

ERIE INDEMNITY CO
Form 10-Q
November 01, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

Commission file number 0-24000

ERIE INDEMNITY COMPANY
(Exact name of registrant as specified in its charter)

PENNSYLVANIA
(State or other jurisdiction of
incorporation or organization)

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

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

16530
(Zip Code)

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

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark 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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of the registrant's Class A Common Stock as of the latest practicable date, with no par value and a stated value of \$0.0292 per share, was 47,071,095 at October 17, 2012.

The number of shares outstanding of the registrant's Class B Common Stock as of the latest practicable date, with no par value and a stated value of \$70 per share, was 2,544 at October 17, 2012.

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	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Revenues				
Premiums earned	\$1,137	\$1,061	\$3,333	\$3,138
Net investment income	105	108	326	326
Net realized investment gains (losses)	169	(422)	358	(234)
Net impairment losses recognized in earnings	0	0	0	0
Equity in earnings of limited partnerships	41	40	99	150
Other income	8	9	24	26
Total revenues	1,460	796	4,140	3,406
Benefits and expenses				
Insurance losses and loss expenses	912	848	2,571	2,724
Policy acquisition and underwriting expenses	278	253	835	749
Total benefits and expenses	1,190	1,101	3,406	3,473
Income (loss) from operations before income taxes and noncontrolling interest	270	(305)	734	(67)
Provision for income taxes	86	(125)	234	(54)
Net income (loss)	184	(180)	500	(13)
Less: Net income (loss) attributable to noncontrolling interest in consolidated entity				
Exchange	133	(227)	370	(156)
Net income attributable to Indemnity	\$ 51	\$ 47	\$ 130	\$ 143
Earnings Per Share				
Net income attributable to Indemnity per share				
Class A common stock basic	\$ 1.08	\$ 0.97	\$ 2.73	\$ 2.90
Class A common stock diluted	\$ 0.96	\$ 0.87	\$ 2.43	\$ 2.59
Class B common stock basic and diluted	\$162.02	\$146.67	\$ 410.89	\$439.39
Weighted average shares outstanding attributable to Indemnity Basic				
Class A common stock	47,188,741	48,503,383	47,476,693	49,176,124
Class B common stock	2,544	2,546	2,544	2,546
Weighted average shares outstanding attributable to Indemnity Diluted				
Class A common stock	53,374,846	54,685,021	53,662,798	55,357,762
Class B common stock	2,544	2,546	2,544	2,546

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Dividends declared per share

Class A common stock	\$ 0.5525	\$ 0.515	\$ 1.6575	\$ 1.545
Class B common stock	\$82.8750	\$77.250	\$248.6250	\$231.750

See accompanying notes to Consolidated Financial Statements. See Note 14. Indemnity Supplemental Information, for supplemental statements of operations information.

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ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in millions)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net income (loss)	\$ 184	\$(180)	\$ 500	\$ (13)
Other comprehensive income (loss)				
Change in unrealized holding gains on investments, net of tax expense (benefit) of \$59, \$(16), \$112 and \$11, respectively	110	(29)	208	20
Reclassification adjustment for gross gains included in net income, net of tax expense of \$5, \$5, \$13 and \$23, respectively	(11)	(8)	(25)	(44)
Other comprehensive income (loss)	99	(37)	183	(24)
Unrealized gains transferred to noncontrolling interest on sale of life affiliate, net of tax expense of \$0, \$0, \$0 and \$4, respectively				9
Comprehensive income (loss)	283	(217)	683	(28)
Less: Comprehensive income (loss) attributable to noncontrolling interest in consolidated entity	230	(263)	549	(169)
Total comprehensive income Indemnity	\$ 53	\$ 46	\$ 134	\$ 141

See accompanying notes to Consolidated Financial Statements.

