective January 1, 2001	
10.57@	2001 Annual Incentive Plan of Erie Indemnity Company	
10.58@	Amended and Restated Deferred Compensation Plan for Outside Directors of Registrant effective April 30, 2002	
10.59@	Employment Agreement effective May 9, 2002 by and between Erie Indemnity Company and Jeffrey A. Ludrof	
10.60@	Form of Subscriber's Agreement whereby policyholders of Erie Insurance Exchange Appoint Registrant as their Attorney-in-Fact	
10.61	Employment Agreement effective December 15, 2002 By and between Erie Indemnity Company and Michael J. Krahe	43
10.62	Employment Agreement effective December 15, 2002 By and between Erie Indemnity Company and Thomas B. Morgan	59
10.63	Addendum to Employment Agreement effective December 12, 2002 by and between Erie Indemnity Company and John J. Brinling, Jr.	75
10.64	Addendum to Employment Agreement effective December 12, 2002 by and between Erie Indemnity Company and Philip A. Garcia	76
10.65	Addendum to Employment Agreement effective December 12, 2002 by and between Erie Indemnity Company and Jan R. Van Gorder	77
10.66	Addendum to Employment Agreement effective December 12, 2002 by and between Erie Indemnity Company and Douglas F. Ziegler	78
11	Statement re computation of per share earnings	79
13	2002 Annual Report to Shareholders. Reference is made to the Annual Report furnished to the Commission, herewith.	80

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Exhibit Number	Description of Exhibit	Sequentially Numbered Page
16	Letter re Change in Certifying Accountant	141
21	Subsidiaries of Registrant	142
99.1##	Report of the Special Committee to the Board of Directors	
99.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	143
99.3	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	144
99.4@	First Amendment to Second Restated Agreement of H.O. Hirt Trust effective December 22, 1980	

\* Such exhibit is incorporated by reference to the like numbered exhibit in Registrant’s Form 10 Registration Statement Number 0-24000 filed with the Securities and Exchange Commission on May 2, 1994.

\*\* Such exhibit is incorporated by reference to the like numbered exhibit in Registrant’s Form 10/A Registration Statement Number 0-24000 filed with the Securities and Exchange Commission on August 3, 1994.

\*\*\* Such exhibit is incorporated by reference to the like titled but renumbered exhibit in Registrant’s Form 10 Registration Statement Number 0-24000 filed with the Securities and Exchange Commission on May 2, 1994.

\*\*\*\* 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, 1995 that was filed with the Commission on March 25, 1996.

\*\*\*\*\* Such exhibit is incorporated by reference to the like titled exhibit in the Registrant’s Form 10-K/A amended annual report for the year ended December 31, 1995 that was filed with the Commission on April 25, 1996.

\*\*\*\*\* 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, 1996 that was filed with the Commission on March 21, 1997.

# 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, 1997 that was filed with the Commission on March 25, 1998.

## 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, 1998 that was filed with the Commission on March 30, 1999.

### 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, 1999 that was filed with the Commission on March 23, 2000.

& 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, 2000 that was filed with the Commission on March 23, 2001.

&& Such exhibit is incorporated by reference to the like titled exhibit in the Registrant’s Form 10-Q quarterly report for the quarter ended June 30, 2001 that was filed with the Commission on July 17, 2001.

&&& 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, 2001 that was filed with the Commission on March 12, 2002.

@ Such exhibit is incorporated by reference to the like titled exhibit in the Registrant’s Form 10-Q/A quarterly report for the quarter ended September 30, 2002 that was filed with the Commission on January 27, 2003.

EMPLOYMENT AGREEMENT

THIS AGREEMENT (the "Agreement") made effective as of the 15th day of December, 2002 (the "Effective Date") by and between ERIE INDEMNITY COMPANY, a Pennsylvania corporation with its principal place of business at Erie, Pennsylvania (the "Company"), and MICHAEL J. KRAHE (the "Executive");

WITNESSETH:

WHEREAS, the Company has determined that it is in the best interests of the Company and its shareholders to secure the continued employment of the Executive on the terms and subject to the conditions set forth in this Agreement; and

WHEREAS, the Executive desires and is willing to accept employment with the Company on the terms and subject to the conditions set forth herein;

NOW THEREFORE, in consideration of the premises and mutual covenants contained herein, and intending to be legally bound hereby, the parties hereto agree as follows:

1. Term. The Company hereby agrees to continue the employment of the Executive and the Executive hereby agrees to continue to serve the Company pursuant to the terms and conditions of this Agreement as Executive Vice President of the Company, or in such other position with the Company of at least commensurate responsibility and authority in all material respects, for a term commencing on the Effective Date hereof and expiring on December 15, 2004, unless earlier terminated pursuant to Section 5 hereof. Notwithstanding the foregoing, the Executive shall serve in said office(s) at the pleasure of the Company's Board of Directors (the "Board of Directors") and the Executive may be removed from said office(s) at any time with or without Cause, as hereinafter defined, pursuant to Sections 5(b) or 5(d) hereof; provided that any such removal shall be without prejudice to any contract rights the Executive may have hereunder. Subject to Section 8(a)(6) and Section 8(b) hereof, this Agreement shall expire by its terms on December 15, 2004.

2. Duties and Responsibilities. The Executive's duties hereunder shall be those which shall be prescribed by the Company's Bylaws, as amended from time to time, and by the Board of Directors or any committee thereof from time to time and shall include such executive authority, duties, powers and responsibilities as customarily attend the office as Executive Vice President of a company comparable to the Company. The Executive shall discharge such duties consistent with sound business practices and in accordance with law and the Company's general employment policies, in each case, as in effect from time to time, in all material respects and the Executive shall use best efforts to promote the best interests of the Company. During the term of this Agreement, the Executive's position (including the Executive's status and reporting requirements), authority, duties, powers and responsibilities shall at all times be at least commensurate in all material respects with the most significant of

those held, exercised or assigned to the Executive as of the Effective Date. The Executive shall devote the Executive's knowledge, skill and all of the Executive's professional time, attention and energies (reasonable absences for vacations and illness excepted), to the business of the Company in order to perform such assigned duties faithfully, competently and diligently. It is understood and agreed between the parties that the Executive may (i) engage in charitable and community activities, including serving on boards of directors or trustees of and holding other leadership positions in non-profit organizations unless the objectives and requirements of such positions are determined by the Board of Directors to be inconsistent with the performance of the Executive's duties hereunder, and, (ii) manage personal investments, so long as such activities do not interfere or conflict with the Executive's performance of responsibilities and obligations hereunder. It is expressly agreed that any such activities engaged in by the Executive as of the Effective Date shall not thereafter be deemed to interfere with the Executive's obligations and responsibilities hereunder. The Executive agrees that the approval of the Board of Directors or a committee thereof shall be required before the Executive first accepts a position as director of any for-profit corporation after the date hereof.

3. Compensation. During the term of this Agreement, the Executive shall receive, for all services rendered to the Company hereunder, the following (hereinafter referred to collectively as "Compensation"):

(a) Salary. The Executive shall be paid an annual base salary at an annual rate at least equal to the annual rate being paid or payable to the Executive by the Company in the month in which the Effective Date occurs, with such increases thereafter as shall be determined from time to time to be fair and reasonable by the Board of Directors or by the Executive Compensation Committee of the Board of Directors (the "Committee") in its discretion after taking into account, among other things, the authority, duties, powers and responsibilities of the Executive's position, the Executive's performance, the Company's performance, the compensation of persons in comparable positions at the Company and at other comparable companies, and the effect of inflation. The Executive's annual base salary shall not be reduced after any such increase. The Executive's annual base salary shall be payable in equal installments in accordance with the Company's general salary payment policies, but no less frequently than bi-weekly.

(b) Incentive Compensation. The Executive shall be eligible for awards under the Company's incentive compensation plans, if any, applicable to senior executive officers of the Company or to key employees of the Company or its subsidiaries, including, but not limited to, management incentive plans and stock option plans, in accordance with and subject to the terms thereof (including any provisions providing for changes in the level of or termination of benefits thereunder), on a basis commensurate with the Executive's position and authorities, duties, powers and responsibilities.

(c) Employee Benefit Plans. The Executive and the Executive's "dependents," as that term may be defined under the applicable employee benefit

plan(s) of the Company, shall be included, to the extent eligible thereunder and subject to the terms of the plans (including any provisions for changing the level of or termination of benefits thereunder), in all plans, programs and policies which provide benefits for Company employees and their dependents on a basis commensurate with the Executive's position and authorities, duties, powers and responsibilities including, without limitation, health care insurance, health and welfare plans, pension and retirement plans, group life insurance plans, split dollar life insurance plans, short and long-term disability plans, survivors' benefits, executive supplemental benefits, holidays and other similar or comparable benefits made available to the Company's employees and senior executive officers (hereinafter, such plans, programs and policies shall be collectively referred to as the "Erie Benefit Plans"). Such plans, programs and policies shall include, but are not limited to, the Erie Insurance Group Retirement Plan for Employees, the Erie Insurance Group Employee Savings Plan, the Erie Insurance Group Deferred Compensation Plan, the Erie Insurance Group Split Dollar Life Insurance Plan, the Erie Insurance Group Supplemental Executive Retirement Plan, and the Erie Insurance Group Health Protection, Prescription Drug, Dental Assistance and Vision Care Plans.

(d) Perquisites. The Executive shall be entitled to all perquisites which the Company from time to time makes available to senior executive officers of the Company. Such perquisites shall include, but are not limited to, parking, club dues, tax preparation assistance, and an annual physical examination.

(e) Expenses and Working Facilities. The Executive is hereby authorized to incur, and shall be reimbursed by the Company for, any and all reasonable and necessary business related expenses, including, but not limited to, expenses for business travel, entertainment, gifts and similar matters, which expenses are incurred by the Executive on behalf of the Company or any of its subsidiaries, upon presentation of itemized accounts of such expenses in accordance with Company policies. The Executive shall be furnished during the term of this Agreement with offices and other working facilities in the Company's principal executive offices located in Erie, Pennsylvania (or other location of the principal executive offices within the Erie metropolitan area) and secretarial and other assistance suitable to the Executive's position and adequate for the performance of duties hereunder.

(f) Performance Appraisal. The Executive's performance may be evaluated by the Board of Directors or the Committee from time to time. The Executive shall be entitled to such additional remuneration, including but not limited to annual bonuses based on performance, as the Board of Directors or the Committee may, in its discretion, determine from time to time.

4. Absences. The Executive shall be entitled to vacations in accordance with the Company's vacation policy in effect from time to time (but in no event shall the Executive be

entitled to fewer vacation days than under the Company's vacation policy as in effect on the Effective Date) and to absences because of illness or other incapacity, and shall also be entitled to such other absences, whether for holiday, personal time, conventions, or for any other purpose, as are granted to the Company's other senior executive officers or as are approved by the Board of Directors or the Committee, which approval shall not be unreasonably withheld.

5. Termination. The Executive's employment hereunder may be terminated only as follows:

(a) Expiration of Term of Office. Upon the expiration of the term of the office(s) to which the Executive has been elected or appointed as set forth in Section 1 hereof, the Board of Directors may (i) determine that the Executive should not continue in such office(s) or (ii) that the Executive should not be elected or appointed to an office with duties, authorities, powers and responsibilities that are at least commensurate with those of said office(s), in either case, for reasons other than for Cause (if the reasons for such noncontinuance, nonreelection or nonreappointment constitute Cause, then Section 5(d) hereof will apply).

(b) By the Company Without Cause. The Company may at any time terminate the Executive's employment hereunder without Cause only by the affirmative vote of a majority of the entire Board of Directors, and upon no less than thirty (30) days prior written notice to the Executive.

(c) By the Executive Without Good Reason. The Executive may at any time terminate employment hereunder for any reason upon no less than thirty (30) days written notice to the Company. Section 5(e) shall apply to any termination of employment by the Executive for Good Reason.

(d) By the Company For Cause. The Company may terminate the Executive's employment hereunder for Cause. In such event, the Company shall give to the Executive prompt written notice (in addition to any notice which may be required by Section 5(d)(1) hereof) specifying in reasonable detail the basis for such termination. For purposes of this Agreement, "Cause" shall mean any of the following conduct by the Executive:

- (1) The deliberate and intentional breach of any material provision of this Agreement, which breach Executive shall have failed to cure within thirty (30) days after Executive's receipt of written notice from the Company specifying the specific nature of the Executive's breach;
- (2) The deliberate and intentional engaging by Executive in gross misconduct that is materially and demonstrably

inimical to the best interests, monetary or otherwise, of the Company; or

- (3) Conviction of a felony or conviction of any crime involving moral turpitude, fraud or deceit.

For purposes of this definition, no act, or failure to act, on the Executive's part shall be considered "deliberate and intentional" unless done, or omitted to be done, by the Executive not in good faith and without reasonable belief that such action or omission was in the best interest of the Company.

(e) By the Executive for Good Reason. The Executive may terminate employment hereunder for Good Reason upon providing thirty (30) days written notice to the Company after the Executive reasonably becomes aware of the circumstances giving rise to such Good Reason. For purposes of this Agreement, "Good Reason" means the following conduct of the Company, unless the Executive shall have consented thereto in writing:

- (1) Material breach of any material provision of this Agreement by the Company, which breach shall not have been cured by the Company within thirty (30) days after Company's receipt from the Executive or the Executive's agent of written notice specifying in reasonable detail the nature of the Company's breach;
- (2) The assignment to the Executive of any duties inconsistent in any material respect with the Executive's position (including any reduction of the Executive's status and reporting requirements), authority, duties, powers or responsibilities with the Company as contemplated by Section 2 of this Agreement, or any other action by the Company, including the removal of the Executive from or any failure to reelect or reappoint the Executive to the office(s) specified in Section 2 or a commensurate office(s) (other than for Cause), which results in a diminution of the Executive's authority, duties, position, responsibilities or status, excluding for this purpose any isolated, insubstantial and inadvertent action respecting the Executive not taken in bad faith and which is remedied by the Company within thirty (30) days after receipt of written notice from the Executive to the Company;
- (3) The Company's relocation of the Executive out of the Company's principal executive offices or the relocation of the Company's principal executive offices to a location outside the Erie, Pennsylvania metropolitan area, except for

required short-term travel on the Company's behalf to the extent necessary for the Executive to carry out his normal duties in the ordinary course of business;

- (4) The failure of the Company to obtain the assumption in writing of its obligations to perform this Agreement by any successor as provided in Section 14 hereof not less than five days prior to a merger, consolidation or sale as contemplated in Section 14; or
- (5) A reduction in the overall level of compensation of the Executive. For purposes of this subsection 5, the following shall not constitute a reduction in the overall level of compensation of the Executive: (i) changes in the cash/stock mix of compensation payable to the Executive; (ii) a reduction in the overall level of compensation of the Executive resulting from the failure to achieve corporate, business unit and/or individual performance goals established for purposes of incentive compensation for any year or other period; provided that the aggregate short-term incentive opportunity, when combined with the Executive's base salary, provides, in the aggregate, an opportunity for the Executive to realize at least the same overall level of compensation as was paid in the immediately prior year or period at target performance levels; and provided, further, that such target performance levels are reasonable at all times during the measurement period, taking into account the fact that one of the purposes of such compensation is to incent the Executive; (iii) reductions in compensation resulting from changes to any Erie Benefit Plan (provided that such changes are generally applicable to all participants in such Erie Benefit Plan); and (iv) any combination of the foregoing.

(f) Disability. In the event that the Executive shall be unable to perform the Executive's duties hereunder on a full time basis for a period of one hundred-eighty (180) consecutive calendar days by reason of incapacity due to illness, accident or other physical or mental disability, then the Company may, at its discretion, terminate the Executive's employment hereunder if the Executive, within ten (10) days after receipt of written notice of termination (which notice may be given before or after the end of the entire 180 day period), shall not have returned to the performance of all of his duties hereunder on a full-time basis.

(g) Death. The Executive's employment under this Agreement shall terminate upon the Executive's death.

(h) Mutual Written Agreement. This Agreement and the Executive's employment hereunder may be terminated at any time by the mutual written agreement of the Executive and the Company.

6. Compensation in the Event of Termination. In the event that the Executive's employment hereunder terminates prior to the expiration of this Agreement for any reason provided in Section 5 hereof, the Company shall pay the Executive, compensation and provide the Executive and the Executive's eligible dependents with benefits as follows:

(a) Executive's Nonreelection to Office; Termination By Company Without Cause; Termination By Executive for Good Reason. In the event that the Executive's employment hereunder is terminated: (i) because the Executive does not continue in office pursuant to Section 5(a) hereof; or (ii) by the Company without Cause pursuant to Section 5(b) hereof; or (iii) by the Executive for Good Reason pursuant to Section 5(e) hereof, then in any such event the Company shall pay or provide, as applicable, the following compensation and benefits to the Executive:

- (1) Three (3) times the following: (A) the highest annual base salary paid or payable to the Executive in the then current year or any one (1) of the three (3) calendar years preceding Executive's termination of employment hereunder; plus (B) an amount equal to the sum of the Executive's highest award(s) under the Company's Annual Incentive Plans for any one (1) of the three (3) calendar years preceding the date of the termination of Executive's employment hereunder (such total is referred to herein as "Covered Compensation"). Such payment to the Executive by the Company shall be paid in a lump sum unless the Executive elects, and so notifies the Company in writing prior to the termination of the Executive's employment hereunder, to receive such payment in three (3) equal annual installments. The lump sum or first payment, as the case may be, shall be paid within sixty (60) days after the date of the termination of the Executive's employment hereunder;
- (2) Any awards or other compensation to which the Executive is entitled under any of the Company's compensation plans or Erie Benefit Plans to the extent not covered in subsection (1) hereof;
- (3) Any award to which the Executive would be entitled under the Company's Long-Term Incentive Plan as in effect on December 16, 1997, calculated under the provision of that Plan as if the Executive ceases to be an Employee of the

Company by reason of death, disability or normal retirement;

- (4) Continuing coverage for all purposes (including eligibility, coverage, vesting and benefit accruals, as applicable), for a period of three (3) years after the date of the termination of Executive's employment hereunder, to the extent not prohibited by law, for the Executive and the Executive's eligible dependents under all of the Erie Benefit Plans in effect and applicable to Executive and the Executive's eligible dependents as of the date of termination. In the event that the Executive and/or the Executive's eligible dependents, because of the Executive's terminated status, cannot be covered or fully covered under any or all of the Erie Benefit Plans, the Company shall continue to provide the Executive and/or the Executive's eligible dependents with the same level of such coverage in effect prior to termination, payable from the general assets of the Company if necessary. Notwithstanding the foregoing, the Executive may elect (by giving written notice to the Company prior to the termination of employment hereunder), on a benefit by benefit basis, to receive in lieu of continuing coverage, cash in an amount equal to the present value (using a 6.5% discount rate over three years) of the projected cost to the Company of providing such benefit for such three year period. The aggregate amount of cash to which the Executive is entitled pursuant to the preceding sentence shall be payable by the Company to the Executive within sixty (60) days after the date of the termination of Executive's employment hereunder; and
- (5) For a period of three (3) years after the date of the termination of Executive's employment hereunder, such perquisites as are made available to the Executive as of the date of the termination of Executive's employment hereunder.

The Executive's subsequent death, disability or attainment of age 65 or any other age shall in no way affect or limit the Company's obligations under this Section 6(a).

(b) Termination By the Company for Cause. In the event that the Company shall terminate the Executive's employment hereunder for Cause pursuant to Section 5(d), this Agreement shall forthwith terminate and the obligations of the parties hereto shall be as set forth in Section 8 hereof.

(c) Termination by the Executive Without Good Reason. In the event that the Executive shall terminate employment hereunder other than for Good Reason pursuant to Section 5(c), this Agreement shall forthwith terminate and the obligations of the parties hereto shall be as set forth in Section 8 hereof.

(d) Disability. In the event that the Company elects to terminate the Executive's employment hereunder pursuant to Section 5(f), the Executive shall continue to receive from the date of such termination through the expiration date of this Agreement, sixty percent (60%) of the then current annual base salary to which the Executive was entitled pursuant to Section 3(a) hereof immediately preceding such termination, in accordance with the payroll practices of the Company for senior executive officers, reduced, however, by the amount of any proceeds from Social Security and disability insurance policies provided by and at the expense of the Company.

(e) Death. In the event of the death of the Executive during the term of this Agreement, the then current annual base salary to which the Executive was entitled pursuant to Section 3(a) hereof immediately preceding the Executive's death shall be paid, in twelve (12) equal monthly installments following the date of death, to the last beneficiary designated by the Executive under the Company's group life insurance policy maintained by the Company or such other written designation expressly provided to the Company for the purposes hereof or, failing either such designation, to the Executive's estate.

(f) Mutual Written Consent. In the event that the Executive and the Company shall terminate the Executive's employment by mutual written agreement, the Company shall pay such compensation and provide such benefits, if any, as the parties may mutually agree upon in writing.

The Executive shall not be required to mitigate the amount of any payment provided for in this Section 6 by seeking employment or otherwise, nor shall any amounts received from employment or otherwise by the Executive offset in any manner the obligations of the Company hereunder except as specifically provided in Section 6(d) hereof.

7. Certain Additional Payments by the Company. Notwithstanding anything in this Agreement to the contrary, in the event it is determined that any payment or distribution by the Company to or for the benefit of the Executive, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise (a "Payment"), is subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code"), or any successor provision, on excess parachute payments, as that term is used and defined in Sections 4999 and 280G of the Code, then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount equal to the then current rate of tax under said Section 4999 multiplied by the total of the amounts so paid or payable, including the Gross-Up Payment, which are deemed to be a part of an excess parachute payment.

8. Effect of Expiration of Agreement or Termination of Executive's Employment. Upon the expiration of this Agreement by its terms or the termination of the Executive's employment hereunder, neither the Company nor the Executive shall have any remaining duties or obligations hereunder except that:

(a) The Company shall:

- (1) Pay the Executive's accrued salary and any other accrued benefits under Sections 3(a), (b), and (c) hereof;
- (2) Reimburse the Executive for expenses already incurred in accordance with Section 3(e) hereof;
- (3) Pay or otherwise provide for any benefits, payments or continuation or conversion rights in accordance with the provisions of any Erie Benefit Plan of which the Executive or any of the Executive's dependents is or was a participant or as otherwise required by law;
- (4) Pay the Executive and the Executive's beneficiaries any compensation and/or provide the Executive or the Executive's eligible dependents any benefits, as the case may be, due pursuant to Section 6 or Section 7 hereof; and
- (5) Unless the employment of the Executive is terminated by the Company for Cause, pay the Executive or the Executive's beneficiaries the full amount or amounts accrued under the Supplemental Executive Retirement Plan of the Company (the "SERP") as in effect on the Effective Date (or as such benefits may be enhanced by subsequent amendments or supplements to such SERP), as though, solely for purposes of determining any otherwise applicable actuarial reduction factors, the event of the termination of Executive's employment hereunder or expiration of this Agreement occurred on the Executive's Normal Retirement Date as defined in such SERP. Accrued benefits under the SERP shall be fully vested and nonforfeitable upon such termination (including termination on account of the Executive's death) or expiration. Any reductions in SERP benefits that would otherwise apply pursuant to Section 10.1 of the Company's Retirement Plan for Employees (or pursuant to any successor provision of such plan or any successor plan) relating to Section 415(b) of the Code shall not be applicable for purposes hereof. No further approval by the Board of Directors or the Committee with respect to payments under the SERP in accordance with the preceding

sentences shall be required. Unreduced payments may begin at age 55, but in no event would payments be made under this Section 8(a)(5) before the Executive reaches age fifty-five (55). The Company shall purchase for the Executive, naming the Executive and/or the Executive's designee the owner, a paid up annuity, from an insurer reasonably acceptable to the Executive but in any event having an A.M. Best rating of A+ or better (or other comparable rating), that will pay to the Executive an amount equal to the benefit to which the Executive would otherwise be entitled under the SERP and payable at the times such SERP benefit would be payable in accordance with the provisions hereof. Upon the purchase and delivery to the Executive of such an annuity, the Executive shall release the Company from any further obligation under the SERP. The Company further agrees to pay the Executive immediately upon termination, a cash payment (the "Tax Gross-up") equal to the sum of the following: (i) all taxes (federal, state, local, and payroll taxes) incurred and due and owing by the Executive, arising from the cost of the annuity purchased by the Company to meet the requirements of this Section 8(a)(5), and (ii) any such taxes incurred and due and owing with respect to the amount paid in (i).

(6) Continue to remain bound by the terms of Section 12 hereof.

(b) The Executive shall remain bound by the terms of Sections 9 and 13 hereof for a period of thirty six (36) months after the expiration of the Agreement by its terms; provided, that the Executive shall not be bound by the terms of Section 9(b) after the termination of employment (other than a termination of the Executive by the Company for Cause) if such termination occurs after the expiration of this Agreement by its terms.

9. Covenants as to Confidential Information and Competitive Conduct. The Executive hereby acknowledges and agrees as follows: (i) this Section 9 is necessary for the protection of the legitimate business interests of the Company, (ii) the restrictions contained in this Section 9 with regard to geographical scope, length of term and types of restricted activities are reasonable; (iii) the Executive has received adequate and valuable new consideration for entering into this Agreement, and (iv) the Executive's expertise and capabilities are such that this obligation hereunder and the enforcement hereof by injunction or otherwise will not adversely affect the Executive's ability to earn a livelihood.

(a) Confidentiality of Information and Nondisclosure. The Executive acknowledges and agrees that the Executive's employment by the Company under this Agreement necessarily involves knowledge of and access to confidential and proprietary information pertaining to the business of the Company and its subsidiaries. Accordingly, the Executive agrees that at all times during the term of this Agreement and at any time thereafter, the Executive will not, directly or indirectly, without the express written approval of the Company, unless directed by applicable legal authority (including any court of competent jurisdiction, governmental agency having supervisory authority over the business of the Company or the subsidiaries, or any legislative or administrative body having supervisory authority over the business of the Company or its subsidiaries) having jurisdiction over the Executive, disclose to or use, or knowingly permit to be so disclosed or used, for the benefit of himself, any person, corporation or other entity other than the Company, (i) any information concerning any financial matters, customer relationships, competitive status, supplier matters, internal organizational matters, current or future plans, or other business affairs of or relating to the Company or its subsidiaries, (ii) any management, operational, trade, technical or other secrets or any other proprietary information or other data of the Company or its subsidiaries, or (iii) any other information related to the Company or its subsidiaries or which the Executive should reasonably believe will be damaging to the Company or its subsidiaries which has not been published and is not generally known outside of the Company. The Executive acknowledges that all of the foregoing constitutes confidential and proprietary information, which is the exclusive property of the Company.

