

**ERIE MUTUAL FIRE
INSURANCE COMPANY
CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009**

ERIE MUTUAL FIRE INSURANCE COMPANY

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DECEMBER 31, 2009

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AUDITORS' REPORT

To the Policyholders of,
ERIE MUTUAL FIRE INSURANCE COMPANY

We have audited the consolidated balance sheet of ERIE MUTUAL FIRE INSURANCE COMPANY as at December 31, 2009 and the consolidated statements of operations, policyholders' surplus, comprehensive loss, accumulated other comprehensive loss and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance 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.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2009 and the results of its operations and the changes in its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

" BDO CANADA LLP"

Chartered Accountants, Licensed Public Accountants

Woodstock, Ontario
January 14, 2010

ERIE MUTUAL FIRE INSURANCE COMPANY

CONSOLIDATED BALANCE SHEET
AS AT DECEMBER 31, 2009

	<u>2009</u>	<u>2008</u>
ASSETS		
Cash	\$ 2,066,372	\$ 1,567,555
Investments (Note 3)	15,149,944	15,266,154
Due from policyholders	1,152,251	1,085,018
Provision for reinsurance recovery on unpaid claims (Note 7)	2,155,399	2,316,405
Due from facility	175,719	202,030
Subrogation recoverable	-	193,515
Income taxes receivable (Note 8)	70,234	318,671
Prepaid expenses	2,307	5,698
Deferred policy acquisition costs	300,284	292,629
Future income tax asset	105,558	54,085
Capital assets (Note 5)	599,442	569,963
	<u>\$ 21,777,510</u>	<u>\$ 21,871,723</u>

LIABILITIES		
Provision for unpaid claims (Note 7)	\$ 4,579,748	\$ 4,990,366
Unearned premiums (Note 6)	2,379,834	2,321,164
Accounts payable and accrued liabilities	697,389	252,513
	<u>7,656,971</u>	<u>7,564,043</u>

Contingent liability (Note 9)

POLICYHOLDERS' SURPLUS		
Policyholders' surplus	14,159,370	14,811,248
Accumulated other comprehensive loss	(38,831)	(503,568)
	<u>\$ 21,777,510</u>	<u>\$ 21,871,723</u>

On behalf of the Board

_____ Director

_____ Director

ERIE MUTUAL FIRE INSURANCE COMPANY

CONSOLIDATED STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2009

	2009	2008
UNDERWRITING INCOME		
Gross premiums written	\$ 5,053,984	\$ 4,927,144
Less reinsurance ceded	(1,152,883)	(1,011,660)
	<hr/>	<hr/>
Net premiums written	3,901,101	3,915,484
Less increase in unearned premiums	(61,348)	(79,803)
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NET PREMIUMS EARNED	3,839,753	3,835,681
	<hr/>	<hr/>
EXPENSES		
Administrative expenses related to claims	52,392	74,098
Allowance for doubtful accounts	1,170	(71)
Association fees	26,809	25,177
Commissions and sales salaries	557,333	607,529
Computer expense	74,923	48,440
Directors fees	71,953	27,750
Donations	12,723	4,004
Inspection and investigations	45,366	43,694
Insurance	13,656	7,730
Net claims and adjusting expenses incurred	3,029,002	2,323,182
Occupancy expenses	49,002	43,285
Other expenses	13,428	755
Postage	13,528	11,831
Premium tax	12,586	11,099
Printing, stationery and office supplies	29,340	21,720
Professional fees	195,780	42,169
Regulatory assessments	1,283	4,607
Salaries and benefits	637,474	381,396
Sales and marketing	12,508	14,489
Telephone	14,222	9,545
Travel	39,193	32,943
	<hr/>	<hr/>
TOTAL EXPENSES	4,903,671	3,735,372
	<hr/>	<hr/>
UNDERWRITING (LOSS) INCOME	(1,063,918)	100,309
NET INVESTMENT INCOME	105,242	241,412
	<hr/>	<hr/>
(LOSS) INCOME BEFORE PROVISION FOR INCOME TAXES	(958,676)	341,721
(RECOVERY OF) PROVISION FOR INCOME TAXES		
Current	(50,575)	(131,965)
Future	(256,223)	197,609
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	(306,798)	65,644
	<hr/>	<hr/>
NET (LOSS) INCOME FOR THE YEAR	\$ (651,878)	\$ 276,077