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ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(dollars in millions, except per share data)

	September 30, 2012 (Unaudited)	December 31, 2011
Assets		
Investments Indemnity		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of \$531 and \$535, respectively)	\$ 547	\$ 548
Equity securities (cost of \$27 and \$24, respectively)	29	25
Trading securities, at fair value (cost of \$24 and \$23, respectively)	30	27
Limited partnerships (cost of \$171 and \$185, respectively)	195	208
Other invested assets	1	1
Investments Exchange		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of \$6,909 and \$6,829, respectively)	7,623	7,292
Equity securities (cost of \$543 and \$531, respectively)	624	564
Trading securities, at fair value (cost of \$2,104 and \$2,021, respectively)	2,639	2,308
Limited partnerships (cost of \$976 and \$1,003, respectively)	1,083	1,082
Other invested assets	20	19
Total investments	12,791	12,074
Cash and cash equivalents (Exchange portion of \$392 and \$174, respectively)	404	185
Premiums receivable from policyholders Exchange	1,100	976
Reinsurance recoverable Exchange	165	166
Deferred income taxes Indemnity	16	19
Deferred acquisition costs Exchange	505	487
Other assets (Exchange portion of \$448 and \$322, respectively)	563	441
Total assets	\$15,544	\$14,348
Liabilities and shareholders equity		
Liabilities		
Indemnity liabilities		
Other liabilities	\$ 472	\$ 455
Exchange liabilities		
Losses and loss expense reserves	3,598	3,499
Life policy and deposit contract reserves	1,721	1,671
Unearned premiums	2,420	2,178
Deferred income taxes	367	147
Other liabilities	123	105
Total liabilities	8,701	8,055
Indemnity shareholders equity		
Class A common stock, stated value \$0.0292 per share; 74,996,930 shares authorized; 68,294,400 and 68,289,600 shares issued, respectively; 47,122,718 and 47,861,842 shares outstanding, respectively	2	2
Class B common stock, convertible at a rate of 2,400 Class A shares for one Class B share, stated value \$70 per share; 2,544 and 2,546 shares authorized, issued and outstanding, respectively	0	0
Additional paid-in-capital	16	16
Accumulated other comprehensive loss	(101)	(105)
Retained earnings	1,945	1,894
Total contributed capital and retained earnings	1,862	1,807
Treasury stock, at cost, 21,171,682 and 20,427,758 shares, respectively	(1,080)	(1,026)
Total Indemnity shareholders equity	782	781
Noncontrolling interest in consolidated entity Exchange	6,061	5,512
Total equity	6,843	6,293
Total liabilities, shareholders equity and noncontrolling interest	\$15,544	\$14,348

See accompanying notes to Consolidated Financial Statements. See Note 14. Indemnity Supplemental Information, for supplemental consolidating statements of financial position information.

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ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in millions)

	Nine months ended September 30,	
	2012	2011
Cash flows from operating activities		
Premiums collected	\$ 3,452	\$ 3,213
Net investment income received	346	340
Limited partnership distributions	94	93
Service agreement fee received	23	25
Commissions and bonuses paid to agents	(470)	(450)
Losses paid	(2,050)	(2,221)
Loss expenses paid	(352)	(331)
Other underwriting and acquisition costs paid	(432)	(406)
Income taxes paid	(246)	(38)
Net cash provided by operating activities	365	225
Cash flows from investing activities		
Purchase of investments:		
Fixed maturities	(1,466)	(1,482)
Preferred stock	(118)	(100)
Common stock	(750)	(1,198)
Limited partnerships	(64)	(108)
Sales/maturities of investments:		
Fixed maturity sales	535	525
Fixed maturity calls/maturities	877	722
Preferred stock	106	63
Common stock	733	1,107
Sale of and returns on limited partnerships	141	82
Net purchase of property and equipment	(27)	(5)
Net distributions on agent loans	0	(1)
Net distributions on life policy loans	(1)	0
Net cash used in investing activities	(34)	(395)
Cash flows from financing activities		
Annuity deposits and interest	72	74
Annuity surrenders and withdrawals	(59)	(60)
Universal life deposits and interest	17	24
Universal life surrenders	(7)	(13)
Purchase of treasury stock	(55)	(132)
Dividends paid to shareholders	(80)	(77)
Net cash used in financing activities	(112)	(184)
Net increase (decrease) in cash and cash equivalents	219	(354)
Cash and cash equivalents at beginning of period	185	430
Cash and cash equivalents at end of period	\$ 404	\$ 76