(b) Restrictive Covenant. During the term of, and for a period of one (1) year (the "Restrictive Period") after the termination of the Executive's employment hereunder for any reason (other than a termination of the Executive hereunder pursuant to Section 5(a), 5(b) or 5(e), hereof), the Executive shall not render, directly, or indirectly, services to any person, firm, corporation, association or other entity which conducts the same or similar business as the Company or its subsidiaries at the date of the Executive's termination of employment hereunder within the states in which the Company or any of its subsidiaries is then licensed and doing business at the date of the Executive's termination of employment hereunder without the prior written consent of the Board of Directors, which may be withheld in its discretion. In the event the Executive violates any of the provisions contained in this Section 9(b) hereof, the Restrictive Period shall be increased by the period of time from the commencement by the Executive of any violation until such violation has been cured to the satisfaction of the Company. The Executive further agrees that at no time during the Restrictive Period will the Executive attempt to directly or indirectly solicit or hire employees of Company or its subsidiaries or induce any of them to terminate their employment with the Company or any of the subsidiaries. Notwithstanding the foregoing, the performance by the Executive of

rights and duties under an agency agreement with the Company shall not constitute a breach of this Section 9(b).

(c) **Company Remedies.** The Executive acknowledges and agrees that any breach of this Section 9 will result in immediate and irreparable harm to the Company, and that the Company cannot be reasonably or adequately compensated by damages in an action at law. In the event of a breach by the Executive of the provisions of this Section 9, the Company shall be entitled, to the extent permitted by law, immediately to cease to pay or provide the Executive or the Executive's dependents any compensation or benefit being, or to be, paid or provided to the Executive pursuant to Section 3, Section 6 or Section 8 of this Agreement, and also to obtain immediate injunctive relief restraining the Executive from conduct in breach of the covenants contained in this Section 9. Nothing herein shall be construed as prohibiting the Company from pursuing any other remedies available to it for such breach, including the recovery of damages from the Executive.

10. **Resolution of Differences Over Breaches of Agreement.** Except as otherwise provided herein, in the event of any controversy, dispute or claim arising out of, or relating to, this Agreement, or the breach thereof, or arising out of any other matter relating to the Executive's employment with the Company, the parties may seek recourse only for temporary or preliminary injunctive relief to the courts having jurisdiction thereof and if any relief other than injunctive relief is sought, the Company and the Executive agree that such underlying controversy, dispute or claim shall be settled by arbitration conducted in Erie, Pennsylvania in accordance with this Section 10 and the Commercial Arbitration Rules of the American Arbitration Association ("AAA"). The matter shall be heard and decided, and awards rendered by a panel of three (3) arbitrators (the "Arbitration Panel"). The Company and the Executive shall each select one arbitrator from the AAA National Panel of Commercial Arbitrators (the "Commercial Panel") and AAA shall select a third arbitrator from the Commercial Panel. The award rendered by the Arbitration Panel shall be final and binding as between the parties hereto and their heirs, executors, administrators, successors and assigns, and judgment on the award may be entered by any court having jurisdiction thereof. Except as provided in Section 11 hereof, each party shall bear sole responsibility for all expenses and costs incurred by such party in connection with the resolution of any controversy, dispute or claim in accordance with this Section 10.

11. **Payment of Executive's Legal Fees.** If the Executive is required to bring any action to enforce rights or to collect moneys due under this Agreement, the Company shall pay to the Executive the fees and expenses incurred by the Executive in bringing and pursuing such action if the Executive is successful, in whole or in part, on the merits or otherwise (including by way of a settlement involving a payment of money by the Company to the Executive), in such action. The Company shall pay such fees and expenses in advance of the final disposition of such action upon receipt of an undertaking from the Executive to repay to the Company such advances if the Executive is not ultimately successful, in whole or in part, on the merits or otherwise, in such action.

12. Severance Pay upon Termination of Employment after Expiration of the Agreement. Notwithstanding the expiration of this Agreement by its terms and notwithstanding the terms of any corporate severance policy then in effect and applicable to the Executive, if the employment of the Executive is terminated without Cause by the Company, by the Executive for Good Reason or upon the expiration of the term of the office(s) to which the Executive has been elected or appointed as set forth in Section 1 hereof (for reasons other than for Cause), in any case, within thirty-six (36) months after the expiration of this Agreement by its terms, then (i) the Company shall pay to the Executive severance compensation in an amount equal to two (2) times the Executive's Covered Compensation as determined on the date of such termination, and (ii) the Executive and the Executive's eligible dependents shall be entitled to continuing coverage under the Company's then-existing group health plans (including medical, dental, prescription drug and vision plans, if any) for a period of two (2) years after the date of the termination of the Executive's employment, to the extent not prohibited by law and subject to the terms of such plans including provisions as to deductibles and copayments and changes in levels of coverage that are generally applicable to employees. The payment to the Executive by the Company pursuant to subsection (i) of the preceding sentence shall be paid in a lump sum unless the Executive elects, and so notifies the Company in writing prior to the Executive's termination of employment, to receive such payment in two (2) equal annual installments. The lump sum or first payment, as the case may be, shall be paid within thirty (30) days after the date of termination of the Executive's employment.

13. Release. The Executive hereby acknowledges and agrees that neither the Company nor any of its representatives or agents will be obligated to pay any compensation or benefit which the Executive has a right to be paid or provided to the Executive or the Executive's dependents pursuant to Section 6, Section 8 or Section 12 of this Agreement, unless the Executive, if requested by the Company in its sole discretion, executes a release in a form reasonably acceptable to the Company, which releases any and all claims the Executive has or may have against the Company or its subsidiaries, agents, officers, directors, successors or assigns.

14. Waiver. The waiver by a party hereto of any breach by the other party hereto of any provision of this Agreement shall not operate or be construed as a waiver of any other or subsequent breach by a party hereto.

15. Assignment. This Agreement shall be binding upon and inure to the benefit of the successors and assigns of the Company, and the Company shall be obligated to require any successor to expressly acknowledge and assume its obligations hereunder. This Agreement shall inure to the extent provided hereunder to the benefit of and be enforceable by the Executive or the Executive's legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. The Executive may not delegate any of the Executive's duties, responsibilities, obligations or positions hereunder to any person and any such purported delegation shall be void and of no force and effect.

16. Notices. Any notices required or permitted to be given under this Agreement shall be sufficient if in writing, and if personally delivered or when sent by first class certified or registered mail, postage prepaid, return receipt requested—in the case of the Executive, to his residence address as set forth below, and in the case of the Company, to the address of its principal place of business as set forth below, to the attention of the Chairman of the Board, or in case the Executive is the Chairman of the Board, to the Chairman of the Compensation Committee of the Board — or to such other person or at such other address with respect to each party as such party shall notify the other in writing.

17. Construction of Agreement.

(a) Governing Law. This Agreement shall be governed by and construed under the laws of the Commonwealth of Pennsylvania.

(b) Severability. In the event that any one or more of the provisions of this Agreement shall be held to be invalid, illegal or unenforceable, the validity, legality or enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

(c) Headings. The descriptive headings of the several paragraphs of this Agreement are inserted for convenience of reference only and shall not constitute a part of this Agreement.

18. Entire Agreement. This Agreement contains the entire agreement of the parties concerning the Executive's employment and all promises, representations, understandings, arrangements and prior agreements on such subject are merged herein and superseded hereby. The provisions of this Agreement may not be amended, modified, repealed, waived, extended or discharged except by an agreement in writing signed by the party against whom enforcement of any amendment, modification, repeal, waiver, extension or discharge is sought. No person acting other than pursuant to a resolution of the Board of Directors or the Committee shall have authority on behalf of the Company to agree to amend, modify, repeal, waive, extend or discharge any provision of this Agreement or anything in reference thereto or to exercise any of the Company's rights to terminate or to fail to extend this Agreement.

IN WITNESS WHEREOF, the Company has caused this Agreement to be executed by its officers thereunto duly authorized, and the Executive has hereunto set his hand all as of the day and year first above written.

ATTEST:

/s/ Jan R. Van Gorder  
Jan R. Van Gorder  
Secretary

ERIE INDEMNITY COMPANY

By: /s/ F. William Hirt  
F. William Hirt  
Chairman of the Board

WITNESS:

/s/ Martina R. Gonzales  
Martina R. Gonzales  
Executive Secretary

/s/ Michael J. Krahe (SEAL)  
Michael J. Krahe  
4516 Cedarwood Ct.  
Erie, PA 16506

EMPLOYMENT AGREEMENT

THIS AGREEMENT (the "Agreement") made effective as of the 15th day of December, 2002 (the "Effective Date") by and between ERIE INDEMNITY COMPANY, a Pennsylvania corporation with its principal place of business at Erie, Pennsylvania (the "Company"), and THOMAS B. MORGAN (the "Executive");

WITNESSETH:

WHEREAS, the Company has determined that it is in the best interests of the Company and its shareholders to secure the continued employment of the Executive on the terms and subject to the conditions set forth in this Agreement; and

WHEREAS, the Executive desires and is willing to accept employment with the Company on the terms and subject to the conditions set forth herein;

NOW THEREFORE, in consideration of the premises and mutual covenants contained herein, and intending to be legally bound hereby, the parties hereto agree as follows:

1. Term. The Company hereby agrees to continue the employment of the Executive and the Executive hereby agrees to continue to serve the Company pursuant to the terms and conditions of this Agreement as Executive Vice President of the Company, or in such other position with the Company of at least commensurate responsibility and authority in all material respects, for a term commencing on the Effective Date hereof and expiring on December 15, 2004, unless earlier terminated pursuant to Section 5 hereof. Notwithstanding the foregoing, the Executive shall serve in said office(s) at the pleasure of the Company's Board of Directors (the "Board of Directors") and the Executive may be removed from said office(s) at any time with or without Cause, as hereinafter defined, pursuant to Sections 5(b) or 5(d) hereof; provided that any such removal shall be without prejudice to any contract rights the Executive may have hereunder. Subject to Section 8(a)(6) and Section 8(b) hereof, this Agreement shall expire by its terms on December 15, 2004.

2. Duties and Responsibilities. The Executive's duties hereunder shall be those which shall be prescribed by the Company's Bylaws, as amended from time to time, and by the Board of Directors or any committee thereof from time to time and shall include such executive authority, duties, powers and responsibilities as customarily attend the office as Executive Vice President of a company comparable to the Company. The Executive shall discharge such duties consistent with sound business practices and in accordance with law and the Company's general employment policies, in each case, as in effect from time to time, in all material respects and the Executive shall use best efforts to promote the best interests of the Company. During the term of this Agreement, the Executive's position (including the Executive's status and reporting requirements), authority, duties, powers and responsibilities shall at all times be at least commensurate in all material respects with the most significant of

those held, exercised or assigned to the Executive as of the Effective Date. The Executive shall devote the Executive's knowledge, skill and all of the Executive's professional time, attention and energies (reasonable absences for vacations and illness excepted), to the business of the Company in order to perform such assigned duties faithfully, competently and diligently. It is understood and agreed between the parties that the Executive may (i) engage in charitable and community activities, including serving on boards of directors or trustees of and holding other leadership positions in non-profit organizations unless the objectives and requirements of such positions are determined by the Board of Directors to be inconsistent with the performance of the Executive's duties hereunder, and, (ii) manage personal investments, so long as such activities do not interfere or conflict with the Executive's performance of responsibilities and obligations hereunder. It is expressly agreed that any such activities engaged in by the Executive as of the Effective Date shall not thereafter be deemed to interfere with the Executive's obligations and responsibilities hereunder. The Executive agrees that the approval of the Board of Directors or a committee thereof shall be required before the Executive first accepts a position as director of any for-profit corporation after the date hereof.

3. Compensation. During the term of this Agreement, the Executive shall receive, for all services rendered to the Company hereunder, the following (hereinafter referred to collectively as "Compensation"):

(a) Salary. The Executive shall be paid an annual base salary at an annual rate at least equal to the annual rate being paid or payable to the Executive by the Company in the month in which the Effective Date occurs, with such increases thereafter as shall be determined from time to time to be fair and reasonable by the Board of Directors or by the Executive Compensation Committee of the Board of Directors (the "Committee") in its discretion after taking into account, among other things, the authority, duties, powers and responsibilities of the Executive's position, the Executive's performance, the Company's performance, the compensation of persons in comparable positions at the Company and at other comparable companies, and the effect of inflation. The Executive's annual base salary shall not be reduced after any such increase. The Executive's annual base salary shall be payable in equal installments in accordance with the Company's general salary payment policies, but no less frequently than bi-weekly.

(b) Incentive Compensation. The Executive shall be eligible for awards under the Company's incentive compensation plans, if any, applicable to senior executive officers of the Company or to key employees of the Company or its subsidiaries, including, but not limited to, management incentive plans and stock option plans, in accordance with and subject to the terms thereof (including any provisions providing for changes in the level of or termination of benefits thereunder), on a basis commensurate with the Executive's position and authorities, duties, powers and responsibilities.

(c) Employee Benefit Plans. The Executive and the Executive's "dependents," as that term may be defined under the applicable employee benefit

plan(s) of the Company, shall be included, to the extent eligible thereunder and subject to the terms of the plans (including any provisions for changing the level of or termination of benefits thereunder), in all plans, programs and policies which provide benefits for Company employees and their dependents on a basis commensurate with the Executive's position and authorities, duties, powers and responsibilities including, without limitation, health care insurance, health and welfare plans, pension and retirement plans, group life insurance plans, split dollar life insurance plans, short and long-term disability plans, survivors' benefits, executive supplemental benefits, holidays and other similar or comparable benefits made available to the Company's employees and senior executive officers (hereinafter, such plans, programs and policies shall be collectively referred to as the "Erie Benefit Plans"). Such plans, programs and policies shall include, but are not limited to, the Erie Insurance Group Retirement Plan for Employees, the Erie Insurance Group Employee Savings Plan, the Erie Insurance Group Deferred Compensation Plan, the Erie Insurance Group Split Dollar Life Insurance Plan, the Erie Insurance Group Supplemental Executive Retirement Plan, and the Erie Insurance Group Health Protection, Prescription Drug, Dental Assistance and Vision Care Plans.

(d) Perquisites. The Executive shall be entitled to all perquisites which the Company from time to time makes available to senior executive officers of the Company. Such perquisites shall include, but are not limited to, parking, club dues, tax preparation assistance, and an annual physical examination.

(e) Expenses and Working Facilities. The Executive is hereby authorized to incur, and shall be reimbursed by the Company for, any and all reasonable and necessary business related expenses, including, but not limited to, expenses for business travel, entertainment, gifts and similar matters, which expenses are incurred by the Executive on behalf of the Company or any of its subsidiaries, upon presentation of itemized accounts of such expenses in accordance with Company policies. The Executive shall be furnished during the term of this Agreement with offices and other working facilities in the Company's principal executive offices located in Erie, Pennsylvania (or other location of the principal executive offices within the Erie metropolitan area) and secretarial and other assistance suitable to the Executive's position and adequate for the performance of duties hereunder.

(f) Performance Appraisal. The Executive's performance may be evaluated by the Board of Directors or the Committee from time to time. The Executive shall be entitled to such additional remuneration, including but not limited to annual bonuses based on performance, as the Board of Directors or the Committee may, in its discretion, determine from time to time.

4. Absences. The Executive shall be entitled to vacations in accordance with the Company's vacation policy in effect from time to time (but in no event shall the Executive be

entitled to fewer vacation days than under the Company's vacation policy as in effect on the Effective Date) and to absences because of illness or other incapacity, and shall also be entitled to such other absences, whether for holiday, personal time, conventions, or for any other purpose, as are granted to the Company's other senior executive officers or as are approved by the Board of Directors or the Committee, which approval shall not be unreasonably withheld.

5. Termination. The Executive's employment hereunder may be terminated only as follows:

(a) Expiration of Term of Office. Upon the expiration of the term of the office(s) to which the Executive has been elected or appointed as set forth in Section 1 hereof, the Board of Directors may (i) determine that the Executive should not continue in such office(s) or (ii) that the Executive should not be elected or appointed to an office with duties, authorities, powers and responsibilities that are at least commensurate with those of said office(s), in either case, for reasons other than for Cause (if the reasons for such noncontinuance, nonreelection or nonreappointment constitute Cause, then Section 5(d) hereof will apply).

(b) By the Company Without Cause. The Company may at any time terminate the Executive's employment hereunder without Cause only by the affirmative vote of a majority of the entire Board of Directors, and upon no less than thirty (30) days prior written notice to the Executive.

(c) By the Executive Without Good Reason. The Executive may at any time terminate employment hereunder for any reason upon no less than thirty (30) days written notice to the Company. Section 5(e) shall apply to any termination of employment by the Executive for Good Reason.

(d) By the Company For Cause. The Company may terminate the Executive's employment hereunder for Cause. In such event, the Company shall give to the Executive prompt written notice (in addition to any notice which may be required by Section 5(d)(1) hereof) specifying in reasonable detail the basis for such termination. For purposes of this Agreement, "Cause" shall mean any of the following conduct by the Executive:

- (1) The deliberate and intentional breach of any material provision of this Agreement, which breach Executive shall have failed to cure within thirty (30) days after Executive's receipt of written notice from the Company specifying the specific nature of the Executive's breach;
- (2) The deliberate and intentional engaging by Executive in gross misconduct that is materially and demonstrably

inimical to the best interests, monetary or otherwise, of the Company; or

- (3) Conviction of a felony or conviction of any crime involving moral turpitude, fraud or deceit.

For purposes of this definition, no act, or failure to act, on the Executive's part shall be considered "deliberate and intentional" unless done, or omitted to be done, by the Executive not in good faith and without reasonable belief that such action or omission was in the best interest of the Company.

(e) By the Executive for Good Reason. The Executive may terminate employment hereunder for Good Reason upon providing thirty (30) days written notice to the Company after the Executive reasonably becomes aware of the circumstances giving rise to such Good Reason. For purposes of this Agreement, "Good Reason" means the following conduct of the Company, unless the Executive shall have consented thereto in writing:

- (1) Material breach of any material provision of this Agreement by the Company, which breach shall not have been cured by the Company within thirty (30) days after Company's receipt from the Executive or the Executive's agent of written notice specifying in reasonable detail the nature of the Company's breach;
- (2) The assignment to the Executive of any duties inconsistent in any material respect with the Executive's position (including any reduction of the Executive's status and reporting requirements), authority, duties, powers or responsibilities with the Company as contemplated by Section 2 of this Agreement, or any other action by the Company, including the removal of the Executive from or any failure to reelect or reappoint the Executive to the office(s) specified in Section 2 or a commensurate office(s) (other than for Cause), which results in a diminution of the Executive's authority, duties, position, responsibilities or status, excluding for this purpose any isolated, insubstantial and inadvertent action respecting the Executive not taken in bad faith and which is remedied by the Company within thirty (30) days after receipt of written notice from the Executive to the Company;
- (3) The Company's relocation of the Executive out of the Company's principal executive offices or the relocation of the Company's principal executive offices to a location outside the Erie, Pennsylvania metropolitan area, except for

required short-term travel on the Company's behalf to the extent necessary for the Executive to carry out his normal duties in the ordinary course of business;

- (4) The failure of the Company to obtain the assumption in writing of its obligations to perform this Agreement by any successor as provided in Section 14 hereof not less than five days prior to a merger, consolidation or sale as contemplated in Section 14; or
- (5) A reduction in the overall level of compensation of the Executive. For purposes of this subsection 5, the following shall not constitute a reduction in the overall level of compensation of the Executive: (i) changes in the cash/stock mix of compensation payable to the Executive; (ii) a reduction in the overall level of compensation of the Executive resulting from the failure to achieve corporate, business unit and/or individual performance goals established for purposes of incentive compensation for any year or other period; provided that the aggregate short-term incentive opportunity, when combined with the Executive's base salary, provides, in the aggregate, an opportunity for the Executive to realize at least the same overall level of compensation as was paid in the immediately prior year or period at target performance levels; and provided, further, that such target performance levels are reasonable at all times during the measurement period, taking into account the fact that one of the purposes of such compensation is to incent the Executive; (iii) reductions in compensation resulting from changes to any Erie Benefit Plan (provided that such changes are generally applicable to all participants in such Erie Benefit Plan); and (iv) any combination of the foregoing.

(f) Disability. In the event that the Executive shall be unable to perform the Executive's duties hereunder on a full time basis for a period of one hundred-eighty (180) consecutive calendar days by reason of incapacity due to illness, accident or other physical or mental disability, then the Company may, at its discretion, terminate the Executive's employment hereunder if the Executive, within ten (10) days after receipt of written notice of termination (which notice may be given before or after the end of the entire 180 day period), shall not have returned to the performance of all of his duties hereunder on a full-time basis.

(g) Death. The Executive's employment under this Agreement shall terminate upon the Executive's death.

(h) Mutual Written Agreement. This Agreement and the Executive's employment hereunder may be terminated at any time by the mutual written agreement of the Executive and the Company.

6. Compensation in the Event of Termination. In the event that the Executive's employment hereunder terminates prior to the expiration of this Agreement for any reason provided in Section 5 hereof, the Company shall pay the Executive, compensation and provide the Executive and the Executive's eligible dependents with benefits as follows:

(a) Executive's Nonreelection to Office; Termination By Company Without Cause; Termination By Executive for Good Reason. In the event that the Executive's employment hereunder is terminated: (i) because the Executive does not continue in office pursuant to Section 5(a) hereof; or (ii) by the Company without Cause pursuant to Section 5(b) hereof; or (iii) by the Executive for Good Reason pursuant to Section 5(e) hereof, then in any such event the Company shall pay or provide, as applicable, the following compensation and benefits to the Executive:

- (1) Three (3) times the following: (A) the highest annual base salary paid or payable to the Executive in the then current year or any one (1) of the three (3) calendar years preceding Executive's termination of employment hereunder; plus (B) an amount equal to the sum of the Executive's highest award(s) under the Company's Annual Incentive Plans for any one (1) of the three (3) calendar years preceding the date of the termination of Executive's employment hereunder (such total is referred to herein as "Covered Compensation"). Such payment to the Executive by the Company shall be paid in a lump sum unless the Executive elects, and so notifies the Company in writing prior to the termination of the Executive's employment hereunder, to receive such payment in three (3) equal annual installments. The lump sum or first payment, as the case may be, shall be paid within sixty (60) days after the date of the termination of the Executive's employment hereunder;
- (2) Any awards or other compensation to which the Executive is entitled under any of the Company's compensation plans or Erie Benefit Plans to the extent not covered in subsection (1) hereof;
- (3) Any award to which the Executive would be entitled under the Company's Long-Term Incentive Plan as in effect on December 16, 1997, calculated under the provision of that Plan as if the Executive ceases to be an Employee of the

Company by reason of death, disability or normal retirement;

- (4) Continuing coverage for all purposes (including eligibility, coverage, vesting and benefit accruals, as applicable), for a period of three (3) years after the date of the termination of Executive's employment hereunder, to the extent not prohibited by law, for the Executive and the Executive's eligible dependents under all of the Erie Benefit Plans in effect and applicable to Executive and the Executive's eligible dependents as of the date of termination. In the event that the Executive and/or the Executive's eligible dependents, because of the Executive's terminated status, cannot be covered or fully covered under any or all of the Erie Benefit Plans, the Company shall continue to provide the Executive and/or the Executive's eligible dependents with the same level of such coverage in effect prior to termination, payable from the general assets of the Company if necessary. Notwithstanding the foregoing, the Executive may elect (by giving written notice to the Company prior to the termination of employment hereunder), on a benefit by benefit basis, to receive in lieu of continuing coverage, cash in an amount equal to the present value (using a 6.5% discount rate over three years) of the projected cost to the Company of providing such benefit for such three year period. The aggregate amount of cash to which the Executive is entitled pursuant to the preceding sentence shall be payable by the Company to the Executive within sixty (60) days after the date of the termination of Executive's employment hereunder; and
- (5) For a period of three (3) years after the date of the termination of Executive's employment hereunder, such perquisites as are made available to the Executive as of the date of the termination of Executive's employment hereunder.

The Executive's subsequent death, disability or attainment of age 65 or any other age shall in no way affect or limit the Company's obligations under this Section 6(a).

(b) Termination By the Company for Cause. In the event that the Company shall terminate the Executive's employment hereunder for Cause pursuant to Section 5(d), this Agreement shall forthwith terminate and the obligations of the parties hereto shall be as set forth in Section 8 hereof.

(c) Termination by the Executive Without Good Reason. In the event that the Executive shall terminate employment hereunder other than for Good Reason pursuant to Section 5(c), this Agreement shall forthwith terminate and the obligations of the parties hereto shall be as set forth in Section 8 hereof.

(d) Disability. In the event that the Company elects to terminate the Executive's employment hereunder pursuant to Section 5(f), the Executive shall continue to receive from the date of such termination through the expiration date of this Agreement, sixty percent (60%) of the then current annual base salary to which the Executive was entitled pursuant to Section 3(a) hereof immediately preceding such termination, in accordance with the payroll practices of the Company for senior executive officers, reduced, however, by the amount of any proceeds from Social Security and disability insurance policies provided by and at the expense of the Company.

(e) Death. In the event of the death of the Executive during the term of this Agreement, the then current annual base salary to which the Executive was entitled pursuant to Section 3(a) hereof immediately preceding the Executive's death shall be paid, in twelve (12) equal monthly installments following the date of death, to the last beneficiary designated by the Executive under the Company's group life insurance policy maintained by the Company or such other written designation expressly provided to the Company for the purposes hereof or, failing either such designation, to the Executive's estate.

(f) Mutual Written Consent. In the event that the Executive and the Company shall terminate the Executive's employment by mutual written agreement, the Company shall pay such compensation and provide such benefits, if any, as the parties may mutually agree upon in writing.

The Executive shall not be required to mitigate the amount of any payment provided for in this Section 6 by seeking employment or otherwise, nor shall any amounts received from employment or otherwise by the Executive offset in any manner the obligations of the Company hereunder except as specifically provided in Section 6(d) hereof.

7. Certain Additional Payments by the Company. Notwithstanding anything in this Agreement to the contrary, in the event it is determined that any payment or distribution by the Company to or for the benefit of the Executive, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise (a "Payment"), is subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code"), or any successor provision, on excess parachute payments, as that term is used and defined in Sections 4999 and 280G of the Code, then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount equal to the then current rate of tax under said Section 4999 multiplied by the total of the amounts so paid or payable, including the Gross-Up Payment, which are deemed to be a part of an excess parachute payment.