The accompanying notes are an integral part of these financial statements

ERIE MUTUAL FIRE INSURANCE COMPANY

CONSOLIDATED STATEMENT OF POLICYHOLDERS' SURPLUS FOR THE YEAR ENDED DECEMBER 31, 2009

	<u>2009</u>	<u>2008</u>
BALANCE AT BEGINNING OF YEAR	\$ 14,811,248	\$ 14,535,171
NET (LOSS) INCOME FOR THE YEAR	<u>(651,878)</u>	<u>276,077</u>
BALANCE AT END OF YEAR	<u>\$ 14,159,370</u>	<u>\$ 14,811,248</u>

CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS FOR THE YEAR ENDED DECEMBER 31, 2009

	<u>2009</u>	<u>2008</u>
NET (LOSS) INCOME	\$ (651,878)	\$ 276,077
OTHER COMPREHENSIVE INCOME (LOSS)		
Change in unrealized loss on available-for-sale mutual funds	(1,992)	(741,978)
Reclassification adjustment for loss (gain) on mutual funds included in income	<u>671,479</u>	<u>(1,641)</u>
Net unrealized gain (loss)	669,487	(743,619)
Income tax effect	<u>204,750</u>	<u>(220,860)</u>
	<u>464,737</u>	<u>(522,759)</u>
COMPREHENSIVE LOSS	<u>\$ (187,141)</u>	<u>\$ (246,682)</u>

CONSOLIDATED STATEMENT OF ACCUMULATED OTHER COMPREHENSIVE LOSS FOR THE YEAR ENDED DECEMBER 31, 2009

	<u>2009</u>	<u>2008</u>
BALANCE AT BEGINNING OF YEAR	\$ (503,568)	\$ 19,191
OTHER COMPREHENSIVE INCOME (LOSS)	<u>464,737</u>	<u>(522,759)</u>
BALANCE AT END OF YEAR	<u>\$ (38,831)</u>	<u>\$ (503,568)</u>

ERIE MUTUAL FIRE INSURANCE COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2009

	<u>2009</u>	<u>2008</u>
OPERATING ACTIVITIES		
Net (loss) income for the year	\$ (651,878)	\$ 276,077
Items not affecting cash:		
Decrease in provision for unpaid claims	(410,618)	(651,141)
Increase in unearned premiums	58,670	79,161
Increase (decrease) in accounts payable and other liabilities	444,876	(73,526)
Amortization of capital assets	34,206	26,262
Decrease in receivables and other assets	565,427	296,765
Increase in deferred policy acquisition costs	(7,655)	(9,490)
Realized loss (gain) from disposal of investments	363,599	(10,868)
Decrease in refund of premium payable	-	(640,000)
Future income taxes	(256,223)	197,609
Write down of investments (Note 3)	57,500	532,206
	<hr/>	<hr/>
Cash provided from operating activities	197,904	23,055
INVESTING ACTIVITIES		
Sale of investments	2,261,354	882,938
Purchase of investments	(1,896,756)	(815,619)
Purchase of capital assets	(63,685)	(22,600)
	<hr/>	<hr/>
Cash provided from investing activities	300,913	44,719
INCREASE IN CASH	498,817	67,774
CASH AT BEGINNING OF YEAR	1,567,555	1,499,781
	<hr/>	<hr/>
CASH AT END OF YEAR	\$ 2,066,372	\$ 1,567,555
	<hr/>	<hr/>
Income taxes recovered during the year	\$ (287,639)	\$ (256,384)
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ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

1. NATURE OF BUSINESS

Company

The company is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property, liability, automobile and farmers' accident insurance in Ontario.

All insurance entities

The company determines and charges premiums to individual policyholders which, taken as a pool with all other policyholders, is expected to cover underwriting costs and claims which may take a number of years to settle. The business risks of insurance reside in determining the product premium, settlement of claims, estimation of claims costs and management of investment funds. Ongoing management policies and practices of the company in underwriting, claims and investment activities are designed to control risk exposure.

To further mitigate underwriting risk, the company purchases reinsurance to share all or part of the risks originally accepted by the company in writing premiums. This reinsurance, however, does not relieve the company of its primary obligation to policyholders. If any reinsurers are unable to meet their obligations under the related agreements, the company would be liable to its policyholders for unrecoverable amounts.