See accompanying notes to Consolidated Financial Statements. See Note 14. Indemnity Supplemental Information, for supplemental cash flow information.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Nature of Operations

Erie Indemnity Company (Indemnity) is a publicly held Pennsylvania business corporation that has been the managing attorney-in-fact for the subscribers (policyholders) at the Erie Insurance Exchange (Exchange) since 1925. The Exchange is a subscriber-owned, Pennsylvania-domiciled reciprocal insurer that writes property and casualty insurance.

Indemnity's primary function is to perform certain services for the Exchange relating to the sales, underwriting and issuance of policies on behalf of the Exchange. This is done in accordance with a subscriber's agreement (a limited power of attorney) executed by each subscriber (policyholder), which appoints Indemnity as their common attorney-in-fact to transact business on their behalf and to manage the affairs of the Exchange. Pursuant to the subscriber's agreement and for its services as attorney-in-fact, Indemnity earns a management fee calculated as a percentage of the direct premiums written by the Exchange and the other members of the Property and Casualty Group (defined below), which are assumed by the Exchange under an intercompany pooling arrangement.

Indemnity has the power to direct the activities of the Exchange that most significantly impact the Exchange's economic performance by acting as the common attorney-in-fact and decision maker for the subscribers (policyholders) at the Exchange.

The Exchange, together with its wholly owned subsidiaries, Erie Insurance Company (EIC), Erie Insurance Company of New York (ENY), Erie Insurance Property and Casualty Company (EPC), and Flagship City Insurance Company (Flagship), operate as a property and casualty insurer and are collectively referred to as the Property and Casualty Group . The Property and Casualty Group operates in 11 Midwestern, Mid-Atlantic and Southeastern states and the District of Columbia.

Erie Family Life Insurance Company (EFL) is an affiliated life insurance company that underwrites and sells individual and group life insurance policies and fixed annuities. On March 31, 2011, Indemnity sold its 21.6% ownership interest in EFL to the Exchange.

All property and casualty and life insurance operations are owned by the Exchange, and Indemnity functions solely as the management company.

The consolidated financial statements of Erie Indemnity Company reflect the results of Indemnity and its variable interest entity, the Exchange, which we refer to collectively as the Erie Insurance Group (we, us, our).

Indemnity shareholder interest refers to the interest in Erie Indemnity Company owned by the Class A and Class B shareholders. Noncontrolling interest refers to the interest in the Erie Insurance Exchange held for the subscribers (policyholders).

Note 2. Significant Accounting Policies

Basis of presentation

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) and include the accounts of Indemnity together with its affiliate companies in which Indemnity holds a majority voting or economic interest.

The preparation of financial statements in conformity with GAAP requires us 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. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods have been included. Operating results for the nine month period ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. The accompanying consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission on February 27, 2012.

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Principles of consolidation

We consolidate the Exchange as a variable interest entity for which Indemnity is the primary beneficiary. All intercompany accounts and transactions have been eliminated in consolidation. The required presentation of noncontrolling interests is reflected in the consolidated financial statements. Noncontrolling interests represent the ownership interests of the Exchange, all of which is held by parties other than Indemnity (i.e. the Exchange's subscribers (policyholders)). Noncontrolling interests also include the Exchange subscribers' ownership interest in EFL.

Presentation of assets and liabilities While the assets of the Exchange are presented separately in the Consolidated Statements of Financial Position, the Exchange's assets can only be used to satisfy the Exchange's liabilities or for other unrestricted activities. Accounting Standards Codification (ASC) 810, *Consolidation*, does not require separate presentation of the Exchange's assets; however, because the shareholders of Indemnity have no rights to the assets of the Exchange and, conversely, the Exchange has no rights to the assets of Indemnity, we have presented the invested assets of the Exchange separately on the Consolidated Statements of Financial Position along with the remaining consolidated assets reflecting the Exchange's portion parenthetically. Liabilities are required under ASC 810, *Consolidation*, to be presented separately for the Exchange on the Consolidated Statements of Financial Position as the Exchange's creditors do not have recourse to the general credit of Indemnity.