8. Effect of Expiration of Agreement or Termination of Executive's Employment. Upon the expiration of this Agreement by its terms or the termination of the Executive's employment hereunder, neither the Company nor the Executive shall have any remaining duties or obligations hereunder except that:

- (a) The Company shall:
  - (1) Pay the Executive's accrued salary and any other accrued benefits under Sections 3(a), (b), and (c) hereof;
  - (2) Reimburse the Executive for expenses already incurred in accordance with Section 3(e) hereof;
  - (3) Pay or otherwise provide for any benefits, payments or continuation or conversion rights in accordance with the provisions of any Erie Benefit Plan of which the Executive or any of the Executive's dependents is or was a participant or as otherwise required by law;
  - (4) Pay the Executive and the Executive's beneficiaries any compensation and/or provide the Executive or the Executive's eligible dependents any benefits, as the case may be, due pursuant to Section 6 or Section 7 hereof; and
  - (5) Unless the employment of the Executive is terminated by the Company for Cause, pay the Executive or the Executive's beneficiaries the full amount or amounts accrued under the Supplemental Executive Retirement Plan of the Company (the "SERP") as in effect on the Effective Date (or as such benefits may be enhanced by subsequent amendments or supplements to such SERP), as though, solely for purposes of determining any otherwise applicable actuarial reduction factors, the event of the termination of Executive's employment hereunder or expiration of this Agreement occurred on the Executive's Normal Retirement Date as defined in such SERP. Accrued benefits under the SERP shall be fully vested and nonforfeitable upon such termination (including termination on account of the Executive's death) or expiration. Any reductions in SERP benefits that would otherwise apply pursuant to Section 10.1 of the Company's Retirement Plan for Employees (or pursuant to any successor provision of such plan or any successor plan) relating to Section 415(b) of the Code shall not be applicable for purposes hereof. No further approval by the Board of Directors or the Committee with respect to payments under the SERP in accordance with the preceding

sentences shall be required. Unreduced payments may begin at age 55, but in no event would payments be made under this Section 8(a)(5) before the Executive reaches age fifty-five (55). The Company shall purchase for the Executive, naming the Executive and/or the Executive's designee the owner, a paid up annuity, from an insurer reasonably acceptable to the Executive but in any event having an A.M. Best rating of A+ or better (or other comparable rating), that will pay to the Executive an amount equal to the benefit to which the Executive would otherwise be entitled under the SERP and payable at the times such SERP benefit would be payable in accordance with the provisions hereof. Upon the purchase and delivery to the Executive of such an annuity, the Executive shall release the Company from any further obligation under the SERP. The Company further agrees to pay the Executive immediately upon termination, a cash payment (the "Tax Gross-up") equal to the sum of the following: (i) all taxes (federal, state, local, and payroll taxes) incurred and due and owing by the Executive, arising from the cost of the annuity purchased by the Company to meet the requirements of this Section 8(a)(5), and (ii) any such taxes incurred and due and owing with respect to the amount paid in (i).

(6) Continue to remain bound by the terms of Section 12 hereof.

(b) The Executive shall remain bound by the terms of Sections 9 and 13 hereof for a period of thirty six (36) months after the expiration of the Agreement by its terms; provided, that the Executive shall not be bound by the terms of Section 9(b) after the termination of employment (other than a termination of the Executive by the Company for Cause) if such termination occurs after the expiration of this Agreement by its terms.

9. Covenants as to Confidential Information and Competitive Conduct. The Executive hereby acknowledges and agrees as follows: (i) this Section 9 is necessary for the protection of the legitimate business interests of the Company, (ii) the restrictions contained in this Section 9 with regard to geographical scope, length of term and types of restricted activities are reasonable; (iii) the Executive has received adequate and valuable new consideration for entering into this Agreement, and (iv) the Executive's expertise and capabilities are such that this obligation hereunder and the enforcement hereof by injunction or otherwise will not adversely affect the Executive's ability to earn a livelihood.

(a) Confidentiality of Information and Nondisclosure. The Executive acknowledges and agrees that the Executive's employment by the Company under

this Agreement necessarily involves knowledge of and access to confidential and proprietary information pertaining to the business of the Company and its subsidiaries. Accordingly, the Executive agrees that at all times during the term of this Agreement and at any time thereafter, the Executive will not, directly or indirectly, without the express written approval of the Company, unless directed by applicable legal authority (including any court of competent jurisdiction, governmental agency having supervisory authority over the business of the Company or the subsidiaries, or any legislative or administrative body having supervisory authority over the business of the Company or its subsidiaries) having jurisdiction over the Executive, disclose to or use, or knowingly permit to be so disclosed or used, for the benefit of himself, any person, corporation or other entity other than the Company, (i) any information concerning any financial matters, customer relationships, competitive status, supplier matters, internal organizational matters, current or future plans, or other business affairs of or relating to the Company or its subsidiaries, (ii) any management, operational, trade, technical or other secrets or any other proprietary information or other data of the Company or its subsidiaries, or (iii) any other information related to the Company or its subsidiaries or which the Executive should reasonably believe will be damaging to the Company or its subsidiaries which has not been published and is not generally known outside of the Company. The Executive acknowledges that all of the foregoing constitutes confidential and proprietary information, which is the exclusive property of the Company.

(b) Restrictive Covenant. During the term of, and for a period of one (1) year (the "Restrictive Period") after the termination of the Executive's employment hereunder for any reason (other than a termination of the Executive hereunder pursuant to Section 5(a), 5(b) or 5(e), hereof), the Executive shall not render, directly, or indirectly, services to any person, firm, corporation, association or other entity which conducts the same or similar business as the Company or its subsidiaries at the date of the Executive's termination of employment hereunder within the states in which the Company or any of its subsidiaries is then licensed and doing business at the date of the Executive's termination of employment hereunder without the prior written consent of the Board of Directors, which may be withheld in its discretion. In the event the Executive violates any of the provisions contained in this Section 9(b) hereof, the Restrictive Period shall be increased by the period of time from the commencement by the Executive of any violation until such violation has been cured to the satisfaction of the Company. The Executive further agrees that at no time during the Restrictive Period will the Executive attempt to directly or indirectly solicit or hire employees of Company or its subsidiaries or induce any of them to terminate their employment with the Company or any of the subsidiaries. Notwithstanding the foregoing, the performance by the Executive of rights and duties under an agency agreement with the Company shall not constitute a breach of this Section 9(b).

(c) Company Remedies. The Executive acknowledges and agrees that any breach of this Section 9 will result in immediate and irreparable harm to the Company, and that the Company cannot be reasonably or adequately compensated by damages in an action at law. In the event of a breach by the Executive of the provisions of this Section 9, the Company shall be entitled, to the extent permitted by law, immediately to cease to pay or provide the Executive or the Executive's dependents any compensation or benefit being, or to be, paid or provided to the Executive pursuant to Section 3, Section 6 or Section 8 of this Agreement, and also to obtain immediate injunctive relief restraining the Executive from conduct in breach of the covenants contained in this Section 9. Nothing herein shall be construed as prohibiting the Company from pursuing any other remedies available to it for such breach, including the recovery of damages from the Executive.

10. Resolution of Differences Over Breaches of Agreement. Except as otherwise provided herein, in the event of any controversy, dispute or claim arising out of, or relating to, this Agreement, or the breach thereof, or arising out of any other matter relating to the Executive's employment with the Company, the parties may seek recourse only for temporary or preliminary injunctive relief to the courts having jurisdiction thereof and if any relief other than injunctive relief is sought, the Company and the Executive agree that such underlying controversy, dispute or claim shall be settled by arbitration conducted in Erie, Pennsylvania in accordance with this Section 10 and the Commercial Arbitration Rules of the American Arbitration Association ("AAA"). The matter shall be heard and decided, and awards rendered by a panel of three (3) arbitrators (the "Arbitration Panel"). The Company and the Executive shall each select one arbitrator from the AAA National Panel of Commercial Arbitrators (the "Commercial Panel") and AAA shall select a third arbitrator from the Commercial Panel. The award rendered by the Arbitration Panel shall be final and binding as between the parties hereto and their heirs, executors, administrators, successors and assigns, and judgment on the award may be entered by any court having jurisdiction thereof. Except as provided in Section 11 hereof, each party shall bear sole responsibility for all expenses and costs incurred by such party in connection with the resolution of any controversy, dispute or claim in accordance with this Section 10.

11. Payment of Executive's Legal Fees. If the Executive is required to bring any action to enforce rights or to collect moneys due under this Agreement, the Company shall pay to the Executive the fees and expenses incurred by the Executive in bringing and pursuing such action if the Executive is successful, in whole or in part, on the merits or otherwise (including by way of a settlement involving a payment of money by the Company to the Executive), in such action. The Company shall pay such fees and expenses in advance of the final disposition of such action upon receipt of an undertaking from the Executive to repay to the Company such advances if the Executive is not ultimately successful, in whole or in part, on the merits or otherwise, in such action.

12. Severance Pay upon Termination of Employment after Expiration of the Agreement. Notwithstanding the expiration of this Agreement by its terms and notwithstanding the terms of any corporate severance policy then in effect and applicable to the Executive, if the

employment of the Executive is terminated without Cause by the Company, by the Executive for Good Reason or upon the expiration of the term of the office(s) to which the Executive has been elected or appointed as set forth in Section 1 hereof (for reasons other than for Cause), in any case, within thirty-six (36) months after the expiration of this Agreement by its terms, then (i) the Company shall pay to the Executive severance compensation in an amount equal to two (2) times the Executive's Covered Compensation as determined on the date of such termination, and (ii) the Executive and the Executive's eligible dependents shall be entitled to continuing coverage under the Company's then-existing group health plans (including medical, dental, prescription drug and vision plans, if any) for a period of two (2) years after the date of the termination of the Executive's employment, to the extent not prohibited by law and subject to the terms of such plans including provisions as to deductibles and copayments and changes in levels of coverage that are generally applicable to employees. The payment to the Executive by the Company pursuant to subsection (i) of the preceding sentence shall be paid in a lump sum unless the Executive elects, and so notifies the Company in writing prior to the Executive's termination of employment, to receive such payment in two (2) equal annual installments. The lump sum or first payment, as the case may be, shall be paid within thirty (30) days after the date of termination of the Executive's employment.

13. Release. The Executive hereby acknowledges and agrees that neither the Company nor any of its representatives or agents will be obligated to pay any compensation or benefit which the Executive has a right to be paid or provided to the Executive or the Executive's dependents pursuant to Section 6, Section 8 or Section 12 of this Agreement, unless the Executive, if requested by the Company in its sole discretion, executes a release in a form reasonably acceptable to the Company, which releases any and all claims the Executive has or may have against the Company or its subsidiaries, agents, officers, directors, successors or assigns.

14. Waiver. The waiver by a party hereto of any breach by the other party hereto of any provision of this Agreement shall not operate or be construed as a waiver of any other or subsequent breach by a party hereto.

15. Assignment. This Agreement shall be binding upon and inure to the benefit of the successors and assigns of the Company, and the Company shall be obligated to require any successor to expressly acknowledge and assume its obligations hereunder. This Agreement shall inure to the extent provided hereunder to the benefit of and be enforceable by the Executive or the Executive's legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. The Executive may not delegate any of the Executive's duties, responsibilities, obligations or positions hereunder to any person and any such purported delegation shall be void and of no force and effect.

16. Notices. Any notices required or permitted to be given under this Agreement shall be sufficient if in writing, and if personally delivered or when sent by first class certified or registered mail, postage prepaid, return receipt requested—in the case of the Executive, to his residence address as set forth below, and in the case of the Company, to the address of its principal place of business as set forth below, to the attention of the Chairman of the Board, or in case the Executive is the Chairman of the Board, to the Chairman of the Compensation Committee of the Board — or to such other person or at such other address with respect to each party as such party shall notify the other in writing.

17. Construction of Agreement.

(a) Governing Law. This Agreement shall be governed by and construed under the laws of the Commonwealth of Pennsylvania.

(b) Severability. In the event that any one or more of the provisions of this Agreement shall be held to be invalid, illegal or unenforceable, the validity, legality or enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

(c) Headings. The descriptive headings of the several paragraphs of this Agreement are inserted for convenience of reference only and shall not constitute a part of this Agreement.

18. Entire Agreement. This Agreement contains the entire agreement of the parties concerning the Executive's employment and all promises, representations, understandings, arrangements and prior agreements on such subject are merged herein and superseded hereby. The provisions of this Agreement may not be amended, modified, repealed, waived, extended or discharged except by an agreement in writing signed by the party against whom enforcement of any amendment, modification, repeal, waiver, extension or discharge is sought. No person acting other than pursuant to a resolution of the Board of Directors or the Committee shall have authority on behalf of the Company to agree to amend, modify, repeal, waive, extend or discharge any provision of this Agreement or anything in reference thereto or to exercise any of the Company's rights to terminate or to fail to extend this Agreement.

IN WITNESS WHEREOF, the Company has caused this Agreement to be executed by its officers thereunto duly authorized, and the Executive has hereunto set his hand all as of the day and year first above written.

ATTEST:

/s/ Jan R. Van Gorder  
Jan R. Van Gorder  
Secretary

WITNESS:

/s/ Sheila M. Hirsch  
Sheila M. Hirsch  
Executive Secretary

ERIE INDEMNITY COMPANY

By: /s/ F. William Hirt  
F. William Hirt  
Chairman of the Board

/s/ Thomas B. Morgan (SEAL)  
Thomas B. Morgan  
6378 Echo Hill Lane  
Fairview, PA 16415

ADDENDUM TO EMPLOYMENT AGREEMENT

This Addendum (the "Addendum") is made effective as of the 12th day of December, 2002 and is intended to amend a certain Employment Agreement (the "Agreement") by and between Erie Indemnity Company and John J. Brinling, Jr. effective as of December 16, 1997.

WHEREAS, the Company has determined that it is in the best interest of the Company and its Shareholders to secure the continued employment of the Executive in accordance with the terms of the Agreement; and

WHEREAS, the Board of Directors of the Company has previously considered and agreed to extend the term of the Agreement from its original term; and

WHEREAS, the Board of Directors of the Company at its meeting of December 10, 2002 has again agreed to extend the term of the Agreement for a period of one (1) additional year as contained herein; and

WHEREAS, the Executive is agreeable to the extension of the Agreement.

NOW, THEREFORE, intending to be legally bound hereby, the parties agree as follows:

1. Paragraph 1 of the Agreement with respect to the Term is hereby amended by extending the Term to expire on December 15, 2004.
2. All other terms and conditions of the Agreement remain in full force and effect.

ATTEST:

ERIE INDEMNITY COMPANY

/s/ Jan R. Van Gorder  
Jan R. Van Gorder  
Secretary

By: /s/ F. William Hirt  
F. William Hirt  
Chairman of the Board

WITNESS:

/s/ Martina R. Gonzales  
Martina R. Gonzales  
Executive Secretary

/s/ John J. Brinling, Jr.  
John J. Brinling, Jr.  
5691 Culpepper Drive  
Erie, PA 16506

ADDENDUM TO EMPLOYMENT AGREEMENT

This Addendum (the "Addendum") is made effective as of the 12th day of December, 2002 and is intended to amend a certain Employment Agreement (the "Agreement") by and between Erie Indemnity Company and Philip A. Garcia effective as of December 16, 1997.

WHEREAS, the Company has determined that it is in the best interest of the Company and its Shareholders to secure the continued employment of the Executive in accordance with the terms of the Agreement; and

WHEREAS, the Board of Directors of the Company has previously considered and agreed to extend the term of the Agreement from its original term; and

WHEREAS, the Board of Directors of the Company at its meeting of December 10, 2002 has again agreed to extend the term of the Agreement for a period of one (1) additional year as contained herein; and

WHEREAS, the Executive is agreeable to the extension of the Agreement.

NOW, THEREFORE, intending to be legally bound hereby, the parties agree as follows:

1. Paragraph 1 of the Agreement with respect to the Term is hereby amended by extending the Term to expire on December 15, 2004.
2. All other terms and conditions of the Agreement remain in full force and effect.

ATTEST:

/s/ Jan R. Van Gorder  
 Jan R. Van Gorder  
 Secretary

ERIE INDEMNITY COMPANY

By: /s/ F. William Hirt  
 F. William Hirt  
 Chairman of the Board

WITNESS:

/s/ Cori Coccarelli  
 Cori Coccarelli  
 Executive Secretary

/s/ Philip A. Garcia  
 Philip A. Garcia  
 786 Stockbridge Drive  
 Erie, PA 16505

ADDENDUM TO EMPLOYMENT AGREEMENT

This Addendum (the "Addendum") is made effective as of the 12th day of December, 2002 and is intended to amend a certain Employment Agreement (the "Agreement") by and between Erie Indemnity Company and Jan R. Van Gorder effective as of December 16, 1997.

WHEREAS, the Company has determined that it is in the best interest of the Company and its Shareholders to secure the continued employment of the Executive in accordance with the terms of the Agreement; and

WHEREAS, the Board of Directors of the Company has previously considered and agreed to extend the term of the Agreement from its original term; and

WHEREAS, the Board of Directors of the Company at its meeting of December 10, 2002 has again agreed to extend the term of the Agreement for a period of one (1) additional year as contained herein; and

WHEREAS, the Executive is agreeable to the extension of the Agreement.

NOW, THEREFORE, intending to be legally bound hereby, the parties agree as follows:

1. Paragraph 1 of the Agreement with respect to the Term is hereby amended by extending the Term to expire on December 15, 2004.
2. All other terms and conditions of the Agreement remain in full force and effect.

ATTEST:

ERIE INDEMNITY COMPANY

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

By: /s/ F. William Hirt  
F. William Hirt  
Chairman of the Board

WITNESS:

/s/ Martina R. Gonzales  
Martina R. Gonzales  
Executive Secretary

/s/ Jan R. Van Gorder  
Jan R. Van Gorder  
6796 Manchester Beach Rd.  
Fairview, PA 16415

ADDENDUM TO EMPLOYMENT AGREEMENT

This Addendum (the "Addendum") is made effective as of the 12th day of December, 2002 and is intended to amend a certain Employment Agreement (the "Agreement") by and between Erie Indemnity Company and Douglas F. Ziegler effective as of December 15, 1999.

WHEREAS, the Company has determined that it is in the best interest of the Company and its Shareholders to secure the continued employment of the Executive in accordance with the terms of the Agreement; and

WHEREAS, the Board of Directors of the Company at its meeting of December 10, 2002 has again agreed to extend the term of the Agreement for a period of one (1) additional year as contained herein; and

WHEREAS, the Executive is agreeable to the extension of the Agreement.

NOW, THEREFORE, intending to be legally bound hereby, the parties agree as follows:

1. Paragraph 1 of the Agreement with respect to the Term is hereby amended by extending the Term to expire on December 15, 2004.
2. All other terms and conditions of the Agreement remain in full force and effect.

ATTEST:

ERIE INDEMNITY COMPANY

/s/ Jan R. Van Gorder  
Jan R. Van Gorder  
Secretary

By: /s/ F. William Hirt  
F. William Hirt  
Chairman of the Board

WITNESS:

/s/ Char Drobniewski  
Char Drobniewski  
Executive Secretary

/s/ Douglas F. Ziegler  
Douglas F. Ziegler  
378 Ridgeview Drive  
Erie, PA 16505

## STATEMENT RE COMPUTATION OF PER SHARE EARNINGS

	2002	2001	2000
Class A weighted average common shares outstanding (stated value \$.0292)	64,121,099	63,974,329	64,586,402
Class B common shares outstanding (stated value \$70)	2,900	3,070	3,070
Conversion of Class B shares to Class A shares (One share of Class B for 2,400 shares of Class A)	6,960,000	7,368,000	7,368,000
Total	71,081,099	71,342,329	71,954,402
Net income	\$ 172,125,706	\$ 122,261,396	\$ 152,393,015
Per share amount	\$ 2.42	\$ 1.71	\$ 2.12

Beginning in 1999, the Company established a stock repurchase program. The Company could repurchase as much as \$120 million of its outstanding Class A common stock through December 31, 2002. In 2002, 207,217 shares were repurchased at a total cost of \$8,486,839, or an average price per share of \$40.96. Since its inception the Company has repurchased 3,402,894 shares at a total cost of \$101,860,014, or an average price per share of \$29.93.

**Erie Indemnity Company**  
**Selected Consolidated Financial Data**

	Years Ended December 31,				
	(Amounts in thousands, except per share data)				
	2002	2001	2000	1999	1998
<b>Operating data</b>					
Total operating revenue	\$ 963,387	\$ 799,861	\$ 698,016	\$ 646,040	\$ 615,965
Total operating expenses	748,535	635,756	549,672	501,061	470,155
Total other income and expenses	40,549	17,998	70,102	58,731	45,770
Equity in earnings of Erie Family Life Insurance Company, net of tax	1,611	719	5,108	4,692	4,443
Provision for income taxes	84,886	60,561	71,161	65,296	61,472
Net income	\$ 172,126	\$ 122,261	\$ 152,393	\$ 143,106	\$ 134,551
<b>Per share data</b>					
Net income per share	\$ 2.42	\$ 1.71	\$ 2.12	\$ 1.95	\$ 1.81
Dividends declared per Class A share	0.7000	0.6275	0.5575	0.4950	0.4425
Dividends declared per Class B share	105.000	94.125	83.625	74.250	66.375
Book value per share	\$ 13.91	\$ 12.15	\$ 10.91	\$ 9.62	\$ 8.81
Weighted average shares outstanding	71,081	71,342	71,954	73,487	74,400
<b>Financial position data</b>					
Investments (1)	\$ 1,047,304	\$ 885,650	\$ 853,146	\$ 785,258	\$ 709,417
Receivables from the Exchange and affiliates	829,049	640,655	532,009	470,969	467,794
Total assets	2,357,676	1,984,370	1,680,599	1,518,794	1,454,062
Shareholders' equity	\$ 987,372	\$ 865,255	\$ 779,015	\$ 697,599	\$ 655,223
Cumulative shares repurchased at December 31	3,403	3,196	2,976	1,900	0

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

## Management's discussion and analysis of financial condition and results of operations

The following discussion and analysis should be read in conjunction with the audited financial statements and related notes found on pages 38 to 61 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. Thus, the financial results are presented in the Analysis of Business Segments section, herein, which management uses internally to monitor and evaluate results, and are an alternative presentation of the Company's Consolidated Statements of Operations.

### General

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The Company operates predominantly as a provider of management services to the Erie Insurance Exchange (the Exchange). The Company has served since 1925 as the attorney-in-fact for the Policyholders of the Exchange. The Exchange is a reciprocal insurance exchange in which each applicant for insurance signs a subscriber's agreement that contains an appointment of the Company as attorney-in-fact. As attorney-in-fact, the Company is required to perform certain management services relating to the sales, underwriting and issuance of policies on behalf of the Exchange. The Company receives a management fee from the Exchange as compensation for acting as attorney-in-fact, which accounts for a majority of the Company's consolidated revenues.

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, its subsidiary, Flagship City Insurance Company (Flagship) and the Company's three property/casualty insurance subsidiaries (collectively the "Property and Casualty Group") write personal and commercial lines property/casualty coverages exclusively through over 8,400 independent Agents and pool their underwriting results. The Company also owns 21.6 percent 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 Company's management operations are affected by factors such as competition, insurance industry market conditions and general economic and investment conditions. The Company's insurance underwriting results are impacted by conditions that affect all property/casualty insurance companies, such as competition, catastrophic events, terrorist actions, changes in the regulatory and legislative environments, increased litigation and changes in general economic and investment conditions.

### Transactions and agreements with related parties

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#### Board oversight

The Company's Board of Directors (Board) oversees intercompany transactions. In its capacity as the Board for the attorney-in-fact, the Board has a fiduciary duty to

protect the interests of the Policyholders of the Exchange in addition to its fiduciary duty to protect the interests of the Company's shareholders. Certain conflicting interests are inherent in these separate fiduciary duties such as: (1) the Company's Board of Directors sets the management fee rate paid by the Exchange to the Company and (2) the Company's Board of Directors determines the participation percentages of the intercompany pooling agreement. As a consequence, the Company's Board of Directors must make decisions or take actions that are not solely in the interest of the Company's shareholders.

If the Board of Directors determines that the Exchange's surplus requires strengthening, it could decide to reduce the management fee rate or change the Company's property/casualty insurance subsidiaries' intercompany pooling participation percentages. The Board of Directors could also require, under such circumstances, that the Company provide capital to the Exchange. Although not subject to a legal obligation, generally, the Board of Directors has historically viewed the capital of the Company as potential backstop capital for the Exchange.

### **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 Exchange and the Company. 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.

### **Intercompany agreements**

Erie Insurance Property and Casualty Company, Flagship, Erie Insurance Company and Erie Insurance Company of New York participate in an intercompany pooling agreement with the Exchange. Under the pooling agreement, all insurance business of the Property and Casualty Group is pooled, with the Exchange as the lead pooling entity. The Erie Insurance Company and Erie Insurance Company of New York share in the underwriting results of the pool through retrocession. Since 1995, the allocation of the pooled underwriting results has been set at 5.0 percent participation for Erie Insurance Company, 0.5 percent participation for Erie Insurance Company of New York and 94.5 percent participation for the Exchange. These participation percentages are determined by the Company's Board of Directors.

To reduce its potential exposure to catastrophe losses and variations in long-term underwriting results, the Company's property/casualty insurance subsidiaries have in effect an all-lines aggregate excess-of-loss reinsurance agreement with the Exchange. This reinsurance treaty is excluded from the intercompany pooling agreement and limits 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 sets the parameters for this excess-of-loss reinsurance agreement in effect between the Exchange and the Company's property/casualty insurance subsidiaries. Factors evaluated by Company management include the premium amount to be received by the Exchange from the Company's insurance subsidiaries, 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.

During 2001, the Erie Insurance Group undertook a series of information technology initiatives to develop eCommerce capabilities. 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 will share certain costs to be incurred for the development of new Internet-enabled property/casualty policy administration and customer relationship management systems.

Also included as part of this eCommerce program are information technology hardware and infrastructure expenditures that are not subject to the Agreement. The Company's share of these eCommerce program costs are included in the cost of management operations in the Company's Consolidated Statements of Operations.

The Exchange leases certain office facilities to the Company on a year-to-year basis. Rental expense under these leases totaled \$11.3 million, \$10.8 million and \$10.7 million in 2002, 2001 and 2000, respectively, and is included in the cost of management operations in the Company's Consolidated Statements of Operations. 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.

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**

A concentration of credit risk results from the pooling agreement with the Exchange 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. The Exchange has an A.M. Best rating of A++ (Superior) and is considered to have a superior credit rating. The receivable from the Exchange related to reinsurance recoverable and ceded unearned premiums amounted

to \$649.0 million and \$491.1 million at December 31, 2002 and 2001, respectively, or 27.5 percent and 24.7 percent of assets, respectively. This receivable relates primarily to unpaid losses ceded to the Exchange as part of the pooling agreement between the Exchange and the Company's property/casualty insurance subsidiaries. Reinsurance contracts do not relieve the Company from its primary obligations to Policyholders. A contingent liability exists with respect to reinsurance recoverable amounts from the Exchange in the event the Exchange would be unable to meet its obligations under its reinsurance agreement. 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 for services performed for administration of the Exchange's unaffiliated reinsurance business as well as costs paid by the Company on behalf of the Exchange. The Company pays certain costs for, and is reimbursed by, EFL as well. 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 receivable from the Exchange and EFL for all fees, costs and reimbursements equaled 7.6 percent and 7.5 percent of total Company assets as of December 31, 2002 and 2001, respectively.

The aggregate of the receivables from the Exchange and EFL at December 31, 2002 and 2001, equaled \$829.0 million and \$640.7 million, respectively, or 35.2 percent and 32.3 percent, respectively, of the Company's total assets. No interest is charged or received on these intercompany balances due to the timely settlement terms and nature of the items.

## Overview

### Results of operations

	Years ended December 31 (dollars in thousands, except per share data)		
	2002	2001	2000
Income from management operations	\$ 241,984	\$ 184,568	\$ 158,746
Underwriting loss	( 27,132)	( 20,463)	( 10,402)
Net revenue from investment operations	42,281	18,771	75,594
Income before income taxes	\$ 257,133	\$ 182,876	\$ 223,938
Net income	\$ 172,126	\$ 122,261	\$ 152,393
Net income per share	\$ 2.42	\$ 1.71	\$ 2.12

Consolidated net income increased 40.8 percent in 2002 to \$172.1 million. Improvements in the Company's management operations, including a 22.2 percent increase in management fee revenue, as well as improvements in investment operations, outpaced increased losses experienced in the Company's insurance underwriting operations. Net revenue from investment operations improved in 2002 compared to 2001 primarily as a result of a \$17.9 million decrease in net realized losses.