The company itself is a reinsurer and therefore shares in risks originally accepted by other insurance companies.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation of the financial statements is in accordance with Canadian generally accepted accounting principles, including the requirements of the Financial Services Commission of Ontario. Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements. Estimates also affect the reported amounts of income and expenses for the reporting period of the statement of operations. Actual results could differ from those estimates.

Basis of presentation of financial statements

These financial statements include the financial statements of Erie Mutual Fire Insurance Company and those of its subsidiary company, 2135671 Ontario Ltd.

Capital assets and amortization

Capital assets are stated at cost less accumulated amortization. Amortization is provided on a diminishing balance basis over the estimated useful life of the assets as follows:

Building	5% and 8%
Computer hardware	30%
Telephone system	8%
Furniture and fixtures	20%
Vehicle	30%

Reinsurance

The company reflects reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to reinsurance and its obligations to policyholders and on a net basis in the statement of operations to indicate the results of its retention of premium written.

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Premium related balances

(a) Premiums and unearned premiums

The company earns premium income evenly over the term of the insurance policy generally using the pro rata method. The portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums.

Premiums receivable are recorded at amounts due less any required provision for doubtful amounts.

(b) Deferred policy acquisition costs

Acquisition costs are comprised of agents' commissions. These costs are deferred and amortized over the terms of the related policies to the extent that they are considered to be recoverable from unearned premiums, after considering the related anticipated claims and expenses and investment income.

Claims related balances

(a) Provisions for unpaid claims and adjustment expenses

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, changes in reported claims and for claims incurred but not reported, based on past experience and business in force. The estimates are regularly reviewed and updated, and any resulting adjustments are included in current income.

Claim liabilities are carried on an undiscounted basis as permitted by the Financial Services Commission of Ontario.

(b) Reinsurers' share of provisions for unpaid claims and adjustment expenses

Expected reinsurance recoveries on unpaid claims and adjustment expenses, net of any required provision for doubtful amounts, are recognized as assets at the same time and using principles consistent with the company's method for establishing the related liability.

(c) Salvage and subrogation recoverable

In the normal course of business, the company obtains the ownership of damaged property, which they resell to various salvage operations. Unsold property is valued at its estimated net realizable value.

Where the company indemnifies policyholders against a liability claim, it acquires rights to subrogate its claim against other parties. These claims are reflected at amounts expected to be received from the subrogated parties net of related costs.

Income taxes

The company follows the asset and liability method for accounting for income taxes. Under the asset and liability method, income taxes are recognized for the future income tax consequences attributable to differences between the financial statement carrying values and their respective income tax basis (temporary differences). Future income tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period that includes the enactment date.

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Financial Instruments

The company classifies its financial instruments into one of the following categories based on the purpose for which the asset was acquired. Transactions costs for financial instruments are expensed as incurred. The company's accounting policy for each category is as follows:

Held for trading

This category is comprised of cash and cash equivalents. They are carried in the balance sheet at fair value with changes in fair value recognized in the statement of operations.

Held to maturity Investments

Held to maturity investments are non-derivative financial assets with fixed or determinable payments, and fixed maturities that the company's management has the positive intention and ability to hold to maturity. They are initially recognized at fair value and subsequently carried at amortized cost, using the effective interest rate method, less any provision for impairment.

Available for sale investments

Available for sale assets are non-derivative financial assets that are designated as available-for sale or are not categorized into any of the other categories described above. They are initially recognized at fair value. They are subsequently carried at fair value with gains and losses arising from changes in fair value being recognized in the Statement of Comprehensive Income. Where a decline in fair value is determined to be other than temporary, the amount of the loss is removed from Other Comprehensive Income and recognized in the Statement of Operations. Purchases and sales of these assets are accounted for at settlement date.

Other financial liabilities

Other financial liabilities includes all financial liabilities other than those classified as held-for-trading and comprise of trade payables, and other short-term monetary liabilities. These liabilities are initially recognized at fair value and subsequently carried at amortized cost using the effective interest rate method.