Consolidated net income decreased 19.8 percent in 2001 to \$122.3 million from \$152.4 million in 2000. The decrease in net income in 2001 was partially due to increased underwriting losses. These resulted from increased losses in the direct business of the Company's

### Management Fee Revenue by State and Line of Business For the year ended December 31, 2002 (dollars in thousands)

State	Private Passenger Auto	Commercial Auto	Homeowners	Commercial Multi Peril	Workers' Compensation	All Other Lines of Business	Total
District of Columbia	\$ 741	\$ 116	\$ 352	\$ 665	\$ 776	\$ 196	\$ 2,846
Illinois	6,023	1,558	2,407	2,891	2,517	686	16,082
Indiana	16,814	2,202	7,651	3,522	2,475	1,545	34,209
Maryland	48,069	8,121	15,294	8,075	8,505	3,739	91,803
New York	14,107	2,808	3,604	4,036	2,534	1,202	28,291
North Carolina	16,641	5,607	8,713	6,277	5,093	2,710	45,041
Ohio	35,133	6,334	12,049	11,098	—	3,194	67,808
Pennsylvania	220,763	28,116	56,129	32,785	34,514	11,648	383,955
Tennessee	5,147	1,910	2,112	2,579	1,874	720	14,342
Virginia	26,547	6,808	9,898	7,900	9,263	3,121	63,537
West Virginia	22,702	3,227	5,079	3,390	—	1,307	35,705
Wisconsin	1,739	290	672	756	300	224	3,981
Total	\$ 414,426	\$ 67,097	\$ 123,960	\$ 83,974	\$ 67,851	\$ 30,292	\$ 787,600

This table is gross of an allowance for management fees returned on mid-term cancellations.



property/casualty subsidiaries, primarily in private passenger and commercial automobile and workers' compensation insurance. Additionally, net income in 2001 was affected by assumed reinsurance losses, including those related to the September 11th terrorist attack on the World Trade Center. The Company also recognized \$29.1 million in net realized losses from investments in 2001 on the sale of securities and related charges for other-than-temporary impairments of equity securities.

Net income, excluding realized gains (losses) and related federal income taxes, totaled \$179.4 million in 2002, \$141.2 million in 2001 and \$141.4 million in 2000. Contributing to the 2002 growth were both the management operations and the investment operations. Income from management operations increased to \$242.0 million in 2002, up from \$184.6 million in 2001. The increase in management fee revenue was a result of the 24.0 percent growth in direct written premiums of the Property and Casualty Group. Management fee revenue also was impacted by a fourth quarter charge to record an allowance for management fees returned on mid-term cancellations, which reduced management fees by \$11.9 million and net income by \$4.0 million, or \$.06 per share, after taxes. Income from management operations also was reduced by an adjustment in the third quarter of 2002 for service charges not earned until a future installment billing date. This adjustment reduced income from management operations by \$6.9 million and net income by \$4.5 million, or \$.06 per share, after taxes at December 31, 2002.

Underwriting losses in 2002 were impacted negatively by adverse development in personal and commercial automobile, particularly uninsured motorist and underinsured motorist, as well as fourth quarter reserve increases to strengthen the Property and Casualty Group's reserve position in light of loss development trends. Increased loss severity was the primary factor driving fourth quarter reserve increases that amounted to \$10.1 million, or \$.09 per share, after income taxes. Catastrophe losses, as defined by the Property and Casualty Group, were higher in 2002, totaling \$7.1 million, or \$.06 per share after taxes.

Net income, excluding net realized losses and related federal income taxes, in 2001 reflected a third quarter after-tax charge of \$3.8 million, or \$.06 per share, from the World Trade Center terrorist attack and a fourth quarter after-tax charge of \$6.9 million, or almost \$.10 a share, for severance charges related to the retirement of the Company's chief executive officer.

## Analysis of business segments

### Management operations

	Years ended December 31		
	2002	2001	2000
	<i>(dollars in thousands)</i>		
Management fee revenue	\$ 775,700	\$ 634,966	\$ 551,646
Service agreement revenue	23,729	27,247	22,662
Total revenue from management operations	\$ 799,429	\$ 662,213	\$ 574,308
Cost of management operations	557,445	477,645	415,562
Income from management operations	\$ 241,984	\$ 184,568	\$ 158,746
Gross margins	30.3%	27.9%	27.6%

Management fees from the Exchange represented 77.3 percent of the Company's total revenues for 2002, 77.6 percent of the Company's total revenues for 2001 and 71.8 percent of the Company's total revenues for 2000. The management fee rate set by the Company's Board of Directors determines the level of management fees paid by the Exchange to the Company. Changes in the management fee rate can affect the Company's revenue and net income significantly. The rate was set at 25.0 percent for 2002, 2001 and 2000. If the Board of Directors had decreased the management fee rate from 25.0 percent to 24.0 percent for 2002, 2001 and 2000, the decrease would have resulted in a reduction of management fee revenue of \$31.5 million, \$25.4 million and \$22.1 million, respectively, and a per share reduction in net income after taxes of \$.29, \$.23 and \$.20, respectively. The Company's Board of Directors reduced the management fee rate to 24.0 percent from the current 25.0 percent rate for 2003.

Management fees are returned to the Exchange when Policyholders cancel their coverage and unearned premiums are refunded. In the fourth quarter of 2002, the Company established an estimated allowance for management fees returned on mid-term cancellations. This charge recognizes the management fee anticipated to be returned to the Exchange based on historical mid-term cancellation rates. Though not material to the financial results or financial condition of the Company, management believes that establishing the allowance is appropriate because it results in better matching of returns with related revenues and is a more conservative basis of accounting for the management fee. The cash flows of the Company are unaffected by the establishment of the allowance. The allowance was \$11.9 million at December 31, 2002.

Future adjustments to the allowance, which will be reflected in operations, will be affected by future premium levels and changes in the mid-term cancellation rate.

Management fee revenue derived from the direct and affiliated assumed premiums of the Exchange, before consideration of the allowance for mid-term cancellations, rose 24.0 percent to \$787.6 million in 2002 from \$635.0 million in 2001 (see also page 20 "Management Fee Revenue by State and Line of Business"). The direct and affiliated assumed premiums of the Exchange grew 24.0 percent in 2002 to \$3.2 billion from \$2.5 billion in 2001, and grew by 15.1 percent in 2001 from \$2.2 billion in 2000.

Increases in average premium per policy, improvements in new policy growth and favorable policy retention rates were all contributing factors in the growth. The average premium per policy increased 9.9 percent to \$898 in 2002 from \$817 in 2001. For personal auto (which accounted for 52.4 percent of the direct written premiums of the Property and Casualty Group and almost 1.6 million policies in force), the average premium per policy increased 7.8 percent to \$1,042 in 2002 from \$967 in 2001.

Continued improvement in new policy growth also drove the gains experienced in the Property and Casualty Group's direct written premium. Policies in force increased 12.8 percent to 3.5 million in 2002 from 3.1 million in 2001 and 8.5 percent in 2001, from 2.9 million in 2000. Personal lines new business premium grew 44.4 percent to \$364.7 million in 2002, while commercial lines new premium grew 50.5 percent to \$216.6 million in 2002.

Policy retention improved to 91.2 percent in 2002 from 90.9 percent in 2001 and 91.0 percent in 2000, for all lines of business combined. Personal lines policy retention rates improved to 91.5 percent in 2002 from 91.3 percent in 2001. Commercial lines policy retention rates also improved to 88.2 percent in 2002 from 87.7 percent in 2001.

Firming pricing in 2001 and 2002 for commercial and personal insurance have allowed the Property and Casualty Group to more adequately price its products while maintaining its competitive advantage in the insurance marketplace. The year-to-year growth rate of the Property and Casualty Group's direct written premium in the fourth quarter was 25.7 percent, up from 25.0 percent growth in the third quarter, 23.1 percent growth in the second quarter and 22.4 percent growth in the first quarter of 2002. Premium increases anticipated due to pricing actions approved through December 31, 2002, could amount to approximately \$121.2 million in premium for the Property and Casualty Group in 2003. Additional rate increases are planned or filed but not yet approved. The majority of the rate increases are in private passenger automobile, totaling \$58.2 million, and homeowners, totaling \$23.8 million. Further rate actions contemplated or awaiting approval could increase 2003 premiums by an additional \$79 million.

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. Such service charges amounted to \$10.9 million, \$16.0 million and \$12.5 million in 2002, 2001 and 2000, respectively. During the third quarter of 2002, the Company determined service charges were incorrectly recognized on future billing installments at the time a policy was issued instead of at the time each billing was rendered. The Company recorded a one-time adjustment to correct for service charge income, reducing it by \$7.9 million in 2002. Excluding this one-time adjustment, service charges increased by 17.6 percent in 2002. The 2001 growth in service charges was impacted positively by service charge increases from \$2 to \$3 per installment for policies renewing in most states beginning in the second quarter of 2000.

Also included in service agreement revenue is service income received from the Exchange as compensation for the management and administration of voluntary assumed reinsurance from nonaffiliated insurers. The Company receives a service fee of 7.0 percent of nonaffiliated assumed reinsurance premiums. These fees totaled \$12.8 million, \$11.2 million and \$10.2 million on net voluntary nonaffiliated assumed reinsurance premiums of \$183.2 million, \$160.7 million and \$145.0 million for 2002, 2001 and 2000, respectively. The Company's Board of Directors approved a reduction in the service fee from 7.0 percent to 6.0 percent beginning January 1, 2003. If the 6.0 percent service fee rate had been in effect for 2002, the Company's net income per share after taxes would have been reduced by \$.02.

The cost of management operations rose 16.7 percent to \$557.4 million in 2002 from \$477.6 million in 2001, and 14.9 percent in 2001 from \$415.6 million in 2000. 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 as well as promotional incentives for Agents and Agent contingency awards. Agent contingency awards are based upon underwriting profitability of the direct business written within the Property and Casualty Group by the independent Agent. The estimate for the Agent contingency awards 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. Commission costs rose 23.3 percent to \$398.3 million in 2002 from \$323.1 million in 2001 and 14.3 percent in 2001 from \$282.7 million in 2000. The provision for Agent contingency awards totaled \$18.0 million, \$15.7 million and \$18.3 million in 2002, 2001 and 2000, respectively.

Scheduled commissions include normal commissions received in the course of writing business. Independent Agents receive a 10.0 percent new and renewal

commission rate on private passenger and commercial automobile business, which comprised 47.5 percent of paid commissions. Independent Agents receive a 15.0 percent new and renewal commission rate on homeowners business, which made up 20.3 percent of paid commissions. Accelerated commissions are offered to newly recruited Agents in addition to normal commission schedules. Accelerated commissions above normal scheduled rate commissions increased 34.2 percent to \$9.1 million in 2002 from \$6.8 million in 2001 driven by new agency appointments in 2002.

Promotional incentive expenses of \$2.4 million in 2002 related entirely to a 2002 sales incentive contest for the Company's independent Agents. There were no sales incentive contest expenses in 2001.

A reduction in commission expense of \$5.8 million was recorded in the fourth quarter of 2002 related to the newly established allowance for management fees returned on mid-term cancellations discussed previously. This commission expense reduction recognizes the commissions that will be returned to the Company on policies cancelled mid-term.

The cost of management operations, excluding commission costs, increased 3.0 percent in 2002 to \$159.1 million from \$154.5 million in 2001 due primarily to increases in personnel and information technology costs. The Company's personnel costs totaled \$90.7 million, \$94.4 million and \$79.3 million in 2002, 2001 and 2000, respectively. Personnel costs increased 8.4 percent in 2002 compared to 2001, excluding the effect of the one-time severance benefit discussed below. This increase was the result of an 8.1 percent increase in staffing levels primarily driven by the growth in business as well as pay rate increases. A portion of the increase in personnel costs in 2001 resulted from recognition of the severance benefit related to the retirement of the Company's president and chief executive officer in January 2002. The Company recorded a severance charge in the fourth quarter 2001 of \$10.7 million. Related benefit costs increased given the growth in the employment base. Retirement plan costs rose \$2.0 million in 2002 due to an increase in participants. Increased enrollment, as well as the medical inflation rate, contributed to an \$0.8 million increase in health insurance plan costs. Expenses for surveys and underwriting reports increased \$2.7 million in 2002 driven by an increase in applications of 31.3 percent.

As mentioned previously, part of the Erie Insurance Group's eCommerce program are information technology hardware, and infrastructure expenditures are included in the cost of management operations in the Company's Consolidated Statements of Operations. These costs totaled \$2.6 million in 2002 and \$1.6 million in 2001. (See additional discussion of this program under "Insurance Underwriting Operations" and "Factors That May Affect Future Results.")

A significant portion of the Erie Insurance Group's information technology resources has been deployed to work on the eCommerce program. As such, certain personnel costs currently are being allocated to the Property and Casualty Group under the terms of the Agreement. However, once the eCommerce program is completed, some of these personnel will again be deployed by the Company, and related expenses will be absorbed in its cost of management operations. There are approximately 100 full-time equivalent staff, or 25.0 percent of the total Erie Insurance Group information technology staff, currently deployed to work on the eCommerce program. The cost of management operations would increase by approximately \$10.0 million per year if all related personnel are reassigned from the eCommerce program back to the Company.

### Insurance underwriting operations

	Years ended December 31 (dollars in thousands)		
	2002	2001	2000
Premiums earned	\$ 163,958	\$ 137,648	\$ 123,708
Losses and loss adjustment expenses incurred	139,225	117,201	99,564
Policy acquisition and other underwriting expenses	51,865	40,910	34,546
Total losses and expenses	\$ 191,090	\$ 158,111	\$ 134,110
Underwriting loss	(\$ 27,132)	(\$ 20,463)	(\$ 10,402)
GAAP combined ratio	116.5	114.9	108.4

The underwriting loss in 2002 resulted from continued adverse loss development, a corresponding fourth quarter adjustment to strengthen reserves, and increased catastrophe losses on direct business when compared to 2001. The 2002 underwriting loss also was impacted by increased underwriting expenses related to the eCommerce technology program and assigned risk buyout program costs. The underwriting loss in 2001 reflects higher losses experienced in private passenger and commercial automobile and workers' compensation lines of business, as well as losses from assumed reinsurance, including those related to the September 11th terrorist attack on the World Trade Center.

The GAAP combined ratio represents the ratio of losses, loss adjustment, acquisition, and other underwriting expenses incurred to premiums earned. The 2002 combined ratio was higher due to adverse loss development, including reserve strengthening, on prior accident years (7.1 points), catastrophe losses (4.3 points) and eCommerce program costs (2.4 points). The higher combined ratio in 2001 compared to 2000 reflects the impact of the September 11th terrorist attack on the World Trade Center, which amounted to 4.2 combined ratio points. Additionally, adverse

development on loss reserves of prior accident years contributed 4.4 points to the 2001 combined ratio.

The Company's insurance subsidiaries' share of the Property and Casualty Group's direct business generated underwriting losses of \$32.8 million, \$14.9 million and \$4.9 million in 2002, 2001 and 2000, respectively. Increased losses were experienced in 2002 primarily due to adverse development of the loss reserves for prior accident years, principally in certain private passenger and commercial automobile coverages. During the fourth quarter of 2002, the Property and Casualty Group increased loss and loss adjustment reserves by \$184.1 million, of which the Company's 5.5 percent share amounted to \$10.1 million. The Company's share of this reserve strengthening related to the following lines of business: \$7.6 million in private passenger automobile, \$1.1 million in commercial automobile, \$0.6 million in homeowners and \$0.8 million in other personal and commercial lines. About half of the reserve strengthening related to prior accident years.

Strengthening of private passenger and commercial automobile loss reserves in 2002 was based on loss and loss adjustment expense indications for increased reserves in uninsured motorist and underinsured motorist (UM/UIM) of \$4.9 million, massive injury of \$1.1 million with the balance for bodily injury. The actual loss development of UM/UIM exceeded established reserves for prior periods due to unfavorable precedents set by court decisions and evolving arbitration systems. The estimated ultimate losses related to massive injury coverages increased due to a change in the assumed inflation level from 4.5 percent to 5.0 percent, as well as a refinement to the estimation process. Increased loss severity drove the increase to bodily injury reserves.

The Company is addressing loss trends by controlling exposure growth, improving underwriting risk selection, instituting programs to control loss severity and obtaining additional premium on risks through rate increases. Over the past two years, rate increases were filed by the Property and Casualty Group for certain lines of business in various states to offset the growing loss costs in those lines of business. The Property and Casualty Group writes one-year policies; therefore, rate increases take 24 months to be reflected fully in earned premiums because it takes 12 months to implement rate increases to all Policyholders and 12 months more to earn fully the increased premiums.

The loss costs in 2001 were reflective of increased loss severity and also included adverse development of prior accident year losses amounting to \$6.1 million, primarily in private passenger and commercial automobile and workers' compensation lines of business.

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. Additionally, the Company's property/casualty insurance subsidiaries' all-lines excess-of-loss reinsurance agreement with the Exchange should substantially mitigate the effect of catastrophe losses on the Company's financial position. During 2002, 2001 and 2000, the Company's share of catastrophe losses, as defined by the Property and Casualty Group, amounted to \$7.1 million, \$1.6 million and \$2.1 million, respectively.

The Company's property/casualty insurance subsidiaries' reinsurance business includes its share of the Property and Casualty Group's unaffiliated voluntary assumed business and reinsurance ceded under the excess-of-loss agreement with the Exchange. The Company's share of the unaffiliated voluntary assumed reinsurance business generated underwriting losses of \$1.0 million in 2002, \$11.4 million in 2001 and \$4.3 million in 2000. The excess-of-loss agreement with the Exchange generated recoveries that exceeded premium of \$6.7 million in 2002 and \$5.8 million in 2001. There were no recoveries in the calendar year 2000 and the Company's property/casualty subsidiaries paid the Exchange \$1.2 million in premium. Pricing in the assumed reinsurance marketplace has firmed considerably since the events of September 11, 2001, and as such, the Company obtained significant price increases in its 2002 treaty renewals. Contributing to the 2001 loss on reinsurance business is the Company's 5.5 percent share of the Erie Insurance Group's estimated incurred reinsurance losses of \$150 million from the September 11th terrorist attack on the World Trade Center. The Company's share of these losses totaled \$8.3 million in 2001, before consideration of recoveries under an excess-of-loss reinsurance agreement with the Exchange.

During 2002 and 2001, Erie Insurance Company and Erie Insurance Company of New York recorded \$8.8 million and \$7.2 million, respectively, in reinsurance recoveries under the excess-of-loss reinsurance agreement with the Exchange. Of the total recoveries in 2002, \$2.0 million relates to accident year 2002, \$2.2 million relates to accident year 2001, \$2.2 million relates to accident year 2000 and \$2.4 million relates to the 1999 accident year. Actual loss development patterns of prior reserve estimates revealed much higher loss amounts than what were previously recorded. Re-estimations of prior accident year reserves as well as the estimate for accident year 2002 were increased after incorporating this new information. Of the 2001 recoveries, \$6.5 million related to the 2001 accident year (including the losses related to the World Trade Center) with the balance related to the 1999 accident year. There were no such recoveries recognized in calendar year 2000. The total recoverable reduces the Company's loss and loss adjustment expenses on the Consolidated Statements of Operations. No cash payments have been made between the companies in 2002 or 2001 for these recoveries as the contract states

the reimbursement is made when the claims are paid. The annual premium paid to the Exchange for this agreement totaled \$2.1 million in 2002, \$1.5 million in 2001 and \$1.2 million in 2000.

The Company experienced an increase in costs associated with assigned risk buyout programs in 2002. Under a buyout program, one insurer pays another insurer to assume the primary insurer's obligations to participate in a state-mandated involuntary coverage program, such as an assigned risk plan for those who are unable to obtain automobile insurance in the voluntary market. These costs are included in the Company's policy acquisition and other underwriting expenses and totaled \$1.0 million in 2002 compared to \$0.3 million in 2001. The buyout programs consist of Limited Assignment Distribution (LAD) agreements, which cover personal automobile risks, and Commercial Limited Assignment Distribution (CLAD) agreements, which cover commercial automobile risks. The Property and Casualty Group has a CLAD program in Pennsylvania and both LAD and CLAD programs in New York, Illinois, Virginia and West Virginia. These programs provide that a servicing carrier perform all administrative functions relative to the assigned risk policies, including collecting premiums and making payments for losses and loss adjustment expenses. The Property and Casualty Group makes payments to the servicing carrier, which includes an administrative fee, as well as a fee for rate inadequacy costs over and above the collected premium.

The increase in LAD/CLAD expense is almost exclusively attributable to the program in the state of New York, which had costs of \$1.0 million in 2002 compared to \$0.2 million in 2001. The rise in costs in New York is the result of significant increases in both the population of assigned risk policies and the rate inadequacy of the New York residual market. Additionally, the Property and Casualty Group's market share in the state has increased, resulting in a higher proportion of policies being allocated to the Property and Casualty Group. The Company has been able to negotiate a much lower rate with the LAD carrier for 2003 due to improved loss experience in the residual market in New York and rate increases approved by New York. The determination of the amount of residual business each company is assigned in New York includes a credit mechanism for policies written in certain "high-risk" areas of New York State. The Company is negotiating a contract with another carrier to purchase its excess credits which will reduce the number of assignments made to the Property and Casualty Group.

Also included in the Company's policy acquisition and other underwriting expenses is the property/casualty insurance subsidiaries' share of costs related to the eCommerce initiative and charges related to guaranty fund assessments. Costs associated with the eCommerce initiative totaled \$3.9 million and \$1.3 million for 2002 and 2001, respectively. These costs relate to application development expenses associated with the eCommerce initiative covered under an intercompany technology cost-sharing agreement ("Agreement"). The Agreement provides that the application development costs and the related enabling technology costs, such as technical infrastructure and architectural tools, will be shared among the Property and Casualty Group in a manner consistent with the sharing of property/casualty underwriting results under the existing intercompany pooling agreement. Since the amounts are pooled within the Exchange and ceded to members of the pooling agreement at their participation levels, the Company, by way of its insurance subsidiaries, incurs a 5.5 percent share of these costs. These technology costs are included in the policy acquisition and other underwriting expenses in the Company's Consolidated Statements of Operations. No such costs were incurred in 2000. A net charge of \$0.6 million for state guaranty fund assessments related to the insolvency of the Pennsylvania Hospital Insurance Company (PHICO) was recorded in December 2002. The 2001 guaranty fund expense includes a net charge of \$1.7 million related to the insolvency of the Reliance Insurance Company.

## Investment operations

	Years ended December 31 (dollars in thousands)		
	2002	2001	2000
Net investment income	\$ 55,440	\$ 49,884	\$ 48,401
Net realized (losses) gains on investments	( 11,237)	( 29,146)	16,968
Equity in earnings of EFL	1,732	773	5,492
Equity in (losses) earnings of limited partnerships	( 3,654)	( 2,740)	4,733
Net revenue from investment operations	\$ 42,281	\$ 18,771	\$ 75,594

Net revenue from investment operations increased \$23.5 million to \$42.3 million in 2002 from \$18.8 million in 2001, and decreased \$56.8 million from \$75.6 million in 2000. The increase in net revenue from investment operations from 2001 to 2002 is primarily due to the \$17.9 million decrease in realized losses from 2001 to 2002. The decrease in net revenue from investment operations from 2000 to 2001 is primarily due to the \$29.1 million in net realized losses recorded in 2001 compared to \$17.0 million in net realized gains recorded in 2000. The \$29.1 million of net realized losses in 2001 is in part due to a proactive year-end tax selling strategy. As a result of this strategy, \$9.1 million was recovered in federal income taxes paid in years 1998, 1999 and 2000. In 2002, net realized losses included \$25.4 million in impairment charges related primarily to bonds in the communications and energy segments. Of the

\$25.4 million, \$4.8 million related to equity securities and \$20.6 million related to fixed maturities.

Net investment income increased 11.1 percent in 2002, 3.1 percent in 2001 and 11.7 percent in 2000. Included in net investment income are primarily interest and dividends on the Company's fixed maturity and equity security portfolios. Increases in investments in taxable bonds contributed to the growth in net investment income in 2002. The growth in net investment income for 2001 and 2000 was affected by cash outflows used by the Company to repurchase its shares that, through December 31, 2001, totaled \$93.4 million.

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, 2002
Fixed maturities-corporate	8.02%
Fixed maturities-municipal	6.52(1)
Preferred stock	7.66(1)
Common stock	( 19.88)
Other indices:	
Lehman Brothers Global Aggregate Bond Index-Unhedged	8.79%
S&P 500 Composite Index	( 17.10)

(1) Returns on municipal fixed maturities and preferred stocks have tax-equivalent yields of 9.53 percent and 9.47 percent, respectively.

Limited partnership earnings pertain to investments in U.S. and foreign private equity, real estate and fixed income partnerships. Private equity and fixed income limited partnerships realized losses of \$8.0 million in 2002 compared to losses of \$4.2 million in 2001. Real estate limited partnerships reflected earnings of \$4.4 million in 2002 compared to \$1.4 million in 2001.

The Company's 21.6 percent ownership of EFL is accounted for under the equity method of accounting. The Company's 2002 earnings from its investment in EFL, before income taxes, increased \$1.0 million from 2001. The increased earnings from the Company's investment in EFL in 2002 are related to a reduction in the realized losses on EFL's investments in 2002 compared to 2001.

#### 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, 2002 and 2001, the Company's investment portfolio of investment-grade bonds, common stock, preferred stock and cash and cash equivalents represents 41.1 percent and 44.0 percent, respectively, of total assets. These investments provide the liquidity the Company requires to meet the demands on its funds.

##### Distribution of investments

	Carrying value at December 31, (Dollars in thousands)			
	2002	%	2001	%
Fixed maturities	\$ 708,068	71	\$ 559,873	67
Equity securities:				
Preferred stock	157,563	16	130,007	15
Common stock	36,515	3	63,791	7
Limited partnerships	91,046	9	81,596	10
Real estate mortgage loans	5,567	1	5,700	1
Total investments	\$ 998,759	100%	\$ 840,967	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.

For common equity securities and equity limited partnerships where the decline in market value is more than 20.0 percent below cost for a period exceeding six months, there is a presumption of impairment. 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 sell the investment at a loss or recognize an impairment charge to operations. For common equity securities and equity limited partnerships that have declined more than 20.0 percent below cost for a period exceeding 12 months, the position is either sold or recognized as impaired and a charge to operations is recognized. Common stock impairments are included in realized losses in the Consolidated Statements of Operations. For limited partnerships, the impairment charge is included as a component of equity in losses or earnings of limited partnerships 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 declined more than 20.0 percent 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. Positions that have incurred market price declines of over 20.0 percent for a period greater than six months where the creditworthiness of the issuer indicates a decline that is other-than-temporary are either sold or recognized as impaired and reflected as a charge to the Company's operations.

### **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. At December 31, 2002, the carrying value of fixed maturity investments represented 70.9 percent of total invested assets.