The carrying amount of the company's financial instruments is as follows:

	Designated held for trading	Available for sale	Other financial liabilities	Total
Cash	\$ 2,066,372	\$ -	\$ -	\$ 2,066,372
Investments	-	15,149,944	-	15,149,944
Accounts payable and accrued liabilities	-	-	(697,389)	(697,389)
	<u>\$ 2,066,372</u>	<u>\$ 15,149,944</u>	<u>\$ (697,389)</u>	<u>\$ 16,518,927</u>

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Fair values

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arms length transaction between knowledgeable, willing parties who are under no compulsion to act. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, the fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets held and offer prices for financial liabilities. When independent prices are not available, fair values are determined by using valuation techniques that refer to observable market data and include discounted estimated realizable value.

Impaired investments

When the value of any debt security, pooled fund or mutual fund is identified as impaired, the carried amounts are adjusted to estimated realizable amounts. Estimated realizable amounts are measured by discounting reasonably determinable expected future cash flows or using the estimated fair values of underlying security less realization costs or observable market prices. Adjustments to carried amounts are included in investment income in the year the impairment is recognized.

3. INVESTMENTS

The cost and carrying values of investments at December 31 were as follows:

AVAILABLE FOR SALE

	2009		2008	
	Cost	Carrying Value	Cost	Carrying Value
Fire mutuals guarantee fund	\$ 12,927	\$ 12,927	\$ 12,743	\$ 12,743
Farm mutual pooled funds				
- Canadian fixed income	14,160,272	14,105,716	13,340,936	13,294,877
Mutual funds	1,024,796	1,031,301	2,572,471	1,901,034
	15,197,995	15,149,944	15,926,150	15,208,654

HELD TO MATURITY

Debt securities	-	-	57,500	57,500
	\$ 15,197,995	\$ 15,149,944	\$ 15,983,650	\$ 15,266,154

The estimated fair market value is equal to the carrying value.

Credit risk

The maximum exposure to credit risk would be the carrying value as shown above.

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

3. INVESTMENTS (cont'd)

Based on the analysis by management, the farm mutual pooled funds have seen a fair market value decline from their cost value. It is management belief that this decline is temporary in nature, and improvement is probable within a timeframe consistent with the company's investment strategy. The other available for sale investments were also reviewed by management and it was determined that there were no impairments that were other than temporary, therefore no write-downs were considered necessary.

Held to Maturity

For held to maturity investments, the estimated fair value of debt securities is determined using discounted future cash flows. The estimated fair value of the debt securities is based on management's best estimate of recoverability based on information available at year end.

The company reviewed the values of the above investments and has determined that there were impairments that were other than temporary. As a result, a write-down of \$57,500 has been recognized in the statement of operations.

4. FAIR VALUE MEASUREMENT

The accounting standards board amended Handbook section 3862, Financial Instruments - Disclosures, by including enhanced disclosure requirements for fair value measurement of financial instruments and liquidity risk. The required disclosure relating to liquidity risk is in Note 13.

In compliance with CICA 3862, the company has categorized its assets and liabilities that are carried at fair value, based on the priority of the inputs to the valuation techniques used to measure fair value, into a three level fair value hierarchy. Financial assets and liabilities measured at fair value are categorized as follows:

Level 1: Fair value is based on unadjusted quoted prices for identical assets or liabilities in an active market.

Level 2: Fair value is based on quoted prices for similar assets or liabilities in active markets, valuation that is based on significant observable inputs or inputs that are derived principally for or corroborated with observable market data through correlation or other means.

Level 3: Fair value is based on valuation techniques that require one or more significant unobservable inputs or the use of broker quotes. These unobservable inputs reflect the company's assumptions about the assumptions market participants would use in pricing the assets or liabilities.

	Level 1	Level 2	Level 3	Total
Fire Mutuals Guarantee Fund	\$ -	\$ 12,927	\$ -	\$ 12,927
Farm Mutual Pooled Funds				
Canadian Fixed Income	-	14,105,716	-	14,105,716
Mutual Funds	-	1,031,301	-	1,031,301
Total assets measured at fair value	\$ -	\$ 15,149,944	\$ -	\$ 15,149,944

The company does not own any level 1 or level 3 investments as at December 31, 2009.

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

5. CAPITAL ASSETS

	2009		2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land	\$ 186,689	\$ -	\$ 186,689	\$ -
Building	688,263	345,126	675,244	327,237
Computer hardware	146,510	123,859	124,993	118,762
Telephone system	10,204	5,914	10,204	5,541
Furniture and fixtures	82,598	72,681	76,168	71,005
Vehicle	45,319	12,561	22,600	3,390
	<u>\$ 1,159,583</u>	<u>\$ 560,141</u>	<u>\$ 1,095,898</u>	<u>\$ 525,935</u>
Net book value		<u>\$ 599,442</u>		<u>\$ 569,963</u>

Amortization for 2009 was \$34,206 (2008 - \$26,262).