The Company's fixed maturity investments includes 97.5 percent of high-quality, marketable bonds and redeemable preferred stock, all of which were rated at investment-grade levels (above Ba/BB) at December 31, 2002. Included in this investment-grade category are \$249.2 million, or 36.1 percent, 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 included in shareholders' equity. At December 31, 2002, the net unrealized gain on fixed maturities, net of deferred taxes, amounted to \$20.9 million compared to \$10.7 million at December 31, 2001.

### **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. At December 31, 2002, equity securities represented 19.4 percent of total invested assets.

The Company's equity securities are carried on the Consolidated Statements of Financial Position at market value. At December 31, 2002, the net unrealized gain on equity securities, net of deferred taxes, amounted to \$12.0 million compared to \$22.1 million at December 31, 2001.

## Limited partnership investments

The Company's limited partnership investments include U.S. and foreign private equity, real estate and fixed income investments. During 2002, limited partnership investments increased \$9.5 million to \$91.0 million. Fixed income and real estate limited partnerships, which comprise 46.9 percent of the total limited partnerships, produce a predictable earnings stream while private equity limited partnerships, which comprise 53.1 percent 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. The estimated loss reserve for reported claims is based primarily upon a case-by-case evaluation of the type of risk involved and knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss. Estimates of reserves for unreported claims and loss settlement expenses are determined on the basis of historical information by line of insurance as adjusted to current conditions. Loss reserves are set at full-expected cost, except for loss reserves for workers' compensation, which have been discounted at 2.5 percent in 2002 and 2001. Inflation is implicitly provided for in the reserving function through analysis of costs, trends and reviews of historical reserving results.

Adverse development of losses from prior accident years results in higher calendar year loss ratios and reduced calendar year underwriting results. To the extent prior year reserve deficiencies are indicative of deteriorating underlying loss trends and are material, the Property and Casualty Group's pricing of affected lines of business would be increased to the extent permitted by state departments of insurance. Management also reviews trends in loss developments in order to determine if adjustments, such as reserve strengthening, are appropriate. Any adjustments considered necessary are reflected in current results of operations.

At December 31, 2002, the Property and Casualty Group had estimated incurred losses related to the events of September 11th of \$150 million. To date only \$45 million has been paid on these losses. Additionally, disputes concerning whether the September 11th attack on the World Trade Center should be considered one or two insurable events are being litigated. The Property and Casualty Group's \$150 million loss estimate anticipates that the events of September 11th will be considered one event. If the attack is considered two events, the total potential exposure for the Property and Casualty Group would increase between \$50 million and \$75 million. The effect on the Company, as a result, would be additional losses between \$2.7 million and \$4.1 million. Taking into consideration the excess-of-loss reinsurance agreement, the net impact of such potential additional losses would be minimal to the Company's results of operations or financial condition.

### Critical accounting estimates

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The Company makes estimates and assumptions that can 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, Employee benefit obligations and guaranty fund liability accruals. 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 and the recognition of other-than-temporary declines in value of these investments. When the decline in value of an investment is considered by management to be other-than-temporary, the investment is written down to its market value. For all investments except limited partnerships, the impairment charge is included as a realized loss in the Consolidated Statements of Operations. For limited partnerships, the impairment charge is included as a component of equity in losses or earnings of limited partnerships. All investments are monitored individually for other-than-temporary declines in value. Management makes judgments about when there are other-than-temporary declines in its investments. Generally, if an individual security has depreciated in value by more than 20.0 percent of original cost, and has been in such unrealized loss position for more than six months, management assumes there has been an other-than-temporary decline in value. In addition, the Company may write down securities in an unrealized loss position depending on certain other factors. The other factors considered include: the significance of the amount by which fair value is below cost; financial condition of the issuer; a significant drop in ratings by Standard & Poor's or Moody's; specific events that occurred affecting an investment; security rating changes; and specific industry or geographic events.

Investments in fixed maturity and marketable equity securities are presented at estimated fair value, which generally represents quoted market prices. Investments in limited partnerships are recorded using the equity method, which approximates the Company's proportionate share of the partnership's reported net equity. There is increased risk in valuation of limited partnerships because of their illiquid nature and the lack of quoted market prices. The recorded value of limited partnerships includes the valuation of investments

held by these partnerships, which include U. S. and foreign private equity, real estate and fixed income investments. These valuations are determined by the general partner, and their reasonableness is reviewed by the Company. Generally, limited partnership market values are derived from audited and unaudited financial statements from these partnerships and other information provided by the general partner. The carrying value of limited partnership investments totaled \$91.0 million at December 31, 2002.

### **Property/casualty insurance liabilities**

Reserves for property/casualty insurance unpaid losses and loss adjustment expenses include estimates of a variety of factors such as medical inflation trends, regulatory and judicial rulings, legal settlements, property replacements and repair cost trends, and losses for assumed reinsurance activities. In recent years, certain of these component costs, such as medical inflation trends and legal settlements, have experienced significant volatility and resulted in incurred amounts higher than original estimates. Management has factored these changes in trends into the Company's loss estimates. Due to the nature of these liabilities, actual results ultimately could vary significantly from the amounts recorded. If the ultimate liability for unpaid losses and loss adjustment expenses were 10.0 percent more than the recorded amount at December 31, 2002, the effect would be a reduction in the Company's pretax income of approximately \$14.0 million, or \$.13 per share, after taxes.

### **Employee benefit obligations**

The Company's pension and other postretirement benefit obligations are developed from actuarial estimates. Inherent in these estimates are key assumptions about inflation, investment returns, mortality, turnover, medical costs and discount rates. 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 selected by Company management. The Company's pension plan for Employees is the largest and only funded benefit plan of the Company. Discount rates and long-term rate-of-return assumptions are reviewed annually by Company management in consideration of setting any additional minimum pension liabilities for this plan. At December 31, 2002, the fair market value of the pension assets totaled \$141.6 million, which continues to exceed the accumulated benefit obligation of \$90.6 million at that date.

### **Liability for guaranty funds**

Members of the Property and Casualty Group are sometimes required to pay assessments for insurance company insolvencies. Company management makes estimates of liabilities for such guaranty fund assessments. This obligation could arise in any state in which the Property and Casualty Group is licensed. The liability for the assessments is recorded when the insolvency event has occurred and can be reasonably estimated. Because it is typically a long process before state guaranty associations know the ultimate assessment amount necessary to fund an insolvency, the Property and Casualty Group often becomes aware of insolvencies prior to receiving specific assessment amounts with which to estimate its share of the liability. When the Property and Casualty Group becomes aware of an insolvency, it will initiate communications with state insurance departments and guaranty associations. Although specifics on ultimate assessment amounts may not be available, the insurance departments and guaranty associations may provide information from which management develops an estimate of the future assessment. A liability is recorded representing the Company's best estimate of the ultimate loss to be incurred due to the insolvency. The estimated liability is adjusted as the guaranty association provides more up-to-date assessment amounts. Each member of the Property and Casualty Group records its share of the estimated liability. The Company receives a 5.5 percent share of this liability by virtue of its property/casualty insurance subsidiaries' participation in the intercompany pooling arrangement.

In 2002, the Company recorded an estimated liability for the insolvency of PHICO. Although the Company had not received definitive notices of assessment amounts as of December 31, 2002, from the guaranty funds, the Property and Casualty Group recorded an estimated liability, of which the Company's share was \$0.6 million, for 2002. This liability was recorded based on preliminary estimates of future assessment amounts provided by the guaranty associations, with related estimates of recoveries from state premium taxes. This liability will be revised as more accurate assessment amounts are received.

### **Impact of inflation**

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Property and 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**

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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 70.9 percent and 66.6 percent of invested assets at December 31, 2002 and 2001, respectively. 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:

	As of December 31, 2002 (dollars in thousands)	
	Principal cash flows	Weighted-average interest rate
Fixed maturities and note from EFL:		
2003	\$ 69,622	6.30%
2004	49,195	6.90%
2005	55,322	6.30%
2006	37,390	6.30%
2007	64,000	5.40%
Thereafter	425,331	6.80%
Total	\$ 700,860	
Market value	\$ 723,068	

	As of December 31, 2001 (dollars in thousands)	
	Principal cash flows	Weighted-average interest rate
Fixed maturities and note from EFL:		
2002	\$ 37,245	6.50%
2003	35,245	6.50%
2004	37,978	7.00%
2005	49,515	6.30%
2006	55,340	6.50%
Thereafter	330,872	7.50%
Total	\$ 546,195	
Market value	\$ 574,874	

Actual cash flows may differ from those stated as a result of calls and overpayments.

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, 2002 and 2001.

#### Fixed maturity interest rate sensitivity analysis

	As of December 31 (dollars in thousands)	
	2002	2001
Market value	\$ 723,068	\$ 574,874
Change in market value (1)	( 29,682)	( 24,145)
Pro forma market value	\$ 693,386	\$ 550,729
Modified duration (2)	4.1%	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's objective is to earn competitive relative returns by investing in a diverse portfolio of high-quality, liquid securities. Portfolio holdings are diversified across industries and among exchange traded mid- to large-cap stocks. The Company measures risk by comparing the performance of the marketable equity portfolio to benchmark returns such as the S&P 500.

The Company's portfolio of limited partnership investments has exposure to market risks, primarily relating to the financial performance of the various entities in which they invested. The limited partnership portfolio comprises 9.1 percent and 9.7 percent of invested assets at December 31, 2002 and 2001. These investments consist primarily of equity investments in small- and medium-sized companies and in real estate. The Company does not hedge its exposure to equity price risk inherent in its equity investments. The Company achieves diversification within the limited partnership portfolio by investing in approximately 60 partnerships that have approximately 1,100 distinct investments. The Company reviews at least quarterly the limited partnership investments by sector, geography and vintage year. These limited partnership investments are diversified to avoid concentration in a particular industry. The Company performs extensive research prior to investment in these partnerships.

### **Foreign currency risk**

The Company has foreign currency risk in the limited partnership portfolio. The limited partnership portfolio includes approximately \$15.4 million of partnerships that are denominated in Euros. The Company also is exposed to foreign currency risk through commitments to the

Euro-denominated partnerships of approximately \$15.3 million. The foreign currency risk in the partnerships denominated in Euros and the foreign currency risk in the commitments due in Euros are to some degree offsetting. This risk is not hedged, although the Euro rate is 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.

### **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 up front underwriting analysis and ongoing reviews of credit quality by position and for the fixed maturity portfolio in total. The Company does not hedge credit risk inherent in its fixed maturity investments.

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

### **Liquidity and capital resources**

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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 percent participation in the underwriting results of the reinsurance pool with the Exchange, and investment income from affiliated and nonaffiliated investments. 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 \$177.2 million and \$147.3 million in 2002 and 2001, respectively. A receivable from EFL for cash settlements totaled \$2.8 million at December 31, 2002, compared to \$2.3 million at December 31, 2001. The Company also has a 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. The reinsurance recoverable from the Exchange rose 32.2 percent to \$649.0 million at December 31, 2002, from the \$491.1 million at December 31, 2001. These increases are the result of corresponding increases in direct loss reserves, loss adjustment expense reserves and unearned premium reserves of the Company's property/casualty insurance subsidiaries that are ceded to the Exchange under the intercompany pooling agreement. The increase in direct loss reserves, loss adjustment expense reserves and unearned premium reserves ceded to the Exchange is a result of a corresponding increase in direct premium written by the Company's property/casualty insurance subsidiaries. The increase in direct written premium of the subsidiaries of the Company that is ceded to the Exchange was 26.7 percent and 18.3 percent for the years ended December 31, 2002 and 2001, respectively. Total receivables from the Exchange represented 11.8 percent of the Exchange's assets at December 31, 2002, and 9.1 percent at December 31, 2001. Cash outflows are variable because of the fluctuations in settlement dates for liabilities for unpaid losses and because of the potential for large losses, either individually or in aggregate.

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, 2002, 2001 and 2000, were \$187.6 million, \$148.6 million and \$130.6 million, respectively.

Proceeds from the sales, calls and maturities of fixed maturity positions totaled \$232.3 million and \$189.9 million in 2002 and 2001, respectively. Each of these years was much higher than the \$120.9 million of sales, calls and maturities in 2000. Market interest rates declined in 2002 and 2001, causing greater levels of calls. There were also record numbers of credit quality downgrades and defaults in 2002 and 2001. The Company sold many of these issues in order to improve the overall credit quality of the fixed income portfolio.

Dividends declared to shareholders totaled \$45.0 million, \$40.4 million and \$36.2 million in 2002, 2001 and 2000, respectively. 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. Dividends from subsidiaries are not material to the Company's cash flows.

Beginning in 1999, the Company established a stock repurchase program. In 2002, there were shares repurchased at a total cost of \$8.5 million. Since its

inception, 3.4 million shares have been repurchased at a total cost of \$101.9 million. The Company discontinued share repurchases under this plan in 2002 due to a secondary offering of the Company's non-voting Class A common stock.

## Commitments

The Company has contractual commitments to invest up to \$109.3 million related to its limited partnership investments at December 31, 2002. These commitments will be funded as required by the partnership's agreements, which principally expire in 2007. At December 31, 2002, the total commitment to fund limited partnerships that invest in private equity securities is \$69.2 million, real estate activities \$22.6 million and fixed income securities \$17.5 million. The Company expects to have sufficient cash flows from operations to meet these partnership commitments.

## Financial ratings

The following table summarizes the current A. M. Best Company ratings for the insurers of the Erie Insurance Group:

Erie Insurance Exchange A++  
Erie Insurance Company A++  
Erie Insurance Property and Casualty Company A++  
Erie Insurance Company of New York A++  
Flagship City Insurance Company A++  
Erie Family Life Insurance Company A+

According to A. M. Best, a superior rating (A++ or 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 very strong ability to meet their obligations to Policyholders over the long term. 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 A+, "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, 2002, the companies comprising the Property and Casualty Group all had RBC levels substantially in excess of levels that would require regulatory action.

## Factors that may affect future results

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### Management operations

#### Financial condition of the Exchange

The Company has a direct interest in the financial condition of the Exchange because management fee revenues, which accounted for 77.3 percent of the Company's 2002 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 percent 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 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 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:

- SAP provides a more conservative approach to the valuation of invested assets
- SAP recognizes expenses when incurred and does not allow for the establishment of deferred policy acquisition cost assets
- Statutory deferred tax calculations follow GAAP with certain modifications for the realization criteria of deferred tax assets and the recording of the impact of changes in its deferred tax balances
- 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.

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 financial data set forth below is only a summary.

	Years ended December 31 (dollars in thousands)	
	2002	2001
(SAP basis)		
Premiums earned	\$ 2,912,147	\$ 2,422,600
Loss and loss adjustment expenses	2,566,724	2,150,749
Insurance underwriting and other expenses*	969,597	766,304
Net underwriting loss	(\$ 624,174)	(\$ 494,453)
Investment income (loss) net	33,650	( 421,754)
Federal income tax benefit	( 173,062)	( 300,257)
Net loss	(\$ 417,462)	(\$ 615,950)

\* Includes management fees paid to the Company

	At December 31 (dollars in thousands)	
	2002	2001
(SAP basis)		
Cash and invested assets	\$ 5,967,051	\$ 5,990,511
Total assets	7,007,803	6,998,794
Claims and unearned premium reserves	3,962,218	3,200,836
Total liabilities	4,892,032	3,953,243
Policyholders' surplus	2,115,771	3,045,551

The Exchange's Policyholders' surplus has declined over the past year primarily as a result of continued underwriting losses (see "Insurance Underwriting Operations" section above) combined with realized and unrealized losses from common equity securities. Common equity securities represent a significant portion of the Exchange's investment portfolio and are exposed to price risk, volatility of the capital markets and general economic conditions. The Exchange had unrealized losses on fixed maturities, equity securities and limited partnerships totaling \$577.7 million, net of statutory deferred taxes, during 2002. Unrealized losses are accounted for under SAP as a component of surplus.

To the extent that the Exchange incurs additional underwriting losses or investment losses resulting from declines in the value of its marketable securities, the Exchange's Policyholders' surplus will be further 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 a 5.5 percent 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 further reduced.

#### Insurance pricing conditions

Given the direct correlation of direct premium written to the management fee revenue of the Company, the premium growth attributable to rate increases of the Property and Casualty Group bears directly on the ongoing profitability of the Company. Beginning in 2001, prices for commercial lines insurance have increased considerably and personal lines prices have stabilized and started to trend higher. These trends accelerated after the events of September 11, 2001. The Company continually evaluates pricing levels balancing competitive conditions and the need to maintain the solid financial condition of the insurers it manages. 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. See the "Pricing actions and underwriting initiatives" immediately following, which quantifies the potential impact of the premium rate increases in 2003 and discusses other factors that may affect future direct premiums written.

#### Insurance underwriting operations

##### Pricing actions and underwriting initiatives

Rate increases filed by the Property and Casualty Group for certain lines of business in various states were sought to offset growing loss costs in those lines. Pricing actions contemplated or taken by the insurers of the Property and Casualty Group are subject to various regulatory requirements of the states in which the insurers operate. Premium increases anticipated due to pricing actions approved through December 31, 2002, could amount to approximately \$121.2 million in premium for the Property and Casualty Group in 2003. There is also the potential for an additional \$79.4 million in premium for the Property and Casualty Group in 2003 resulting from pricing actions contemplated or filed and awaiting approval. The majority of the anticipated increase stems from the private passenger and commercial auto lines of business as well as the homeowners line of business. Further rate actions continue to be contemplated for 2003. Price increases can reduce the Property and Casualty Group's ability to attract new Policyholders and to retain existing Policyholders because of the possibility of acquiring coverage for less premium from other insurers.

In addition to pricing actions, the Property and Casualty Group has issued and is implementing more restrictive underwriting standards, the criteria under which Policyholders are selected or renewed and premium rates are determined. Restricting underwriting standards will affect the number of new Policyholders eligible for coverage with the Property and Casualty Group as well as the number eligible to renew and the terms of



renewal. Taken together, pricing actions and restricting underwriting standards are designed to improve the overall underwriting result of the Property and Casualty Group. These actions will also reduce the growth rate of the Property and Casualty Group's new and renewal premium and could adversely affect policy retention rates currently enjoyed by the Property and Casualty Group. To the extent the premium growth rate of the Property and Casualty Group direct written premiums is impacted by these actions, the growth in the Company's management fee revenue will be proportionally affected.

### **Catastrophe losses**

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 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 hurricanes, earthquakes, tornadoes, wind and hail storms, fires and explosions. Since 1993, the Property and Casualty Group had not purchased catastrophe reinsurance because Company management concluded the benefits of such coverage were outweighed by the costs of the coverage in light of the Exchange's substantial surplus position and its ratio of net premiums written to surplus. The lower surplus levels of the Exchange, along with increasing catastrophe risk exposure as a result of accelerating policy growth, have resulted in management's decision to purchase catastrophe occurrence reinsurance coverage. Effective January 1, 2003, the Property and Casualty Group entered into a reinsurance treaty to mitigate the future potential catastrophe loss exposure. The agreement is a property catastrophe reinsurance treaty that provides coverage of up to 95.0 percent of a loss of \$415 million in excess of the Property and Casualty Group's loss retention of \$115 million per occurrence.

### **Incurred But Not Reported (IBNR) losses**

The insurance companies owned and managed by the Company are 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 percent participation in the intercompany reinsurance pooling agreement with the Exchange.

### **Insurance company insolvencies**

The insurance companies of the Property and Casualty Group pay assessments under the solvency or guaranty laws of the various states in which they are licensed. An assessment for the insolvency of Pennsylvania-based PHICO, which became insolvent in late 2001, impacted insurance underwriting operations in 2002 when an estimated net expense of \$0.6 million was recorded in the Consolidated Statements of Operations based upon preliminary data. This estimate is subject to change as more information becomes available. This and future insolvencies of property and casualty insurers in states where the Erie Insurance Group does business could result in future assessments.

### **Information technology costs**

In 2001, the Erie Insurance Group began a comprehensive program of eCommerce initiatives in support of the Erie Insurance Group's agency force and back office policy underwriting, issuance and administration. The eCommerce program is intended to improve service and efficiency, as well as result in increased sales. The first major component of the eCommerce program (network and desktop hardware deployment) was completed during the second quarter of 2002. Also, the Erie Insurance Group completed the release of the new Web interface to a limited number of Agents and Employees in July 2002.

In August 2002, the eCommerce program took advantage of a significant business opportunity to work with a well-known provider of information technology services and solutions to develop the Erie Insurance Group's eCommerce system called *ERIEConnection<sub>SM</sub>*. The Erie Insurance Group is now working with that service provider to be the chief integrator and co-manager of the eCommerce program and to provide software applications that meet the Company's needs. Management of Erie Insurance Group believes this approach will allow the eCommerce program to meet the established goals for deliverables, timing and budgets.

Through December 31, 2002, the Erie Insurance Group has spent \$90 million on its current technology development efforts. The Erie Insurance Group expects to incur additional costs of \$85 million over the next two years for a total program cost of \$175 million. Of the \$85 million, \$7.3 million already is committed for computer leases and certain maintenance agreements. The Company's share of the costs remaining for implementation under the eCommerce program amounts to \$4.7 million (\$3.1 million and \$.04 per share, after taxes). These costs will be incurred over the next two years.

Post implementation expenses will be incurred for maintaining *ERIEConnection<sub>SM</sub>* and related staffing costs. These expenses will be borne by the Property and Casualty Group, and the Company will share in the expenses by virtue of the Cost-Sharing Agreement for Information Technology Development.

Certain staffing costs in future, post-implementation years will increase given the need to support two systems. The future costs and their impact on the Company are not yet estimable. Post-implementation staffing costs related to personnel no longer deployed to the eCommerce program will not be subject to the

Agreement. They will be subject to cost allocations which will likely result in a greater proportion of cost absorbed by the Company.

### **Exposure to losses for mold**

The industry continues to work to understand mold and toxic mold, and control exposures and losses involving property damage and personal injuries arguably related to mold. Due to media coverage and heightened awareness, the Property and Casualty Group is seeing an increase in the number of claims with a mold component from both first-party and third-party coverages in personal and commercial lines. The costs associated with these losses, both investigative and remedial, will continue to rise. At December 31, 2002, approximately 1,200 mold or mold-related claims had been submitted to the Property and Casualty Group, including 900 in 2002. Over 800 of these claims have been settled with an average loss and loss adjustment expense paid of approximately \$5,000.

Mold exclusions and limitations for commercial lines are in the process of being filed, with planned effective dates of June 1, 2003, for liability coverages and August 1, 2003, for property coverages in all states except Maryland and New York. The state of New York has disapproved any mold exclusions or limitations on commercial lines. Exclusions and limitations in personal lines policies were filed, have been approved and became effective February 1, 2003, in six states in which the Property and Casualty Group writes business, including Pennsylvania. The remaining states filings are in various stages.

### **Contingencies**

In February 2000, a civil class action lawsuit was filed against Erie Insurance Company and Erie Insurance Exchange (collectively, "ERIE") in the Court of Common Pleas of Philadelphia County, Pennsylvania. The Exchange issued an automobile insurance policy to the plaintiff. The class action complaint alleges that the plaintiff was involved in an accident and that her insured vehicle was damaged in the accident. The complaint alleges that ERIE acted improperly when it used non-original equipment manufacturer (non-OEM) parts in repairing the damage to the plaintiff's vehicle. In March 2002, the courts granted the plaintiff's Revised Motion for Class Certification.

ERIE attempted to appeal the court order granting certification of the class. ERIE filed a Petition for Review with the Pennsylvania Superior Court. On August 8, 2002, the Superior Court denied ERIE's Petition for Review. ERIE then filed a Petition for Allowance of Appeal with the Supreme Court of Pennsylvania. On November 27, 2002, the Supreme Court denied ERIE's Petition for Allowance of Appeal.

ERIE filed a Class Certification Joinder Complaint against several individuals and/or entities that are the manufacturers and/or distributors of non-OEM crash parts. The Joinder Complaint asserts causes of action against the manufacturers and/or distributors of the non-OEM crash parts.

In January 2003, ERIE and the plaintiffs reached an agreement, in principle, to settle this litigation. The settlement would result in the dismissal of all claims against ERIE. The parties are in the process of drafting the appropriate settlement documents. After the documents are drafted and executed by the parties, a Motion for Approval will be filed with the Court. Although the parties have reached an agreement in principle to settle the case, it is still possible that the settlement will not be finalized and/or approved by the Court. It is still too early to assess the probable outcome or the amount of damages of this civil class action lawsuit if the settlement is not finalized or approved by the Court. The Company believes ERIE has meritorious legal and factual defenses to this lawsuit and these defenses will be pursued vigorously if the case is not resolved through settlement.

Like other members of the insurance industry, the Property and Casualty Group is the target of an increasing number of class action lawsuits like the one described above as well as other types of litigation. The litigation is based on a variety of issues, including insurance and claim settlement practices. Company management assesses the likelihood of any adverse outcomes to these matters as well as potential ranges of probable losses. There can be no assurance that actual outcomes will not differ from those assessments.

### **Geographic expansion**

In 2001, the Company announced the Erie Insurance Group's intention to expand its operations into Minnesota. Minnesota will be the 12th state served by the Erie Insurance Group, in addition to the District of Columbia. The Erie Insurance Group intends to write all lines of insurance it currently offers, including auto, home, business, life and annuities, in Minnesota, beginning in the third quarter 2004.

### **Regulatory**

#### **Federal chartering**

Congress is considering legislation that would create an optional federal charter for insurers. The Insurance Industry Modernization Act would establish an Office of National Insurers within the Treasury Department. The office would have the power to charter, license and regulate national insurers and its director would be required to establish a Division of Consumer Affairs within the office. The proposed legislation would repeal the McCarran-Ferguson Act, except for the sharing of historical loss data and activities associated with participation in mandatory residual market and workers' compensation mechanisms.

Federal chartering has the potential to create an uneven playing field for insurers. Federally chartered companies could be subject to different regulatory requirements

than state chartered insurers in the areas of market conduct oversight, solvency regulation, guaranty fund participation and premium tax burdens. If this occurs, federally chartered insurers may obtain a competitive advantage over state licensed carriers. The federal proposal also raises the specter of a matrix of regulation and costly duplicative, or conflicting, federal and state requirements. The repeal of the McCarran-Ferguson Act and its partial exemption for the insurance industry from federal antitrust laws would make it extremely difficult for insurers to compile and share loss data, develop standard policy forms and manuals and predict future loss costs. The ability of the industry, under the exemption permitted in the McCarran-Ferguson Act, to collect loss cost data and build a credible database as a means of predicting future loss costs is an extremely important part of cost-based pricing. If the ability to collect this data is removed, then the predictability of future loss costs, and hence, the reliability of pricing would be greatly undermined.