6. UNEARNED PREMIUMS

The company is exposed to a pricing risk to the extent that unearned premiums are insufficient to meet the related future policy costs. Evaluation is performed regularly to estimate future claims costs, related expenses, investment income and expected profit in relation to unearned premiums. There was no premium deficiency at December 31, 2009 or 2008.

The company cedes all reinsurance business to Farm Mutual Reinsurance Plan Inc. No provision is necessary at December 31, 2009 or 2008 for doubtful collection of reinsurance recoveries related to unearned premiums.

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

7. PROVISION FOR UNPAID CLAIMS AND ADJUSTMENT EXPENSES

Scope

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of three major variables being the development of claims, reinsurance recoveries, and future investment income.

The Financial Services Commission of Ontario has required that consideration of future investment income be disregarded except in the evaluation of automobile accident benefit claims.

The provision for unpaid claims and adjustment expenses and related reinsurers' share are estimates subject to variability, and the variability could be material in the near term. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, or significant changes in severity or frequency of claims from historical trends. The estimates are principally based on the company's historical experience. Methods of estimation have been used which the company believes produce reasonable results given current information.

The table below details the provision for unpaid claims and adjustment expenses by risk categories.

	Gross	2009 Ceded	Gross	2008 Ceded
Long settlement term	\$ 2,514,593	\$ 1,285,704	\$ 2,630,480	\$ 1,066,106
Short settlement term	1,845,187	869,695	2,154,980	1,250,299
Facility Association and other residual pools	219,968	-	204,906	-
	\$ 4,579,748	\$ 2,155,399	\$ 4,990,366	\$ 2,316,405

Claim development

The estimation of claim development involves assessing the future behaviour of claims taking into consideration other consistency of the company's claim handling procedures, the amount of information available, the characteristics of the line of business from which the claim arises, and historical delays in reporting claims. In general, the longer the term required for the settlement of a group of claims the more variable the estimates. Short settlement term claims are those which are expected to be substantially paid within a year of being reported.

Comments and assumptions for specific claims categories

The ultimate cost of long settlement general liability claims is difficult to predict for several reasons. The claim may not be reported until many years after a policy expires. Changes in the legal environment have created further complications. Court decisions and federal and provincial legislation may dramatically increase the liability between the time a policy is written and associated claims are ultimately resolved. For example, liability for exposure to toxic substances and environmental impairment, which did not appear likely or even exist when the policies were written, has been imposed by legislators and judicial interpretation. Tort liability has been expanded by some jurisdictions to cover defective workmanship. Provisions for such difficult-to-estimate liabilities are established by examining the facts of tendered claims and adjusted in the aggregate for ultimate loss expectations based upon historical experience patterns and current socioeconomic trends.

The company must participate in industry automobile residual pools of business, and recognizes a share of this business based on its automobile market share. The company records its share of the liabilities provided by the actuaries of the pools.

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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8. INCOME TAXES

The company is subject to income taxes on that portion of its income derived from insuring other than farm related risks.

9. GUARANTEES & CONTINGENT LIABILITIES

In connection with its operations, certain of the company's officers and directors have been named as a defendant in an action for damages and costs allegedly sustained by the plaintiffs. The Company expects such actions to be resolved with minimal damages or expense in excess of the amounts accrued. There however exists an exposure in excess of amounts accrued. This exposure could be material and is not reasonably determinable.

Also, in the normal course of the company's operations and in common with the insurance industry in general, the company is subject to litigation arising in the normal course of conducting its insurance business which is taken into account in establishing the provision for unpaid claims and adjustment expenses.

Pursuant to an agreement effective January 1, 1976, the company is a member of the Fire Mutuals Guarantee Fund ("the Fund"). The Fund was established to provide payment of outstanding policyholders' claims if a member company becomes bankrupt. As a result, the company may be required to contribute assets, to their proportionate share, in meeting this objective.