## **Terrorism**

The World Trade Center terrorist attack resulted in staggering losses for the insurance industry and has caused uncertainty in the insurance and reinsurance markets. The Property and Casualty Group incurred a loss of \$150 million in this attack, assuming it continues to be considered one occurrence. The Company's 5.5 percent share of this incurred loss was \$5.8 million, after consideration of recoveries under the excess-of-loss reinsurance agreement. Accordingly, the industry has been compelled to re-examine policy language and to address the potential for future threats of terrorist events and losses. The Property and Casualty Group's personal and commercial property/casualty insurance policies were not priced to cover the risk of terrorist attacks and losses such as those suffered in the World Trade Center terrorist attack. The Property and Casualty Group has withdrawn from some coverages and exposures where permitted by state regulators. However, even in states where exclusions have been permitted and utilized to address certain risks, the Property and Casualty Group is still exposed to terrorism under several lines, including personal lines and workers' compensation, and in most states, losses caused by an ensuing fire. On November 26, 2002, President Bush signed the Terrorism Risk Insurance Act of 2002 ("Act"), establishing a program for commercial property and casualty losses, including workers' compensation, resulting from foreign acts of terrorism. The Act requires commercial insurers to make terrorism coverage available immediately and provides limited federal protection above individual company retention levels, based upon a percentage of direct earned premium, and above aggregate industry retention levels that range from \$10 billion in the first year to \$15 billion in the third year. The federal government will pay 90.0 percent of covered terrorism losses that exceed retention levels. The Act is scheduled to expire on December 31, 2005. 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 could incur large unexpected losses if future terrorist attacks occur.

The Erie Insurance Group is taking the steps necessary to comply with the Act by providing notices to all 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. The Act pre-empts any existing exclusion or provision that excludes or limits coverage for losses from foreign acts of terrorism. Insurers may only exclude such if the Policyholder accepts an exclusion or fails to pay additional premium charges.

## **Privacy**

The insurance industry continues to address compliance issues required by the Gramm Leach Bliley Financial Services Modernization Act (GLBA) and the Health Insurance Portability and Accountability Act (HIPAA).

The GLBA places limits on how insurers may use and disclose consumer information. It also requires all financial institutions to adopt internal policies and procedures to protect the privacy and security of consumer information and to deliver an annual privacy notice to all customers. Following delivery of these notices in July 2001, consumer groups complained that the notices were legalistic, complex and generally not consumer friendly. In response, the NAIC organized a task force to study the adoption of simplified model language for insurer privacy notices. The NAIC has also proposed model regulations that address the security of consumer information and provide standards for insurance departments to measure compliance with privacy laws.

In February 2001, the Department of Health and Human Services (HHS) issued regulations under HIPAA requiring health plans, health care providers and health care clearinghouses ("covered entities") to adopt privacy policies for the protection of health information. Regulations also have been adopted to set standards for the electronic transfer of health information. Although the Company's insurance operations are not directly subject to the regulations, the Company's health plan for Employees, which is a covered entity under the regulations, will be required to reach compliance by April 2003.

**"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 2002 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 Information

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. The Company's insurance underwriting operations are impacted by the mix of the Group's direct written premium. Below is a summary of direct written premiums of the Property and Casualty Group by state and line of business.

	Years Ended December 31		
	2002	2001	2000
<b>Premiums written as a percent of total by state:</b>			
District of Columbia	0.4%	0.3%	0.3%
Illinois	2.0	1.2	0.6
Indiana	4.3	4.2	4.0
Maryland	11.7	11.9	11.9
New York	3.6	3.1	2.7
North Carolina	5.7	5.3	4.6
Ohio	8.6	8.2	8.0
Pennsylvania	48.8	51.7	53.9
Tennessee	1.8	1.6	1.4
Virginia	8.1	8.0	8.0
West Virginia	4.5	4.4	4.6
Wisconsin	0.5	0.1	0.0
	100.0%	100.0%	100.0%
<b>Premiums written by line of business:</b>			
Personal:			
Automobile	52.6%	54.6%	56.9%
Homeowners	15.8	16.0	16.1
Other	2.1	1.2	1.3
	70.5%	71.8%	74.3%
<b>Commercial:</b>			
Automobile	8.5%	8.3%	7.8%
Workers' Compensation	8.6	8.0	7.2
Commercial multi-peril	10.7	10.2	9.1
Other	1.7	1.7	1.6
	29.5%	28.2%	25.7%

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

	Years Ended December 31 (amounts in thousands)		
	2002	2001	2000
<b>Policies in force:</b>			
Personal lines	3,072	2,724	2,517
Commercial lines	437	386	349
	3,509	3,110	2,866
<b>Policy retention percentages:</b>			
Personal Policy Retention Percentages	91.5%	91.3%	91.5%
Commercial Policy Retention Percentages	88.2%	87.7%	87.3%
Total Policy Retention Percentages	91.2%	90.9%	91.0%

**Index to Graphs included in  
Management's Discussion and Analysis**

Pie Chart # 1	DIVERSIFICATION OF FIXED MATURITIES	
	Carrying value at December 31, 2002	
	U.S. Industrial & Miscellaneous	59%
	Special Revenue	14%
	Foreign	9%
	States & Political Subdivisions	7%
	Public Utilities	7%
	Redeemable preferred stock	3%
	Other	1%

Pie Chart # 2	QUALITY* OF FIXED MATURITIES	
	Carrying value at December 31, 2002	
	Aaa/AAA	22%
	Aa/AA	13%
	A	27%
	Baa/BBB	35%
	Ba/BB or lower	3%

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

Pie Chart # 3	DIVERSIFICATION OF EQUITY SECURITIES	
	Carrying value at December 31, 2002	
	(1) U.S. Industrial & Miscellaneous	18%
	(1) U.S. banks, trusts & insurance companies	1%
	(2) U.S. industrial & miscellaneous	46%
	(2) Foreign	13%
	(2) U.S. banks, trusts & insurance companies	12%
	(2) Public utilities	10%
	(1) Common stock	
	(2) Nonredeemable preferred stock	

## Report of management

The management of Erie Indemnity Company is responsible for the preparation of information included in the financial statements in this annual report to shareholders. The financial statements have been prepared in conformity with Generally Accepted Accounting Principles. The balances in the financial statements are developed from the financial records of the Company and reflect estimates using judgment where amounts cannot be measured precisely or for transactions not yet complete.

The Company's system of internal control is designed to safeguard Company assets from unauthorized use or disposition and to provide for proper authorization, execution and recording of Company transactions. Company personnel design, maintain and monitor internal control on an ongoing basis. In addition, the Company's internal auditors review and report on the functioning of various aspects of internal control.

The Audit Committee of the Board of Directors, composed of outside directors, meets periodically with the Company's management, internal auditors and independent auditors to review the work of each and to inquire as to their assessment of the performance of Company financial personnel. The independent auditors and internal auditors have full and free access to the Audit Committee, without the presence of management, to discuss results of work performed and communicate other appropriate matters.

/s/ Jeffrey A. Ludrof  
Jeffrey A. Ludrof  
President and Chief Executive Officer  
February 7, 2003

/s/ Philip A. Garcia  
Philip A. Garcia  
Executive Vice President and Chief Financial Officer  
February 7, 2003

/s/ Timothy G. NeCastro  
Timothy G. NeCastro  
Senior Vice President and Controller  
February 7, 2003

Independent auditors' report 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, 2002 and 2001, and the related Consolidated Statements of Operations, Shareholders' Equity, and Cash Flows for each of the three years in the period ended December 31, 2002. These 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 auditing standards generally accepted in the United States of America. 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, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

/s/ Malin, Bergquist & Company, LLP  
Malin, Bergquist & Company, LLP  
Erie, Pennsylvania  
February 7, 2003

ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As of December 31, 2002 and 2001

(Dollars in thousands)

	2002	2001
<b>ASSETS</b>		
<b>Investments</b>		
Fixed maturities at fair value (amortized cost of \$675,876 and \$543,423, respectively)	\$ 708,068	\$ 559,873
Equity securities at fair value (cost of \$175,593 and \$159,727, respectively)	194,078	193,798
Limited partnerships (cost of \$94,194 and \$79,668, respectively)	91,046	81,596
Real estate mortgage loans	5,567	5,700
<b>Total investments</b>	<b>\$ 998,759</b>	<b>\$ 840,967</b>
Cash and cash equivalents	85,712	137,017
Accrued investment income	10,892	9,138
Premiums receivable from Policyholders	239,704	186,175
Prepaid federal income taxes	12,000	14,056
Reinsurance recoverable from Erie Insurance Exchange on unpaid losses	577,917	438,605
Ceded unearned premiums to Erie Insurance Exchange	71,091	52,450
Note receivable from Erie Family Life Insurance Company	15,000	15,000
Other receivables from Erie Insurance Exchange and affiliates	180,041	149,600
Reinsurance recoverable from non-affiliates	232	372
Deferred policy acquisition costs	21,713	17,018
Property and equipment	14,378	14,635
Equity in Erie Family Life Insurance Company	48,545	44,683
Prepaid pension	40,352	25,451
Other assets	41,340	39,203
<b>Total assets</b>	<b>\$ 2,357,676</b>	<b>\$ 1,984,370</b>

	2002	2001
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Unpaid losses and loss adjustment expenses	\$ 717,015	\$ 557,278
Unearned premiums	393,091	311,969
Commissions payable and accrued	135,311	110,121
Securities lending collateral	43,916	48,804
Accounts payable and accrued expenses	39,139	46,164
Deferred income taxes	12,618	12,945
Dividends payable	12,250	10,930
Employee benefit obligations	16,964	20,904
<b>Total liabilities</b>	<b>\$ 1,370,304</b>	<b>\$ 1,119,115</b>
<b>SHAREHOLDERS' EQUITY</b>		
Capital stock		
Class A common, stated value \$.0292 per share; authorized 74,996,930 shares; 67,440,000 and 67,032,000 shares issued, respectively; 64,037,106 and 63,836,323 shares outstanding, respectively	\$ 1,967	\$ 1,955
Class B common, convertible at a rate of 2,400 Class A shares for one Class B share; stated value \$70 per share; 2,900 and 3,070 shares authorized, issued and outstanding, respectively	203	215
Additional paid-in capital	7,830	7,830
Accumulated other comprehensive income	38,685	35,222
Retained earnings	1,040,547	913,406
<b>Total contributed capital and retained earnings</b>	<b>\$ 1,089,232</b>	<b>\$ 958,628</b>
Treasury stock, at cost, 3,402,894 shares and 3,195,677 shares, respectively	( 101,860)	( 93,373)
<b>Total shareholders' equity</b>	<b>\$ 987,372</b>	<b>\$ 865,255</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 2,357,676</b>	<b>\$ 1,984,370</b>

See accompanying notes to consolidated financial statements.

ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31, 2002, 2001 and 2000

(Amounts in thousands, except per share data)

	2002	2001	2000
<b>OPERATING REVENUE</b>			
Management fee revenue	\$ 775,700	\$ 634,966	\$ 551,646
Premiums earned	163,958	137,648	123,708
Service agreement revenue	23,729	27,247	22,662
<b>Total operating revenue</b>	<b>\$ 963,387</b>	<b>\$ 799,861</b>	<b>\$ 698,016</b>
<b>OPERATING EXPENSES</b>			
Cost of management operations	\$ 557,445	\$ 477,645	\$ 415,562
Losses and loss adjustment expenses incurred	139,225	117,201	99,564
Policy acquisition and other underwriting expenses	51,865	40,910	34,546
<b>Total operating expenses</b>	<b>\$ 748,535</b>	<b>\$ 635,756</b>	<b>\$ 549,672</b>
<b>OTHER INCOME and EXPENSES</b>			
Investment income, net of expenses	\$ 55,440	\$ 49,884	\$ 48,401
Net realized (losses) gains on investments	( 11,237)	( 29,146)	16,968
Equity in (losses) earnings of limited partnerships	( 3,654)	( 2,740)	4,733
<b>Total other income and expenses</b>	<b>\$ 40,549</b>	<b>\$ 17,998</b>	<b>\$ 70,102</b>
Income before income taxes and equity in earnings of Erie Family Life Insurance Company	\$ 255,401	\$ 182,103	\$ 218,446
Less: Provision for income taxes	84,886	60,561	71,161
Equity in earnings of Erie Family Life Insurance Company, net of tax	1,611	719	5,108
<b>Net income</b>	<b>\$ 172,126</b>	<b>\$ 122,261</b>	<b>\$ 152,393</b>
<b>Net income per share</b>	<b>\$ 2.42</b>	<b>\$ 1.71</b>	<b>\$ 2.12</b>
<b>Weighted average shares outstanding</b>	<b>71,081</b>	<b>71,342</b>	<b>71,954</b>

See accompanying notes to consolidated financial statements.



Conversion of Class B to  
Class A shares

12 ( 12)

Dividends declared:

Class A \$.70 per share ( 44,668) ( 44,668)

Class B \$105.00 per  
share ( 317) ( 317)

**Balance, December 31,  
2002**

**\$ 987,372**

**\$ 1,040,547**

**\$ 38,685**

**\$ 1,967**

**\$ 203**

**\$ 7,830**

**(\$ 101,860)**

See accompanying notes to consolidated financial statements.

ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years Ended December 31, 2002, 2001 and 2000  
(Dollars in thousands)

	2002	2001	2000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
<b>Net income</b>	<b>\$ 172,126</b>	<b>\$ 122,261</b>	<b>\$ 152,393</b>
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	3,986	2,350	2,745
Deferred income tax (benefit) expense	( 124)	1,013	( 2,112)
Amortization of deferred policy acquisition costs	29,928	24,276	22,793
Realized loss (gain) on investments	11,237	29,146	( 16,968)
Equity in losses (income) from limited partnerships	3,654	2,740	( 4,733)
Net amortization of bond discount	( 203)	( 199)	( 43)
Undistributed earnings of Erie Family Life Insurance Company	( 15)	0	( 4,020)
Dividends received in excess of undistributed earnings — Erie Family Life Insurance Company	0	821	0
Deferred compensation	( 775)	294	642
Increase in accrued investment income	( 1,754)	( 51)	( 1,089)
Increase in reinsurance recoverable from Erie Insurance Exchange on unpaid losses	( 139,312)	( 63,078)	( 37,656)
Increase in receivables	( 102,471)	( 75,135)	( 38,584)
Policy acquisition costs deferred	( 34,623)	( 28,092)	( 24,591)
Increase in prepaid expenses and other assets	( 16,326)	( 14,460)	( 939)
(Decrease) increase in accounts payable and accrued expenses	( 5,848)	16,362	8,068
Increase in commissions payable and accrued	25,190	13,298	3,950
Decrease (increase) in income taxes recoverable	2,056	( 10,452)	( 629)
Increase in loss reserves	159,737	79,398	44,984
Increase in unearned premiums	81,122	48,115	26,403
<b>Net cash provided by operating activities</b>	<b>\$ 187,585</b>	<b>\$ 148,607</b>	<b>\$ 130,614</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of investments:			
Fixed maturities	(\$ 371,793)	(\$ 235,854)	(\$ 153,029)
Equity securities	( 70,845)	( 67,549)	( 54,649)
Limited partnerships	( 45,635)	( 28,380)	( 24,753)
Sales/maturities of investments:			
Fixed maturity sales	124,616	109,634	61,333
Fixed maturity calls/maturities	107,727	80,223	59,570
Equity securities	50,940	90,589	55,596
Mortgage loans	133	882	1,649
Limited partnership sales or distributions	27,454	6,634	6,227
(Decrease) increase in collateral from securities lending	( 4,888)	48,804	0
Purchase of property and equipment	( 3,173)	( 2,014)	( 308)
Purchase of computer software	( 557)	( 1,113)	( 1,032)
Loans to agents	( 3,379)	( 7,612)	( 1,781)
Collections on agent loans	2,663	2,358	1,719
<b>Net cash used in investing activities</b>	<b>(\$ 186,737)</b>	<b>(\$ 3,398)</b>	<b>(\$ 49,458)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Dividends paid to shareholders	(\$ 43,666)	(\$ 39,316)	(\$ 35,203)
Purchase of treasury stock	( 8,487)	( 7,654)	( 31,389)
<b>Net cash used in financing activities</b>	<b>(\$ 52,153)</b>	<b>(\$ 46,970)</b>	<b>(\$ 66,592)</b>
Net (decrease) increase in cash and cash equivalents	(\$ 51,305)	\$ 98,239	\$ 14,564
Cash and cash equivalents at beginning of year	137,017	38,778	24,214
<b>Cash and cash equivalents at end of year</b>	<b>\$ 85,712</b>	<b>\$ 137,017</b>	<b>\$ 38,778</b>

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:**

Cash paid during the years ended December 31, 2002, 2001 and 2000 for income taxes was \$94,943, \$70,751 and \$74,286, respectively.

See accompanying notes to consolidated financial statements.



## ERIE INDEMNITY COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All dollar amounts are in thousands except per share data

#### **NOTE 1. NATURE OF BUSINESS**

Erie Indemnity Company (Company), formed in 1925, is the attorney-in-fact for the Erie Insurance Exchange (Exchange), a reciprocal insurance exchange. The Exchange is a Pennsylvania-domiciled property/casualty insurer rated A++ Superior by A. M. Best. The Exchange is the 25th largest insurer in the United States based on net premiums written for all lines of business. The Exchange and its wholly-owned subsidiary, Flagship City Insurance Company (Flagship) and the Companies subsidiaries, Erie Insurance Company (EIC), Erie Insurance Company of New York (EINY) and the Erie Insurance Property & Casualty Company (EIPC), collectively the Property and Casualty Group, operates in 11 states and the District of Columbia. The Company also owns 21.6 percent 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 operates collectively as the Erie Insurance Group (the Group).

The Company earns a management fee for services provided to the Exchange and its affiliates. A subscriber's agreement between each Policyholder and the Exchange, permits the Company to retain as a management fee up to 25.0 percent of the direct written premiums of the members of the Property and Casualty Group, all of which are assumed by the Exchange under a pooling agreement. The management fee rate is generally set annually by the Company's Board of Directors. In consideration for this payment, the Company performs certain services for the Exchange relating to the sales, underwriting and issuance of policies on behalf of the Exchange. Each subscriber's agreement provides that the remainder of the premium must be used by the Exchange for losses, loss adjustment expenses, investment expenses, damages, legal expenses, court costs, taxes, assessments, licenses, fees, any other governmental fines and charges, establishment of reserves and surplus, and reinsurance and may be used for dividends and other purposes to the advantage of the Policyholders of the Exchange.

The Company's property/casualty insurance subsidiaries share proportionately in the results of all property/casualty insurance underwriting operations of the Property and Casualty Group. The Exchange, EIC, and EINY are part of an intercompany pooling agreement. Under this agreement, all members of the Property and Casualty Group cede 100 percent of their property/casualty insurance business, including property/casualty insurance operations assets and liabilities, to the Exchange. The pooling arrangement expressly does not apply to investment and other non-underwriting operations and income tax obligations of the companies. The Exchange acts on behalf of the Property and Casualty Group to fulfill all obligations under ceded insurance policies and to adjust and pay all related claims and underwriting expenses.

Under the pooling agreement, the Exchange retrocedes to EIC and EINY a specified percentage (5.0 percent for EIC and .5 percent for EINY during 2002, 2001 and 2000) of all pooled property/casualty insurance business, including insurance operations assets and liabilities. There are no retrocessions to other members of the Property and Casualty Group and the Exchange retains 94.5 percent of the Property and Casualty Group's pooled business. The specified percentages may only be changed by each party executing a written amendment with the approval by the Board of Directors. Insurance ceded by EIC, EINY, and EIPC to the Exchange does not relieve the Companies property/casualty insurance subsidiaries from their primary liability as the original insurers.

#### **NOTE 2. SIGNIFICANT ACCOUNTING POLICIES**

##### Basis of presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America that differ from statutory accounting practices prescribed or permitted for insurance companies by regulatory authorities. See also Note 13.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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 percent equity ownership of Erie Family Life Insurance Company (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 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 and marketable equity securities are classified as "available-for-sale." Equity securities consist primarily of common and nonredeemable preferred stocks while fixed maturities consist of bonds, notes and redeemable preferred stock. Available-for-sale securities are stated at fair value, with the unrealized gains and losses, net of deferred tax, reflected in shareholders' equity in accumulated other comprehensive income. There are no securities classified as "trading" or "held-to-maturity." Realized gains and losses on sales of investments are recognized in income on the specific identification method. Interest and dividend income is recorded as earned.

Limited partnerships include U.S. and foreign private equity, real estate and fixed income 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 carrying value of the partnership. Unrealized gains and losses on private equity limited partnerships are reflected in shareholders' equity in accumulated other comprehensive income, net of deferred taxes. The Company has not guaranteed any partnership liabilities.

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 factors specific to the issuer, the Company considers the length of time the market value is below cost and the amount the market value is below cost.

For common equity securities and equity limited partnerships where the decline in market value is more than 20.0 percent below cost for a period exceeding six months, there is a presumption of impairment. 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 sell the investment at a loss or recognize an impairment charge to operations. For common equity securities and equity limited partnerships that have declined more than 20.0 percent below cost for a period exceeding twelve months, the position is either sold or recognized as impaired. Common equity impairments are recognized as realized losses in the Consolidated Statements of Operations. For limited partnerships, the impairment charge is included as a component of equity in losses or earnings of limited partnerships in the Consolidated Statements of Operations.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

For fixed maturity and preferred stock investments, the Company individually analyzes all positions with emphasis on those that have declined more than 20.0 percent 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. Positions that have incurred market price decline of over 20.0 percent for a period greater than six months where the creditworthiness of the issuer indicates a decline that is other-than-temporary are either sold or recognized as impaired and reflected as a charge to the Company's operations.

Mortgage loans on commercial real estate are recorded at unpaid balances, adjusted for amortization of premium or discount. A valuation allowance would be provided for impairment in net realizable value based on periodic valuations as needed.

The Company participates in a securities lending program whereby certain securities from its portfolio are loaned to other institutions for short periods of time. A fee is paid to the Company by the borrower in return. Company policy requires collateral equal to 102 percent of the fair value of the loaned securities. The Company maintains full ownership rights to the securities loaned, and continues to earn interest on them. In addition, the Company has the ability to sell the securities while they are on loan. The Company has an indemnification agreement with the lending agent in the event a borrower becomes insolvent or fails to return securities. Securities lending collateral is recorded by the Company as a liability. The proceeds from the collateral are invested in cash and short-term investments and are reported on the Consolidated Statements of Financial Position as cash and cash equivalents. The Company shares a portion of the interest on these short-term investments with the borrower.

The Company had loaned securities included as part of its invested assets with a market value of \$42,747 and \$46,771 at December 31, 2002 and 2001, respectively. The Company has incurred no losses on the loan program since the program's inception.

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

**Fair value of financial instruments**

Fair values of available-for-sale securities are based on quoted market prices, where available, or dealer quotations. The carrying amounts reported in the Consolidated Statements of Financial Position approximate fair value. The carrying value of receivables and liabilities arising in the ordinary course of business approximates fair value.

**Deferred policy acquisition costs**

Commissions and other costs of acquiring property/casualty insurance policies that vary with, and are primarily related to, the production of new and renewal business are deferred and amortized over the terms of the property/casualty policies or reinsurance treaties to which they relate. The amount of policy acquisition costs to be deferred would be reduced to the extent future policy premiums and anticipated investment income would not exceed related losses, expenses and Policyholder dividends. There have been no reduction in costs deferred in any of the years presented. Amortization expense, which is included in policy acquisition and other underwriting expenses, equaled \$29,928, \$24,276 and \$22,793 in 2002, 2001 and 2000, respectively.

**Property and equipment**

Property and equipment are stated at cost. Improvements and replacements are capitalized, while expenditures for maintenance and repairs are charged to expense as incurred.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Depreciation of property and equipment is computed using straight-line and accelerated methods over the estimated useful lives of the assets. The costs and accumulated depreciation and amortization of property sold or retired are removed from the accounts and gains or losses, if any, are reflected in earnings for the year.

Property and equipment as of December 31 is summarized as follows:

	2002	2001
Land	\$ 737	\$ 737
Buildings	6,420	5,879
Leasehold improvements	896	518
Computer software	20,081	18,836
Computer equipment	7,029	5,416
Transportation equipment	496	544
	<u>\$ 35,659</u>	<u>\$ 31,930</u>
Less accumulated depreciation	21,281	17,295
	<u>\$ 14,378</u>	<u>\$ 14,635</u>

Software development costs, primarily salaries and benefits totaling \$7,842, are included in property and equipment at December 31, 2002 and 2001, respectively. There were no software development costs capitalized during 2002 and \$45 capitalized in 2001. These costs are amortized on a straight-line basis over the expected life of the applications once the software is ready for intended use. Software amortization related to these costs totaled \$2,015, \$2,007 and \$1,697 in 2002, 2001 and 2000, respectively.

During 2001 and 2002, the Company entered into various operating lease agreements for computer equipment. These leases contain various early termination provisions which allow the Company to cancel the leases generally after three years from inception of the lease. The total projected commitment for these leases at December 31, 2002, approximates \$9,388 through the year 2005. Included in this amount are \$6,926 in lease commitments associated with the eCommerce program. Approximately \$5,539 of the \$9,388 will be reimbursed to the Company from its affiliates. The total rental expense for 2002 and 2001 was \$1,386 and \$165, respectively.

**Insurance liabilities**

Losses incurred refer to amounts paid or expected to be paid for loss events which have occurred through the balance sheet date. The cost of investigating, resolving and processing claims is referred to as "loss adjustment expenses." A liability is established for the total unpaid cost of losses and loss adjustment expenses, including events occurring in current and prior years. Losses are reported on the Consolidated Statements of Operations as operating expenses.

The liability for losses and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. Inflation is provided for in the reserving function through analysis of costs, trends and reviews of historical reserving results. Such liabilities are necessarily based on estimates and, while management believes the amount is appropriate, the ultimate liability may differ from the amounts provided. In establishing the liability for unpaid losses and loss adjustment expenses related to environmental claims, management considers facts currently known and the current state of the law and coverage litigation. Liabilities are recognized for known claims (including the

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

cost of related litigation) when sufficient information has been developed to indicate the involvement of a specific insurance policy, and management can reasonably estimate its liability. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments considered necessary are reflected in current earnings.

Loss reserves, as permitted by insurance department statute, are set at full expected cost except for loss reserves for workers' compensation which have been discounted at 2.5 percent in 2002 and 2001. Unpaid losses and loss adjustment expenses in the Consolidated Statements of Financial Position were reduced by \$2,655 and \$2,390 at December 31, 2002 and 2001, respectively, due to discounting. The reserves for losses and loss adjustment expenses are reported net of receivables for salvage and subrogation of \$4,494 and \$3,661 at December 31, 2002 and 2001, respectively. The total amount of the Company's property/casualty insurance subsidiaries' share of paid losses and loss reserves pertaining to environment-related claims is immaterial.

**Liability for guaranty fund and other assessments**

The Company's property/casualty insurance subsidiaries may be required, under the solvency or guaranty laws of the various states in which they are licensed, to pay assessments up to prescribed limits to fund Policyholder losses or liabilities of insolvent insurance companies. The liability for guaranty fund or other assessments is recorded when the event obligating the Company has occurred and the amount can be reasonably estimated. Although the insurance departments and guaranty associations may not be able to provide specifics on the ultimate assessment amounts, they will sometimes provide information from which Company management develops an estimated range of future assessment. A liability is recorded representing the Company's best estimate of the ultimate loss to be incurred due to the insolvency. The estimated liability is adjusted as the guaranty association provides the Company with more up-to-date assessment amounts. The estimated liability for guaranty fund and other assessments at December 31, 2002 and 2001, totaled \$2,861 and \$2,383, respectively. The 2002 increase in the liability is primarily the result of the insolvency of Pennsylvania Hospital Insurance Company (PHICO). The Company recorded an estimated liability of \$643 at December 31, 2002, for the PHICO insolvency. During 2001, the Company received notification of the insolvency of Reliance Insurance Company. The Company recorded an estimated liability for the Reliance insolvency of \$1,750 and \$2,024 at December 31, 2002 and 2001.