The company is a member of the Farm Mutual Reinsurance Plan Inc. ("the Plan"), which is a general reinsurer that shares in the insurance risks originally accepted by member insurance companies. As a member of the Plan, the company may be required to contribute additional capital to the Plan should the Plan's capital fall below a prescribed minimum. The additional capital would be provided by purchasing subordinated debt obligations issued by the Plan.

10. PENSION PLAN

The company makes contributions to the Ontario Mutual Insurance Association Pension Plan, which is a multi-employer plan, on behalf of its employees. The plan is a money purchase, with a defined benefit option at retirement which specifies the amount of the retirement benefit plan to be received by the employees based on length of service and rates of pay.

The amount contributed to the plan for 2009 was \$42,368 (2008 - \$42,076) for current service. These payments are included as an expenditure in the statement of operations.

11. GOVERNMENT REGULATION OF AUTOMOBILE INSURANCE

The company's automobile insurance rates are subject to approval by the Financial Services Commission of Ontario (FSCO). Applications for automobile rate changes are presented to FSCO by the Farm Mutual Reinsurance Plan Inc. (FMRP) on behalf of some members of the Ontario Mutual Insurance Association (OMIA). The rate filings include actuarial justification for the rate increases or decreases. All rate filings must be approved by FSCO prior to implementation.

Rate regulation may affect the automobile insurance revenues that are earned by the company. The actual impact of rate regulation would depend on the competitive environment at the time.

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

12. CAPITAL MANAGEMENT

The company's objectives with respect to capital management are to maintain a capital base that is structured to exceed regulatory requirements and to best utilize capital allocations.

The regulators measure the financial strength of property and casualty insurers using a minimum capital test (MCT). The regulators generally expect property and casualty companies to comply with capital adequacy requirements. This test compares a company's capital against the risk profile of the organization. The risk-based capital adequacy framework assesses the risk of assets, policy liabilities and other exposures by applying various factors. The regulator indicates that the company should produce a minimum MCT of 150%. The regulator has the authority to request more extensive reporting and can place restrictions on the company's operations if deemed necessary.

The company's MCT ratio is reviewed by the company and regulators on a quarterly basis through the preparation and submission of their quarterly P&C1 filings. Throughout the year the company met and exceeded the required minimum MCT ratio.

For the purpose of capital management, the company has defined capital as policyholders' equity excluding accumulated other comprehensive income.

There have been no changes in the company's objectives regarding capital management during the year.

Reinsurance

Reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable.

The company is substantially dependent on reinsurance contracts with a related party. There is no single non-related reinsurer which is material to the company. The reinsurance transactions with its related party are in the normal course of business.

During 2009, the company purchased excess of loss reinsurance which limits the liability of the company on property, liability and automobile insurance contracts to a maximum amount on any one claim of \$125,000 plus 10% of the excess up to \$1,000,000. In addition, the company has obtained stop loss reinsurance which limits the company's liability of all claims to 80% of gross net earned premium of the specific year for property, and 100% of all claims of gross net earned premium of the specific year for automobile and liability.

To limit the potential impact of a catastrophic event, catastrophe coverage was purchased limiting the company's exposure to \$375,000 plus 5% of the remaining loss. The \$375,000 net retained amount represents approximately 2.7% of company's capital.

ERIE MUTUAL FIRE INSURANCE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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13. FINANCIAL INSTRUMENT RISK MANAGEMENT

Credit Risk

Credit risk is the risk of financial loss to the company if a party to the company's financial instruments fails to discharge an obligation or make payments of interest and principal when due. The company is exposed to this risk relating to its debt securities and mutual fund holdings in its investment portfolio and the reliance on reinsurers to make payment when certain loss conditions are met.

The company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The majority of fixed income investments are held within a pooled fund that reports quarterly to ensure that it is in compliance with mandated constraints. Pooled funds are invested in bonds and debentures of Federal, Provincial, Corporate and non-Canadian issuers with a minimum rating of 'BBB' or better. The Policy for fixed income pooled funds limits the investment in any one corporate name rated 'A' or better to a maximum of 5% of the total fixed income portfolio. This policy also includes limits on the Provincial 'BBB' rated investments to a maximum of 5% of the total fixed income portfolio and holdings in non-Canadian investments require a rating of 'A' or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by the Board of Directors on a quarterly basis.

Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer. Management monitors the creditworthiness of FMRP by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by the Board of Directors prior to renewal of the reinsurance contract.

Accounts receivables are short-term in nature and are not subject to material credit risk.