Certain states permit these assessments, or a portion thereof, to be recovered as an offset to future premium taxes. When an assessment can be recovered, an asset is established on a basis consistent with the credits to be realized under applicable state law. At December 31, 2002 and 2001, the Company's property/casualty insurance subsidiaries had recorded assets of \$521 and \$559, respectively, related to these recoverable credits which will be recovered in accordance with state law which ranges between a 5 and 10 year period. These liabilities and corresponding recoverable assets are presented gross on the Consolidated Statements of Financial Position.

**Employee benefit obligations**

The Company has three defined benefit pension plans consisting of:

(1) a pension plan covering substantially all Employees of the Company, (2) a supplemental pension plan for the Company's executive management and division officers and (3) a pension plan for certain of the Company's outside directors. The pension cost for these plans is accounted for in accordance with Financial Accounting Standard (FAS) 87, "Employers' Accounting for Pensions." The Company also provides postretirement medical coverage for eligible retired Employees and eligible dependents

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

which is accounted for in accordance with FAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Related information for all plans is presented in accordance with FAS 132, "Employers' Disclosures About Pensions and Other Postretirement Benefits."

**Reinsurance**

Reinsurance transactions are recorded on a basis consistent with FAS 113, "Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts." The insurance underwriting operations segment in the Consolidated Statements of Operations is presented net of reinsurance activities. Gross losses and expenses incurred are reduced for amounts expected to be recovered under reinsurance agreements. Reinsurance transactions are recorded gross on the Consolidated Statements of Financial Position. 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. Reinsurance premiums are recognized as revenue on a pro-rata basis over the policy term.

**Revenue recognition**

In 2000, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements." SAB 101 states revenue should not be recognized until it is realized or realizable and earned. Cited in SAB 101 are certain criteria that generally should be met to determine when revenue is realized or realizable and earned. The Company periodically evaluates its revenue recognition practices in relation to the requirements of SAB 101 and other Generally Accepted Accounting Principles (GAAP) and SEC guidance. Management believes its revenue recognition practices are in compliance with the provisions of SAB 101.

**Recognition of management fee revenue**

A management fee is charged the Exchange by the Company for management of certain affairs of the Exchange. The fee is recorded as revenue, calculated as a percentage of Exchange direct and affiliated assumed premiums written. The Exchange issues policies with annual terms only. The management fees are recognized upon policy issuance or renewal since substantially all of the services required to be performed by the Company have been satisfied at that time. A provision for mid-term policy cancellations was established in 2002 and is adjusted quarterly. 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. These activities are inconsequential and perfunctory. During the fourth quarter of 2002, the Company first recorded an estimated allowance for returned management fees from mid-term cancellations. Although the Company is not required to do so, it has historically reduced the management fee charged the Exchange when mid-term cancellations occur. The effect of recording this estimated allowance was a reduction in the Company's management fee revenue of \$11,900 for the year ended December 31, 2002.

**Recognition of premium revenues and losses**

Property and liability premiums are generally 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 in the Consolidated Statements of Operations net of amounts ceded to the Exchange. See also Note 12.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Recognition of service agreement revenue

Service agreement revenue includes service income received from the Exchange as compensation for the management of voluntary assumed reinsurance from nonaffiliated insurers. In 2002, 2001 and 2000, the Company received a service fee of 7.0 percent of nonaffiliated assumed reinsurance premiums written. In December 2002, the Board of Directors reduced the service fee to 6.0 percent for all of 2003. The service fee revenue is recognized in the period in which the related premium is earned since the Company's services extend to that same period.

Also included in service agreement revenue are service charges the Company collects from Policyholders for providing extended payment terms 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.

Agent contingency award estimates

The estimate for the agent contingency awards 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. The Company uses projected underwriting data for the remainder of the current year in order to model the 36-month underwriting results by agency. At December 31 of each year, the Company uses actual data available and records a contingency award accrual based on expected near-term payout amount.

Income taxes

Provisions for income taxes include deferred taxes resulting from changes in cumulative temporary differences between the tax bases and financial statement bases of assets and liabilities. Deferred taxes are provided on the liability method, whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Earnings per share

Earnings per share is based on the weighted average number of Class A shares outstanding, giving effect to the conversion of the weighted average number of Class B shares outstanding at a rate of 2,400 Class A shares for one Class B share. The total weighted average number of Class A equivalent shares outstanding (including conversion of Class B shares) was 71,081,099, 71,342,329 and 71,954,402 during 2002, 2001 and 2000, respectively.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 3. INVESTMENTS**

The following tables summarize the cost and market value of available-for-sale securities at December 31, 2002 and 2001:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2002				
Fixed Maturities:				
U.S. treasuries & government agencies	\$ 6,788	\$ 523	\$ 0	\$ 7,311
States & political subdivisions	48,394	2,940	0	51,334
Special revenue	95,854	4,910	0	100,764
Public utilities	45,076	2,353	894	46,535
U. S. industrial & miscellaneous	398,791	22,965	3,629	418,127
Foreign	60,920	3,355	1,297	62,978
<b>Total bonds</b>	<b>\$ 655,823</b>	<b>\$ 37,046</b>	<b>\$ 5,820</b>	<b>\$ 687,049</b>
Redeemable preferred stock	20,053	1,076	110	21,019
<b>Total fixed maturities</b>	<b>\$ 675,876</b>	<b>\$ 38,122</b>	<b>\$ 5,930</b>	<b>\$ 708,068</b>
Equity Securities:				
Common stock:				
U. S. banks, trusts & insurance companies	\$ 1,030	\$ 554	\$ 171	\$ 1,413
U. S. industrial & miscellaneous	20,478	14,986	1,061	34,403
Foreign	417	282	0	699
Nonredeemable preferred stock:				
Public utilities	18,902	599	135	19,366
U. S. banks, trusts & insurance companies	21,713	1,550	315	22,948
U. S. industrial & miscellaneous	89,628	4,193	3,297	90,524
Foreign	23,425	1,370	70	24,725
<b>Total equity securities</b>	<b>\$ 175,593</b>	<b>\$ 23,534</b>	<b>\$ 5,049</b>	<b>\$ 194,078</b>
<b>Total available-for-sale securities</b>	<b>\$ 851,469</b>	<b>\$ 61,656</b>	<b>\$ 10,979</b>	<b>\$ 902,146</b>

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 3. INVESTMENTS (CONTINUED)**

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2001				
Fixed Maturities:				
U.S. treasuries & government agencies	\$ 11,211	\$ 502	\$ 0	\$ 11,713
States & political subdivisions	42,392	1,817	88	44,121
Special revenue	110,267	3,496	345	113,418
Public utilities	25,150	1,156	36	26,270
U. S. industrial & miscellaneous	311,757	8,989	1,438	319,308
Foreign	26,634	859	17	27,476
	<u>527,411</u>	<u>16,819</u>	<u>1,924</u>	<u>542,306</u>
Total bonds	\$ 527,411	\$ 16,819	\$ 1,924	\$ 542,306
Redeemable preferred stock	16,012	1,555	0	17,567
	<u>16,012</u>	<u>1,555</u>	<u>0</u>	<u>17,567</u>
Total fixed maturities	\$ 543,423	\$ 18,374	\$ 1,924	\$ 559,873
Equity Securities:				
Common stock:				
U. S. banks, trusts & insurance companies	\$ 3,284	\$ 814	\$ 16	\$ 4,082
U. S. industrial & miscellaneous	28,718	31,570	579	59,709
Nonredeemable preferred stock:				
Public utilities	2,370	12	3	2,379
U. S. banks, trusts & insurance companies	14,685	938	58	15,565
U. S. industrial & miscellaneous	91,185	2,573	2,111	91,647
Foreign	19,485	1,039	108	20,416
	<u>159,727</u>	<u>36,946</u>	<u>2,875</u>	<u>193,798</u>
Total equity securities	\$ 159,727	\$ 36,946	\$ 2,875	\$ 193,798
	<u>703,150</u>	<u>55,320</u>	<u>4,799</u>	<u>753,671</u>
Total available-for-sale securities	\$ 703,150	\$ 55,320	\$ 4,799	\$ 753,671

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 3. INVESTMENTS (CONTINUED)**

The amortized cost and estimated fair value of fixed maturities at December 31, 2002, by remaining contractual term to maturity, are shown below.

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 66,458	\$ 66,800
Due after one year through five years	187,492	196,059
Due after five years through ten years	231,753	247,224
Due after ten years	188,593	196,405
Bonds in default	1,580	1,580
	<u>\$ 675,876</u>	<u>\$ 708,068</u>

Changes in unrealized gains (losses) consist of the following for the years ended December 31:

	2002	2001	2000
Equity securities	(\$ 15,586)	\$ 14,593	(\$ 24,410)
Fixed maturities	15,741	9,076	11,246
Limited partnerships	( 5,076)	( 5,651)	5,930
Equity in unrealized gains of Erie Family Life Insurance Company	5,909	4,890	2,005
Deferred federal income tax (liability) benefit	( 346)	( 8,018)	1,830
Increase (decrease) in unrealized gains	<u>\$ 642</u>	<u>\$ 14,890</u>	<u>(\$ 3,399)</u>

Sources of investment income, net of expenses, for the years ended December 31 are as follows:

	2002	2001	2000
Fixed maturities	\$ 41,711	\$ 36,569	\$ 34,445
Equity securities	11,963	11,022	11,034
Cash equivalents and other	2,608	3,034	3,416
Total investment income	<u>\$ 56,282</u>	<u>\$ 50,625</u>	<u>\$ 48,895</u>
Less: investment expenses	842	741	494
Investment income, net of expenses	<u>\$ 55,440</u>	<u>\$ 49,884</u>	<u>\$ 48,401</u>

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 3. INVESTMENTS (CONTINUED)**

Following are the components of net realized (losses) gains on investments as reported on the Consolidated Statements of Operations. Included in 2002 gross realized losses are impairment charges of \$20,584 and \$4,796 related to fixed maturity and equity securities, respectively. The impairment charges were primarily for bonds in the communications and energy segments. Included in the 2001 gross realized losses for equity securities is an impairment charge totaling \$1,855 related primarily to preferred stocks in the equipment leasing and agricultural industry segments. In 2000, impairment charges of \$1,267 resulted from preferred stocks in the financial services industry and are included in gross realized losses.

	2002	2001	2000
<b>Fixed maturities:</b>			
Gross realized gains	\$ 9,750	\$ 4,216	\$ 2,921
Gross realized losses	( 21,909)	( 7,941)	( 311)
Net realized (losses) gains	(\$ 12,159)	(\$ 3,725)	\$ 2,610
<b>Equity securities:</b>			
Gross realized gains	\$ 10,691	\$ 4,997	\$ 18,070
Gross realized losses	( 9,769)	( 30,418)	( 3,712)
Net realized gains (losses)	\$ 922	(\$ 25,421)	\$ 14,358
Net realized (losses) gains on investments	(\$ 11,237)	(\$ 29,146)	\$ 16,968

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

	2002	2001	2000
Private equity	(\$ 7,644)	(\$ 4,746)	\$ 1,464
Real estate	4,365	1,424	1,926
Fixed income	( 375)	582	1,343
Total equity in (losses) earnings of limited partnerships	(\$ 3,654)	(\$ 2,740)	\$ 4,733

Impairment charges where the decline in value of limited partnerships is considered other-than-temporary by Company management are included in the related equity income category in the table above. Included in the 2002 private equity partnership losses is an impairment charge of \$6,877 resulting from various partnerships concentrated in telecommunications, technology, facility resources and equipment rental industries. A 2001 limited partnership impairment charge of \$2,733 resulted from one private equity partnership that had investments of preferred stock in the eCommerce industry and common stock in the customer relationship software industry.

See also Note 14 for investment commitments related to partnerships.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 4. COMPREHENSIVE INCOME**

Comprehensive income is defined as any change in equity from transactions and other events originating from nonowner sources. The components of other comprehensive income follow for the years ended December 31:

	2002	2001	2000
Unrealized holding (losses) gains on securities arising during period	(\$ 10,249)	(\$ 6,238)	\$ 11,739
Less: losses (gains) included in net income	11,237	29,146	( 16,968)
Net unrealized holding gains (losses) arising during period	\$ 988	\$ 22,908	(\$ 5,229)
Income tax (liability) benefit related to unrealized gains or losses	( 346)	( 8,018)	1,830
Net appreciation (depreciation) of investments	\$ 642	\$ 14,890	(\$ 3,399)
Minimum pension liability adjustment (See also Note 6)	4,340	( 4,384)	0
Tax (liability) asset related to pension adjustment	( 1,519)	1,534	0
Net pension liability adjustment	\$ 2,821	(\$ 2,850)	\$ 0
Other comprehensive income (loss), net of tax	\$ 3,463	\$ 12,040	(\$ 3,399)

**NOTE 5. EQUITY IN ERIE FAMILY LIFE INSURANCE COMPANY**

The Company owns 21.6 percent 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 ten states and the District of Columbia.

The following represents condensed financial information for EFL on a generally accepted accounting principles (GAAP) basis:

	2002	2001	2000
Investments	\$ 1,142,070	\$ 869,723	\$ 881,069
Total assets	1,389,619	1,169,442	1,020,343
Liabilities	1,165,172	963,683	824,623
Shareholders' equity	224,447	205,759	195,720
Revenues	112,284	89,514	115,373
Net income	8,840	2,738	25,390
Comprehensive income	26,626	17,410	31,421
Dividends paid to shareholders	7,796	7,229	6,662

The Company's share of EFL's net unrealized gains on securities, reflected in shareholders' equity, is \$7,818, \$3,983 and \$801 at December 31, 2002, 2001 and 2000, respectively. Dividends paid to the Company totaled \$1,686, \$1,564 and \$1,441, for the years ended December 31, 2002, 2001 and 2000, respectively.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 6. BENEFIT PLANS**

All liabilities for the plans mentioned 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 in this note are presented in the Consolidated Statements of Financial Position as accounts payable and accrued expenses.

Pension plans

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 management and division officers and (3) an unfunded pension plan for certain of its outside directors. Information about the plans follows for the years ended December 31:

	2002	2001
<b>Net periodic benefit cost:</b>		
Service cost	\$ 8,425	\$ 6,837
Interest cost	9,619	8,325
Expected return on plan assets	( 16,509)	( 13,709)
Amortization of prior service cost	878	844
Recognized net actuarial gain	( 851)	( 2,583)
Amortization of unrecognized initial net asset	( 234)	( 234)
Settlement cost	3,311	0
	<u>          </u>	<u>          </u>
Net periodic benefit cost	\$ 4,639	( \$520)
	<u>          </u>	<u>          </u>

In January 2002, Stephen A. Milne, the Company's president and chief executive officer, retired. The 2002 settlement cost due Mr. Milne for his SERP payment was completely satisfied through the purchase of an annuity by the plan. The settlement amount was recognized under the provisions of FAS 88 "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits."

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6. BENEFIT PLANS (CONTINUED)

	2002	2001
<b>Change in projected benefit obligation:</b>		
Benefit obligation at January 1	\$ 144,704	\$ 116,693
Service cost	8,425	6,837
Interest cost	9,619	8,325
Amendments	928	55
Actuarial loss	5,738	14,523
Settlement cost	( 6,334)	0
Benefits paid	( 322)	( 1,729)
Benefit obligation at December 31	<u>\$ 162,758</u>	<u>\$ 144,704</u>
<b>Change in plan assets:</b>		
Fair value of plan assets at January 1	\$ 147,765	\$ 171,636
Actual return on plan assets	( 19,507)	( 31,413)
Employer contributions	13,637	9,271
Benefits paid	( 322)	( 1,729)
Fair value of plan assets at December 31	<u>\$ 141,573</u>	<u>\$ 147,765</u>
<b>Reconciliation of funded status:</b>		
Funded status at December 31	( \$21,185)	\$ 3,061
Unrecognized net actuarial loss	50,279	10,986
Unrecognized prior service cost	5,286	5,236
Unrecognized initial net asset	( 234)	( 469)
Net amount recognized on Consolidated Statements of Financial Position	<u>\$ 34,146</u>	<u>\$ 18,814</u>
<b>Amounts recognized in the Consolidated Statements of Financial Position consist of:</b>		
Prepaid benefit cost	\$ 40,352	\$ 25,451
Accrued benefit liability	( 9,026)	( 13,686)
Intangible asset	2,776	2,665
Accumulated other comprehensive income	44	4,384
Net amount recognized at year end	<u>\$ 34,146</u>	<u>\$ 18,814</u>
<b>Weighted-average assumptions as of December 31:</b>		
Employee pension plan:		
Discount rate	6.75%	7.00%
Expected return on plan assets	8.75	8.25
Rate of compensation increase	5.00	5.00
SERP:		
Discount rate	6.75%	7.00%
Rate of compensation increase	6.00-7.25	6.00-7.25

The 2002 amendment amount relates primarily to one additional participant being added to the SERP and the enhancement of a SERP participant's benefits resulting from a new employment contract. The 2001 amendment amount was primarily due to two additional participants being added to the SERP.

The Employee pension plan has assets that include cash, treasury bonds, corporate bonds, common stock (including 60,000 Company Class A shares), preferred stock and mortgages.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 6. BENEFIT PLANS (CONTINUED)**

At December 31, 2002, an additional minimum pension liability of \$44 was recorded related to the outside directors pension plan. An additional minimum pension liability of \$4,384 resulted in 2001 due to changes in discount rates, the rate of compensation increase and certain other assumptions of the SERP. The additional pension liability was recorded as a reduction to shareholders' equity as accumulated other comprehensive income, net of deferred income taxes.

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.

The Employee pension plan purchases individual annuities periodically from EFL to settle retiree benefit payments. Such purchases equaled \$149, \$4,513 and \$5,627 in 2002, 2001 and 2000, respectively. These are nonparticipating annuity contracts under which EFL has unconditionally contracted to provide specified benefits to beneficiaries in return for a fixed premium from the plan. However, the plan remains the primary obligor to the beneficiaries and a contingent liability exists in the event EFL could not honor the annuity contracts. The benefit obligation has been reduced for these annuities purchased for retirees.

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets (SERP and the pension plan for outside directors) were \$16,899, \$9,026 and \$0, respectively, as of December 31, 2002, and \$20,348, \$13,686 and \$0 respectively, as of December 31, 2001.

Postretirement benefits other than pensions

The Company provides postretirement medical coverage for eligible retired Employees and eligible dependents. To be eligible for benefits, an Employee must be 60 years old and have 15 years of continuous full-time service. The benefits are provided from retirement to age 65. The benefits are unfunded as the Company pays the obligations when due. The cash payments for such benefits were \$342, \$379 and \$161 in 2002, 2001 and 2000, respectively. Actuarially determined costs are recognized over the period the Employee provides service to the Company. Information about this plan follows for the years ended December 31:

	2002	2001
<b>Net periodic benefit cost:</b>		
Service cost	\$ 579	\$ 400
Interest cost	512	389
Amortization of prior service cost	( 50)	( 36)
Recognized net actuarial loss (gain)	21	( 50)
	<u>\$ 1,062</u>	<u>\$ 703</u>
<b>Change in benefit obligation:</b>		
Benefit obligation at January 1	\$ 7,132	\$ 5,803
Service cost	579	400
Interest cost	513	389
Amendments	( 164)	0
Actuarial loss	970	919
Benefits paid	( 342)	( 379)
	<u>\$ 8,688</u>	<u>\$ 7,132</u>

The 2002 amendments were the result of all retirees in the traditional medical plan being moved into the preferred medical provider medical plan effective January 1, 2002, and the monthly retiree contribution amount for family coverage increasing in 2002.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6. BENEFIT PLANS (CONTINUED)

	2002	2001
<b>Reconciliation of funded status:</b>		
Funded status at December 31	(\$ 8,688)	(\$ 7,132)
Unrecognized net actuarial loss	1,194	244
Unrecognized prior service costs	( 444)	( 330)
Net liability recognized on Consolidated Statements of Financial Position	\$ (7,938)	\$ (7,218)

The weighted average discount rate used to measure the accumulated post retirement benefit obligation was 6.75 percent and 7.0 percent in 2002 and 2001, respectively. The December 31, 2002, accumulated benefit obligation was based on a 10.0 percent increase in the cost of covered health care benefits during 2002. The expected health care cost trend rate assumption for 2003 is 9.1 percent. This rate is assumed to decrease gradually to 5.5 percent per year in 2007 and to remain at that level thereafter.

	2002	2001
<b>Effect on total of service and interest cost components:</b>		
1 percent increase	\$ 178	\$ 126
1 percent decrease	( 149)	( 106)
<b>Effect on post retirement benefit obligation:</b>		
1 percent increase	\$ 1,228	\$ 1,023
1 percent decrease	( 1,046)	( 871)

Employee savings plan

The Company has an Employee Savings Plan for its Employees. The maximum percentage that eligible participants are permitted to contribute to the plan is 15.0 percent. The Company match is 100 percent of the participant contributions up to 3.0 percent of compensation and 50.0 percent of participant contributions over 3.0 percent and up to 5.0 percent 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 in 2002, 2001 and 2000 were \$6,106, \$5,329 and \$3,499, respectively. Employees are permitted to invest a portion of employer 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 83,873 Company Class A shares at December 31, 2002.

Management incentive plans and deferred compensation

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

The annual incentive plan is a bonus plan that annually pays cash bonuses to executive management and division officers of the Company. The incentives under the plan are 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 write predominately personal lines insurance and that are also rated A++ by A.M. Best. The cost of the plan is charged to operations as the compensation is earned over the performance periods.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 6. BENEFIT PLANS (CONTINUED)**

The long-term incentive plan (LTIP) of the Company is a restricted stock award plan designed to reward executive management and division officers who can have a significant impact on the performance of the Company with long-term compensation that is settled in Company stock. Awards are determined based on the achievement of pre-determined Company financial performance objectives. According to the plan, the Company cannot issue new stock or stock from treasury to settle the compensation award obligations under the LTIP, but instead must purchase its stock on the open market to settle all plan obligations. The restricted stock awards are granted at the end of a three-year performance period. The stock awards vest over a three-year period subsequent to the performance period. A liability is recorded and compensation expense is recognized ratably over the performance period. The effects of changes in the stock price are recognized as compensation expense over the vesting period. At December 31, 2002, 2001 and 2000, the unvested outstanding restricted shares under the LTIP totaled 97,061 shares, 81,903 shares and 72,339 shares, respectively, with average grant prices of \$35.57, \$33.16 and \$28.32, respectively. The following table shows the number of shares awarded, forfeited and not yet vested at December 31, 2002.

	Weighted Average Grant Price	Number of Shares
<b>1998-2000</b>		
<b>Performance period:</b>		
Awarded	\$ 27.64	48,810
Forfeited		2,434
Shares vested		36,272
Shares not yet vested		10,104
<b>1999-2001</b>		
<b>Performance period:</b>		
Awarded	\$ 38.15	39,975
Forfeited		0
Shares vested		21,259
Shares not yet vested		18,716
<b>2000-2002</b>		
<b>Performance period:</b>		
Awarded	\$ 35.96	68,241
Forfeited		0
Shares vested		0
Shares not yet vested		68,241
Restricted shares not yet vested at December 31, 2002		97,061

The deferred compensation plans are arrangements for executive management, division officers and regional 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 Company also matches a portion of some deferrals to the plans depending on the amount of deferral and the election of the participant. 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.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 6. BENEFIT PLANS (CONTINUED)**

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:

	2002	2001	2000
	<u>          </u>	<u>          </u>	<u>          </u>
Plan awards, employer match and hypothetical earnings:			
Long-term incentive plan awards	\$ 2,157	\$ 1,843	\$ 1,300
Annual incentive plan awards	2,481	2,169	2,291
Deferred compensation plan, employer match and hypothetical earnings	( 227)	( 412)	90
	<u>          </u>	<u>          </u>	<u>          </u>
Total plan awards and earnings	\$ 4,411	\$ 3,600	\$ 3,681
	<u>          </u>	<u>          </u>	<u>          </u>
Total plan awards paid	\$ 4,099	\$ 2,441	\$ 1,590
	<u>          </u>	<u>          </u>	<u>          </u>
Compensation deferred under the plans	\$ 903	\$ 1,060	\$ 895
	<u>          </u>	<u>          </u>	<u>          </u>
Distributions from the deferred compensation plans	(\$ 1,621)	(\$ 355)	(\$ 341)
	<u>          </u>	<u>          </u>	<u>          </u>
Outstanding incentive plan and deferred compensation liabilities at December 31	\$ 12,079	\$ 12,485	\$ 10,621
	<u>          </u>	<u>          </u>	<u>          </u>

Stock compensation plan for outside directors

In 2002, the Company's Board of Directors, at the recommendation of the Executive Compensation Committee, approved 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 25.0 percent 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 the fair value of its grants under those plans in accordance with FAS 148, "Accounting for Stock-Based Compensation." The annual charge related to this plan totaled \$277 for 2002.

Health and dental benefits

The Company has self-funded health and dental care plans for all of its Employees and eligible dependents. Estimated unpaid claims incurred are accrued as a liability at December 31, 2002 and 2001. Operations were charged \$21,883, \$19,826 and \$17,456 in 2002, 2001 and 2000, respectively, for the cost of health and dental care provided under these plans.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 7. INCOME TAXES**

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

	2002	2001	2000
<b>Federal income taxes:</b>			
Currently due	\$ 85,010	\$ 59,602	\$ 73,657
Deferred	( 124)	959	( 2,496)
<b>Total</b>	<b>\$ 84,886</b>	<b>\$ 60,561</b>	<b>\$ 71,161</b>

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:

	2002	2001	2000
<b>Income tax at statutory rates:</b>	\$ 89,997	\$ 64,007	\$ 78,378
Tax-exempt interest	( 2,617)	( 2,729)	( 3,046)
Dividends received deduction	( 2,483)	( 2,398)	( 2,160)
Other	( 11)	1,681	( 2,011)
<b>Provision for income taxes</b>	<b>\$ 84,886</b>	<b>\$ 60,561</b>	<b>\$ 71,161</b>

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

	2002	2001
<b>Deferred tax assets:</b>		
Loss reserve discount	\$ 5,262	\$ 4,580
Unearned premiums	6,051	4,960
Net allowance for service fees and premium cancellations	4,549	0
Employee benefit plan obligations	4,982	4,800
Severance benefits	0	3,801
Write-downs of securities	6,916	1,606
Other	4,575	1,525
<b>Total deferred tax assets</b>	<b>\$ 32,335</b>	<b>\$ 21,272</b>
<b>Deferred tax liabilities:</b>		
Deferred policy acquisition costs	\$ 7,600	\$ 5,956
Unrealized gains	16,619	16,822
Pension and other benefits	17,650	7,021
Other	3,084	4,418
<b>Total deferred tax liabilities</b>	<b>\$ 44,953</b>	<b>\$ 34,217</b>
<b>Net deferred income tax liability</b>	<b>\$ 12,618</b>	<b>\$ 12,945</b>

The Company, as a corporate attorney-in-fact for a reciprocal insurer, is not subject to state corporate taxes.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 8. 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. In 2002, 170 Class B shares were converted to 408,000 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 percent of any dividend declared on each share of Class B common stock. The Company may declare and pay a dividend in respect of Class A common stock without any requirement that any dividend be declared and paid in respect of 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.