The maximum exposure to credit risk and concentration of this risk is outlined in note 3.

There have been no significant changes from the previous year in the exposure to risk or policies procedures and methods used to measure the risk.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of market factors. Market factors include three types of risk: currency risk, interest rate risk and equity risk.

The company's investment policy operates within the guidelines of the Insurance Act. An investment policy is in place and its application is monitored by the Investment Committee and the Board of Directors. Diversification techniques are utilized to minimize risk. Each of the company's advisors are provided with an investments mandate which restricts the types of investments that funds can be invested in.

Derivative instruments are not used in any investment activity.

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13. FINANCIAL INSTRUMENT RISK MANAGEMENT (cont'd)

Interest Rate Risk

Interest rate risk is the potential for financial loss caused by fluctuations in fair value or future cash flows of financial instruments because of changes in market interest rates.

The company is exposed to this risk through its interest bearing investments (Debt securities, mutual funds and pooled funds).

Historical data and current information is used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. However, because a significant portion of the company's assets relate to its capital rather than liabilities, the value of its interest rate based assets exceeds its interest rate based liabilities. As a result, generally, the company's investment income will move with interest rates over the medium to long-term with short term interest rate fluctuations creating unrealized gain or losses in Other Comprehensive Income. There are no occurrences where interest would be charged on liabilities, therefore, little protection is needed to ensure the fair market value of assets will be offset by a similar change in liabilities due to an interest rate change.

The objective and policies and procedures for managing interest rate risk is to diversify bond holdings through pooled fund investments in such a way that the company is invested in a laddered and balanced portfolio through its ownership of units in various mutual funds with a fixed income component.

At December 31, 2009, a 1% move in interest rates, with all other variables held constant, could impact the market value of pooled and mutual funds by \$980,000. This change in market value would impact Other Comprehensive Income.

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure the risk.

Equity Risk

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The company is exposed to this risk through its mutual fund holdings within its investment portfolio.

The company's portfolio includes mutual funds that are invested in Canadian stocks with fair values that move with the Toronto Stock Exchange Composite Index. A 10% movement in the stock markets with all other variables held constant would have an estimated affect on the fair values of the company's mutual funds of \$105,000. This change in fair values would impact Other Comprehensive Income.

The company's investment policy limits equity investments to 25% of the total portfolio investment, in accordance with the Insurance Act. Investment managers are mandated to follow the same conservative strategy, and must also diversify across various sectors and securities of the market. All equity investments must be freely tradable and listed on a recognized stock exchange in Canada.

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13. FINANCIAL INSTRUMENT RISK MANAGEMENT (cont'd)

Liquidity Risk

Liquidity risk is the risk that the company will not be able to meet all cash outflow obligations as they come due. The company mitigates this risk by monitoring cash activities and expected outflows. The company's current liabilities arise as claims are made. The company does not have material liabilities that can be called unexpectedly at the demand of a lender or client. The company has no material commitments for capital expenditures and there is no need for such expenditures in the normal course of business. Claim payments are funded by current operating cash flow including investment income.

The company's investment policy requires that 5% - 15% of investable assets are held in cash and short term investments, which can include treasury bills, commercial paper and term deposits with an original maturity of less than one year.

There have been no significant changes from the previous year in the exposure to risk or policies procedures and methods used to measure the risk.

14. NEW ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements that have been issued but are not yet effective, and have a potential implication for the company, are as follows:

International financial reporting standards (IFRS)

The Accounting Standards Board confirmed in 2008 that the use of International Financial Reporting Standards ("IFRS") by publicly accountable enterprises will be required in 2011 with comparative data for the prior year. IFRS uses a conceptual framework similar to Canadian GAAP, but there could be significant differences in recognition, measurement and disclosures that will need to be addressed.

In order to prepare for the conversion to IFRS, Erie Mutual Fire Insurance Company has developed an IFRS conversion plan. The IFRS conversion plan is well underway with key IFRS standards analyzed and compared against Erie Mutual's current Canadian GAAP policies. The key accounting policy alternatives have been identified including contract classification and first-time adoption of IFRS, however final decisions are pending. The impacts of these decisions are currently being addressed. Developments relating to existing standards and new standards are being monitored to assess the impact on the conversion plan. Our transition status is currently on track with our implementation schedule.

15. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the current year's presentation.