On January 21, 2003, 10 shares of Class B stock were converted into 24,000 Class A shares.

Stock repurchase plan

In 1999, the Board of Directors authorized a stock repurchase program. The plan allowed the Company to repurchase as much as \$120 million of its outstanding Class A common stock through December 31, 2002. Treasury shares are recorded on the Consolidated Statements of Financial Position at cost. In 2002, there were 207,217 shares repurchased at a total cost of \$8,487, or an average price per share of \$40.96. In total, 3,402,894 shares were repurchased at a total cost of \$101,860, or an average price per share of \$29.93.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 9. 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:

	2002	2001	2000
Total unpaid losses and loss adjustment expenses at January 1, gross	\$ 557,278	\$ 477,879	\$ 432,895
Less reinsurance recoverables	438,605	375,567	337,911
Net balance at January 1	\$ 118,673	\$ 102,312	\$ 94,984
Incurred related to:			
Current accident year	133,787	111,258	93,416
Prior accident years	5,438	5,943	6,148
Total incurred	\$ 139,225	\$ 117,201	\$ 99,564
Paid related to:			
Current accident year	71,558	59,637	53,251
Prior accident years	47,242	41,203	38,985
Total paid	\$ 118,800	\$ 100,840	\$ 92,236
Net balance at December 31	\$ 139,098	\$ 118,673	\$ 102,312
Plus reinsurance recoverables	577,917	438,605	375,567
Total unpaid losses and loss adjustment expenses at December 31, gross	\$ 717,015	\$ 557,278	\$ 477,879

The 2002 incurred losses and loss adjustment expenses of \$5,438, net of reinsurance recoveries, related to prior accident years are the result of: 1) adverse development of private passenger and commercial automobile reserves, 2) increased reserves in other personal and commercial lines of business due to increased development on liability claims and 3) increased reserves in homeowners due to increased loss severity.

Included in the 2001 losses and loss adjustment expenses incurred of \$111,258 related to the current accident year are the Company's share of estimated incurred losses of the Property and Casualty Group's reinsurance business stemming from the attack on the World Trade Center of \$8,250. Partially offsetting these losses is an aggregate excess-of-loss reinsurance agreement between the Exchange and the Company's property/casualty insurance subsidiaries. See also Note 10. This agreement reduced the net retention of these losses recorded by the Company to \$5,839. Loss estimates were based on the assumption that the attack will be considered one event. If the attack comes to be considered two events, the total potential exposure for the Property and Casualty Group would increase between \$50,000 and \$75,000. The effect on the Company would be additional losses between \$2,750 and \$4,125. Taking into consideration the excess-of-loss reinsurance agreement, the net impact of such potential additional losses would be minimal to the Company.

The 2001 incurred losses related to prior accident years of \$5,943 are due primarily to adverse development of losses in the private passenger auto liability and workers' compensation lines of business. Recorded reserves are subject to ongoing analysis of recent loss development trends. These losses are reflected in operating expenses on the Consolidated Statements of Operations.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 9. UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES (CONTINUED)**

The 2000 incurred losses related to prior accident years of \$6,148 are due to adverse development of reinsurance losses from the catastrophic storms in Europe in December 1999, combined with increased loss severity in private passenger automobile and in commercial lines of business.

**NOTE 10. 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 Exchange direct and affiliated assumed premiums written. The percentage rate is adjusted periodically within specified limits by the Company's Board of Directors. The management fee charged the Exchange was 25.0 percent for each year from 1999 to 2002. The Board of Directors elected to reduce the fee to 24.0 percent beginning January 1, 2003. The provisions in the subscriber's agreements executed by the Policyholders regarding the Company's appointment as attorney-in-fact are the sole agreements governing the services performed by the Company for the Exchange. There is no provision for termination of the Company's appointment as attorney-in-fact and it is not affected by an insured's disability or incapacity.

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 5.0 percent and 0.5 percent, respectively, of the total of the Exchange's insurance business (including the business assumed from EIC and EINY). The companies settle accounts between them by payment of amounts due 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

EIC and EINY have in effect an all-lines aggregate excess-of-loss reinsurance agreement with the Exchange. The purpose of the excess-of-loss agreement is 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. Under this agreement, EIC and EINY reinsure their net retained share of the intercompany reinsurance pool such that once EIC and EINY have sustained ultimate net losses in any applicable accident year that exceed an amount equal to 72.5 percent of EIC and EINY's net premiums earned in that period, the Exchange will be liable for 95.0 percent of the amount of such excess, up to but not exceeding, an amount equal to 95.0 percent of 15.0 percent of EIC and EINY's net premium earned. Losses equal to 5.0 percent of the net ultimate net loss in excess of the retention under the contract are retained net by EIC and EINY. The annual premium is subject to a minimum premium of \$950. This reinsurance treaty is excluded from the intercompany pooling agreement. The annual premium

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 10. RELATED PARTY TRANSACTIONS (CONTINUED)**

paid to the Exchange for the agreement totaled \$2,137, \$1,450 and \$1,199 in 2002, 2001 and 2000, respectively. Recoveries during 2002 amounted to \$8,815, of which \$2,002 relates to the 2002 accident year. The balance of the recoveries under this agreement recorded in 2002 related to the 2001, 2000 and 1999 accident years. Loss recoveries in 2001 totaled \$7,241. There were no loss recoveries by EIC or EINY under the agreement for 2000.

eCommerce program and related information technology infrastructure

During 2001, the Group undertook a series of initiatives to develop its capabilities to transact business electronically. 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 Group will share the costs to be incurred for the development of new Internet-enabled property/casualty policy administration and customer relationship management systems.

The Agreement provides that the cost of the systems and the 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. These costs are included in the policy acquisition and other underwriting expenses in the Consolidated Statements of Operations. The Company's share of these costs, incurred by the Company's property/casualty insurance subsidiaries under the pooling agreement, totaled \$3,913 and \$1,315, for the years ended December 31, 2002 and 2001, respectively.

Certain other costs of the eCommerce Program are related to information technology hardware and are not included under the Agreement. These costs are included in the cost of management operations in the Consolidated Statements of Operations. For the years ended December 31, 2002 and 2001, the Company's share of these infrastructure costs amounted to \$2,602 and \$1,589, respectively.

Service agreement revenue

A service agreement fee is charged to the Exchange to compensate the Company for its management of nonaffiliated assumed voluntary reinsurance business on behalf of the Exchange. In 2002, 2001 and 2000, the Company received a fee of 7.0 percent of voluntary reinsurance premiums assumed from nonaffiliated insurers and is responsible for accounting, underwriting, and operating expenses in connection with the administration of this business. Service agreement fee revenue amounted to \$12,821, \$11,251 and \$10,149 in 2002, 2001 and 2000, respectively. The Company's Board of Directors approved a reduction in the fee to 6.0 percent beginning January 1, 2003.

Also included in service agreement revenue are service charges collected from Policyholders for providing extended payment terms on policies written by the insurers managed by the Company. During the third quarter of 2002, the Company determined service charges were incorrectly recognized on future billing installments at the time a policy was issued instead of at the time each billing was rendered. The Company recorded a one-time adjustment to correct for service charge income, reducing it by \$7,900 in 2002. Service charge revenue amounted to \$10,908, \$15,996 and \$12,513 in 2002, 2001 and 2000, respectively.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 10. RELATED PARTY TRANSACTIONS (CONTINUED)**

Expense allocations

The claims handling function of the Exchange is established and its services 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 and 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 is 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:

	2002	2001	2000
Erie Insurance Exchange	\$ 205,839	\$ 162,549	\$ 142,519
Erie Family Life Insurance Company	23,784	18,545	18,631
<b>Total cash settlements</b>	<b>\$ 229,623</b>	<b>\$ 181,094</b>	<b>\$ 161,150</b>

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 \$11,280, \$10,842 and \$10,703 in 2002, 2001 and 2000, respectively. The Company has a lease commitment until 2008 with EFL for a branch office. Rentals paid to EFL under this lease totaled \$318 in 2002, \$312 in 2001 and \$309 in 2000.

Note receivable from EFL

The Company is due \$15 million from EFL in the form of a surplus note. The note bears an annual interest rate of 6.45 percent and all payments of interest and principal of the note may be repaid only out of unassigned surplus of EFL and are subject to prior approval of the Pennsylvania Insurance Commissioner. Interest on the surplus note is scheduled to be paid semi-annually. The note will be payable on demand on or after December 31, 2005. During 2002, 2001 and 2000, EFL paid interest to the Company totaling \$968 each year.

Structured settlements with EFL

The Property and Casualty Group periodically purchases annuities from EFL in connection with the structured settlement of claims. The Company's pro-rata share (5.5 percent) of such annuities purchased equaled \$1,021, \$708 and \$889 in 2002, 2001 and 2000, respectively.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 11. 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.

Management fee and expense allocation amounts due from the Exchange were \$177,194 and \$147,344 at December 31, 2002 and 2001, respectively. A receivable from EFL for expense allocations totaled \$2,847 at December 31, 2002, compared to \$2,256 at December 31, 2001. The Company also has a receivable due from the Exchange for reinsurance recoverable from unpaid losses and loss adjustment expenses and unearned premium balances ceded to the pool totaling \$649,008 and \$491,055 at December 31, 2002 and 2001, respectively.

Premiums receivable from Policyholders at December 31, 2002 and 2001, equaled \$239,704 and \$186,175, respectively. A significant amount of these receivables are ceded to the Exchange as part of the intercompany pooling agreement. At December 31, 2002, the Exchange's statutory total assets totaled more than \$7 billion and Policyholders' surplus totaled \$2.1 billion.

**NOTE 12. REINSURANCE**

Since 1993, the Property and Casualty Group had not purchased catastrophe reinsurance because management concluded the benefits of such coverage were outweighed by the costs of the coverage in light of the Exchange's substantial surplus position and its ratio of net premiums written to surplus. The lowering of the surplus levels of the Exchange, along with increasing catastrophe risk exposure as a result of accelerating policy growth, have resulted in management's decision to purchase catastrophe reinsurance coverage. Reinsurance for catastrophe exposure reduces the variability of earnings and protects the balance sheet and income statement against large and infrequent events.

Effective January 1, 2003, the Property and Casualty Group entered into a new reinsurance treaty to mitigate future potential catastrophe loss exposure. The agreement is a property catastrophe reinsurance treaty that provides coverage of up to 95.0 percent of a loss of \$415 million in excess of the Property and Casualty Group's loss retention of \$115 million per occurrence.

The Property and Casualty Group also entered into two new reinsurance treaties to replace coverage previously provided by individual facultative contracts, beginning January 1, 2003. The first agreement is a property risk excess-of-loss reinsurance treaty on commercial property risks that provides coverage of 100 percent of a loss of \$20 million in excess of the Property and Casualty Group's loss retention of \$5 million per risk. There is a limit of \$40 million per any one loss occurrence. The second agreement is an umbrella excess-of-loss reinsurance treaty covering commercial and personal catastrophe liability risks. This treaty provides coverage of 80.0 percent 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 is \$9 million and \$4 million, respectively.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 12. REINSURANCE (CONTINUED)**

To the extent the Exchange assumes reinsurance business from nonaffiliated sources, the Company participates because of its pooling agreement with the Exchange. Similarly, the Company also participates in the business ceded from the Exchange. Reinsurance premiums, commissions, expense reimbursements and reserves related to reinsurance business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums ceded to the Exchange have been reported as a reduction of premium income. The Company's property and liability reinsurance assumed from foreign insurance companies is accounted for using the periodic method, whereby premiums are recognized as revenue over the policy term, and claims, including an estimate of claims incurred but not reported, are recognized as they occur. The amount of reinsurance business assumed from foreign insurance companies is not significant.

Reinsurance contracts do not relieve the Company from its primary obligations to Policyholders. A contingent liability exists with respect to reinsurance receivables in the event reinsurers are unable to meet their obligations under the reinsurance agreements.

The following summarizes insurance and reinsurance activities for the Company. See Note 10 for a discussion of the intercompany pooling agreement with the Exchange.

	2002	2001	2000
	<u>                    </u>	<u>                    </u>	<u>                    </u>
<b>Premiums earned:</b>			
Direct	\$ 531,479	\$ 432,307	\$ 377,570
Assumed nonaffiliates	10,409	7,391	4,824
Ceded to Erie Insurance Exchange	( 541,888)	( 439,698)	( 382,394)
Assumed from Erie Insurance Exchange	163,958	137,648	123,708
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Net	\$ 163,958	\$ 137,648	\$ 123,708
	<u>                    </u>	<u>                    </u>	<u>                    </u>
<b>Losses and loss adjustment expenses incurred:</b>			
Direct	\$ 512,141	\$ 374,440	\$ 325,644
Assumed nonaffiliates	19,676	14,262	3,956
Ceded to Erie Insurance Exchange	( 531,817)	( 388,702)	( 329,600)
Assumed from Erie Insurance Exchange	139,225	117,201	99,564
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Net	\$ 139,225	\$ 117,201	\$ 99,564
	<u>                    </u>	<u>                    </u>	<u>                    </u>

**NOTE 13. STATUTORY INFORMATION**

Accounting principles used to prepare statutory financial statements differ from those used to prepare financial statements on the basis of GAAP. The statutory financial statements of EIPC and EIC are prepared in accordance with accounting practices prescribed by the Pennsylvania Insurance Department. EINY prepares its statutory financial statements in accordance with accounting practices prescribed by the New York Insurance Department. Prescribed Statutory Accounting Practices (SAP) include state laws, regulations, and general administration rules, as well as a variety of publications from the National Association of Insurance Commissioners (NAIC). The NAIC adopted the Codification of Statutory Accounting Practices (Codification), effective January 1, 2001, as the NAIC-supported basis of accounting. The Codification was approved with a provision allowing for prescribed or permitted accounting practices to be determined by each states' insurance

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 13. STATUTORY INFORMATION (CONTINUED)**

commissioner. Accordingly, such discretion will continue to allow prescribed or permitted accounting practices that may differ from state to state. The Pennsylvania Insurance Department permits the discounting of workers' compensation reserves on a nontabular basis. However, the New York Insurance Department does not. Thus, under SAP, EIC includes discounting of these reserves while EINY does not. Surplus of the Company's property/casualty insurance subsidiaries was increased by \$2,414, \$2,173 and \$1,372 as a result of this practice, as of December 31, 2002, 2001 and 2000.

Adoption of codified SAP in 2001 resulted in changes to the Company's statutory-basis financial statements, the most significant of which was the recording of statutory deferred taxes for EIC and EIPC. The total cumulative adjustment increased the surplus of the Company's property/casualty insurance subsidiaries by \$4,446 as of January 1, 2001.

In 2002, the New York State Insurance Department adopted the deferred tax provisions of codification resulting in an increase in the surplus of EINY of \$658 at December 31, 2002.

Consolidated balances including amounts reported by the Company's property/casualty insurance subsidiaries on the statutory basis, are as follows:

	2002	2001	2000
	<u>          </u>	<u>          </u>	<u>          </u>
Shareholders' equity at December 31	\$ 970,940	\$ 854,003	\$ 767,894
Net income for the year ended December 31	169,308	118,475	150,942

The minimum statutory capital and surplus requirements under Pennsylvania and New York law for the Company's stock property/casualty subsidiaries amounts to \$9,450. The Company's subsidiaries total statutory capital and surplus well exceeded these minimum requirements, totaling \$93,485 at December 31, 2002.

Cash and securities with carrying values of \$3,493 and \$3,332 were deposited by the Company's property/casualty insurance subsidiaries with regulatory authorities under statutory requirements as of December 31, 2002 and 2001, respectively.

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) 10.0 percent 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) 10.0 percent of its statutory surplus as reported on its last annual statement, or (b) 100 percent of its adjusted net investment income during such period. At December 31, 2002, the maximum dividend the Company could receive from its property/casualty insurance subsidiaries was \$9,349. No dividends were paid to the Company from its property/casualty insurance subsidiaries in 2002 or 2001.

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) 10.0 percent 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 2003 without prior Pennsylvania Commissioner approval is \$1,937. Dividends declared to the Company totaled \$1,717 in 2002 and \$1,594 in 2001.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 14. COMMITMENTS**

The Company has contractual commitments to invest up to \$109,311 related to its limited partnership investments at December 31, 2002. These commitments will be funded as required by the partnership's agreements which principally expire in 2007. At December 31, 2002, the total commitment to fund limited partnerships that invest in private equity securities is \$69,266, real estate activities \$22,570 and fixed income securities \$17,475. The Company expects to have sufficient cash flows from operations to meet these partnership commitments.

During 2001 and 2002, the Company entered into contracts to provide services related to the eCommerce program with various external vendors. The total outstanding commitment for these contracts at December 31, 2002, was \$50,171, of which approximately \$47,332 will be reimbursed to the Company by the Exchange. The majority of these committed services are expected to be performed in 2003.

**NOTE 15. 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. See also Note 2. Assets are not allocated to the segments and are reviewed in total by management for purposes of decision-making. No single customer or agent provides 10.0 percent 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. 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.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 15. SEGMENT INFORMATION (CONTINUED)**

Summarized financial information for these operations is presented below.

	2002	2001	2000
<b>Management operations:</b>			
<i>Operating revenue:</i>			
Management fee revenue	\$ 775,700	\$ 634,966	\$ 551,646
Service agreement revenue	23,729	27,247	22,662
<b>Total operating revenue</b>	<b>\$ 799,429</b>	<b>\$ 662,213</b>	<b>\$ 574,308</b>
Cost of management operations	557,445	477,645	415,562
<b>Income before income taxes</b>	<b>\$ 241,984</b>	<b>\$ 184,568</b>	<b>\$ 158,746</b>
<b>Net income from management operations</b>	<b>\$ 161,548</b>	<b>\$ 123,187</b>	<b>\$ 107,032</b>
<b>Insurance underwriting operations:</b>			
<i>Operating revenue:</i>			
<b>Premiums earned:</b>			
Commercial lines	\$ 46,398	\$ 34,970	\$ 28,456
Personal lines	113,339	97,078	89,369
Reinsurance	7,491	7,416	6,681
<b>Total premiums earned (SAP)</b>	<b>167,228</b>	<b>139,464</b>	<b>124,506</b>
GAAP adjustments	( 3,270)	( 1,816)	( 798)
<b>Total premiums earned (GAAP)</b>	<b>\$ 163,958</b>	<b>\$ 137,648</b>	<b>\$ 123,708</b>
<i>Operating expenses:</i>			
<b>Losses and expenses:</b>			
Commercial lines	\$ 53,331	\$ 41,417	\$ 31,914
Personal lines	141,503	107,851	92,012
Reinsurance	1,784	12,970	12,203
<b>Total losses and expenses (SAP)</b>	<b>196,618</b>	<b>162,238</b>	<b>136,129</b>
GAAP adjustments	( 5,528)	( 4,127)	( 2,019)
<b>Total losses and expenses (GAAP)</b>	<b>\$ 191,090</b>	<b>\$ 158,111</b>	<b>\$ 134,110</b>
<b>Loss before income taxes</b>	<b>( \$27,132)</b>	<b>( \$ 20,463)</b>	<b>( \$ 10,402)</b>
<b>Net loss from insurance underwriting operations</b>	<b>( \$18,113)</b>	<b>\$ (13,658)</b>	<b>\$ (7,013)</b>
<b>Investment operations:</b>			
Investment income, net of expenses	\$ 55,440	\$ 49,884	\$ 48,401
Net realized (losses) gains on investments	( 11,237)	( 29,146)	16,968
Equity in (losses) earnings of limited partnerships	( 3,654)	( 2,740)	4,733
<b>Income before income taxes and equity in earnings of EFL</b>	<b>\$ 40,549</b>	<b>\$ 17,998</b>	<b>\$ 70,102</b>
<b>Equity in earnings of EFL, net of tax</b>	<b>\$ 1,611</b>	<b>\$ 719</b>	<b>\$ 5,108</b>
<b>Net revenue from investment operations</b>	<b>\$ 28,691</b>	<b>\$ 12,732</b>	<b>\$ 52,374</b>

Operating expenses in the reinsurance component decreased in 2002 compared to 2001. Assumed voluntary reinsurance losses were significantly greater in 2001 due in large part to the September 11th World Trade Center attack. In addition there were \$8,815 in recoveries under the all-lines aggregate excess-of-loss agreement with the Exchange in 2002, compared to \$7,241 in 2001.

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 15. SEGMENT INFORMATION (CONTINUED)**

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.

**NOTE 16. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)**

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>2002</b>				
Operating revenue	\$ 222,813	\$ 254,785	\$ 252,431	\$ 233,358
Operating expenses	( 169,626)	( 193,984)	( 193,261)	( 191,664)
Other income and expenses	12,011	10,553	10,623	7,362
Income before income taxes and equity in earnings of EFL	\$ 65,198	\$ 71,354	\$ 69,793	\$ 49,056
Net income	\$ 44,202	\$ 47,826	\$ 46,162	\$ 33,936
Net income per share	\$ 0.62	\$ 0.67	\$ 0.65	\$ 0.48
Comprehensive income	\$ 37,379	\$ 44,712	\$ 52,142	\$ 41,356
<b>2001</b>				
Operating revenue	\$ 184,255	\$ 208,583	\$ 209,163	\$ 197,860
Operating expenses	( 144,593)	( 157,265)	( 164,708)	( 169,190)
Other income and expenses	11,452	17,289	6,667	( 17,410)
Income before income taxes and equity in earnings of EFL	\$ 51,114	\$ 68,607	\$ 51,122	\$ 11,260
Net income	\$ 34,785	\$ 47,129	\$ 34,430	\$ 5,917
Net income per share	\$ 0.49	\$ 0.66	\$ 0.48	\$ 0.08
Comprehensive income	\$ 36,407	\$ 45,414	\$ 31,081	\$ 21,399
<b>2000</b>				
Operating revenue	\$ 164,223	\$ 182,787	\$ 183,466	\$ 167,540
Operating expenses	( 130,808)	( 141,067)	( 141,791)	( 136,006)
Other income and expenses	18,108	19,386	17,682	14,926
Income before income taxes and equity in earnings of EFL	\$ 51,523	\$ 61,106	\$ 59,357	\$ 46,460
Net income	\$ 36,185	\$ 42,518	\$ 41,192	\$ 32,498
Net income per share	\$ 0.50	\$ 0.59	\$ 0.58	\$ 0.45
Comprehensive income	\$ 50,036	\$ 35,093	\$ 41,565	\$ 22,300

ERIE INDEMNITY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 16. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)**

During the fourth quarter 2002, the Company realized net losses on the sale of impaired securities and realized charges for other-than-temporary impairments of fixed maturities and limited partnerships totaling \$8,448. Realized losses resulted in an after-tax earnings per share reduction of \$.08. Additionally in the fourth quarter of 2002, the Company reduced its management fee revenue by \$11,900 establishing an allowance for mid-term cancellations on premiums. See Note 2. Commission expense, a component of cost of management operations, for the fourth quarter of 2002 was correspondingly reduced by \$5,800. The net after-tax effect of the allowance for mid-term cancellations was approximately \$.06 per share. The Company also reduced service agreement revenue in the third quarter 2002 by recording an adjustment for service fees not earned until a future installment billing date. This adjustment resulted in a reduction of income from management operations of \$6.9 million, or \$.06 per share after taxes in the third quarter 2002.

During the fourth quarter of 2001, the Company realized net losses on the sale of impaired securities and realized charges for other-than-temporary impairments of equity securities and limited partnerships totaling \$29,153. Realized losses resulted in an after-tax earnings per share reduction of \$.27. The investment sales were part of a proactive year-end tax planning strategy that produced a recovery of \$9.1 million of federal income taxes paid in 1998, 1999 and 2000. Also contributing to the fourth quarter 2001 decline in net income per share were charges for a severance benefit stemming from the retirement of the president and CEO of the Group. The Company's share of charges related to this severance benefit was approximately \$.10 per share, after taxes.

Market price of and dividends on the 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

	2002		2001	
	Low	High	Low	High
First Quarter	\$ 37.65	\$ 40.82	\$ 26.50	\$ 30.00
Second Quarter	40.44	45.49	27.54	36.12
Third Quarter	37.45	44.50	32.70	39.55
Fourth Quarter	35.90	42.39	36.91	40.63

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 83,873 Company Class A shares at December 31, 2002.

Effective January 1, 1999, a stock repurchase plan was established under which the Company could repurchase as much as \$120 million of its outstanding Class A common stock through December 31, 2002. The plan allowed the Company to 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. Treasury shares have been recorded on the Consolidated Statements of Financial Position at cost. In 2002, there were 207,217 shares repurchased at a total cost of \$8.5 million, or an average price per share of \$40.96. Shares repurchased for the duration of the plan totaled 3,402,894 at a total cost of \$101.9 million, or an average price per share of \$29.93.

In January 2003, 3.0 million shares of the Company's Class A common stock owned by Black Interests Limited Partnership were sold to the public in a secondary offering at an initial price of \$34.50 per share. The Company did not receive any proceeds from the sale of the shares. Co-lead underwriters for the offering were Goldman, Sachs & Co. and Credit Suisse First Boston.

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 2002 and 2001 are as follows:

Dividends declared

2002:	Class A share	Class B share
First Quarter	\$ .1700	\$ 25.500
Second Quarter	.1700	25.500
Third Quarter	.1700	25.500
Fourth Quarter	.1900	28.500
	<hr/>	<hr/>
	\$ .7000	\$ 105.000
2001:	Class A share	Class B share
First Quarter	\$ .1525	\$ 22.875
Second Quarter	.1525	22.875
Third Quarter	.1525	22.875
Fourth Quarter	.1700	25.500
	<hr/>	<hr/>
	\$ .6275	\$ 94.125

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

Malin,Bergquist & Co.,LLP  
2402 West 8th Street  
Erie, PA 16505

March 27, 2003

Securities and Exchange Commission  
Washington, D.C. 20549

We have read Item 4 of the Current Report on Form 8-K/A of Erie Indemnity Company, Inc. for March 27, 2003, and we agree with the statements contained therein insofar as they relate to our firm.

Very truly yours,

/s/ MALIN, BERGQUIST & COMPANY, LLP  
Certified Public Accountants

## SUBSIDIARIES OF REGISTRANT

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

Name	State of Formation
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

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

In connection with the Annual Report of Erie Indemnity Company (the "Company") on Form 10-K for the period ending December 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jeffrey A. Ludrof, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act that:

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

/s/ Jeffrey A. Ludrof

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Jeffrey A. Ludrof  
President and CEO

March 27, 2003

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

In connection with the Annual Report of Erie Indemnity Company (the "Company") on Form 10-K for the period ending December 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Philip A. Garcia, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act that:

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

/s/ Philip A. Garcia

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Philip A. Garcia  
Executive Vice President & CFO

March 27, 2003