Rights of shareholders of Indemnity and subscribers (policyholders) of the Exchange The shareholders of Indemnity, through the management fee, have a controlling financial interest in the Exchange; however, they have no other rights to or obligations arising from assets and liabilities of the Exchange. The shareholders of Indemnity own its equity but have no rights or interest in the Exchange's (noncontrolling interest) income or equity. The noncontrolling interest equity represents the Exchange's equity held for the interest of its subscribers (policyholders), who have no rights or interest in the Indemnity shareholder interest income or equity.

All intercompany assets, liabilities, revenues and expenses between Indemnity and the Exchange have been eliminated in the Consolidated Financial Statements.

Adopted accounting pronouncements

In October 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. This guidance modifies the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal insurance contracts. The amendments in this guidance specify that the costs are limited to incremental direct costs that result directly from successful contract transactions and would not have been incurred by the insurance entity had the contract transactions not occurred. These costs must be directly related to underwriting, policy issuance and processing, medical and inspection reports and sales force contract selling. The amendments also specify that advertising costs are only included as deferred acquisition costs if the direct-response advertising criteria are met. ASU 2010-26 was effective for interim and annual reporting periods beginning after December 15, 2011. We have elected to prospectively adopt this guidance. The change does not affect the Indemnity shareholder interest nor does it affect Indemnity earnings per share. Acquisition costs capitalized during the three and nine months ended September 30, 2012 totaled \$195 million and \$559 million, respectively. Acquisition costs that would have been capitalized during the three and nine months ended September 30, 2012 using the previous method of capitalization totaled \$200 million and \$574 million, respectively. Included in this note below is our updated accounting policy under the caption *Deferred acquisition costs*.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurements*. This guidance changes the description of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements and certain other changes to converge with the fair value guidance of the International Accounting Standards Board (IASB). The amendments in this guidance detail the requirements specific to

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measuring the fair value of an instrument classified in a reporting entity's shareholders' equity. The amendments also clarify that a reporting entity should disclose quantitative information about the significant unobservable inputs used in the fair value measurement categorized within Level 3 of the fair value hierarchy. ASU 2011-04 was effective for interim and annual periods beginning after December 15, 2011. The adoption of this new guidance did not have a material impact on our consolidated financial statements. The additional disclosures required by this guidance have been included in Note 6. Fair Value .

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In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income*. This guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in shareholders' equity. The amendments in this guidance specify that an entity has the option to present the total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The disclosures required remain the same. In both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 was effective for interim and annual periods beginning after December 15, 2011. In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income - Deferral of The Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05*. The amendments in this ASU supersede changes to paragraphs in ASU 2011-05 that pertain to how, when and where reclassification adjustments are presented. We have elected to present total comprehensive income in two separate but consecutive statements. The disclosures required by this guidance have been included in the Consolidated Statements of Operations and the Consolidated Statements of Comprehensive Income.

Deferred acquisition costs

Acquisition costs that vary with and relate to the successful production of insurance and investment-type contracts are deferred. Beginning in 2012, deferred acquisition costs (DAC) are incremental direct costs of contract acquisition and are limited to the successful acquisition of new and renewal contracts. Such costs consist principally of commissions, premium taxes and policy issuance expenses.

Property and casualty insurance DAC related to property and casualty insurance contracts are primarily composed of commissions, premium taxes and certain underwriting expenses. These costs are amortized on a pro rata basis over the applicable policy term. We consider investment income in determining if a premium deficiency exists, and if so, it would first be recognized by charging any unamortized acquisition costs to expense to the extent required to eliminate the deficiency. If the premium deficiency would be greater than unamortized acquisition costs, a liability would be accrued for the excess deficiency.

There was no reduction in costs deferred in any periods presented. Profitability is analyzed annually to ensure recoverability.

Life insurance DAC related to traditional life insurance products is amortized in proportion to premium revenues over the premium-paying period of related policies using assumptions about mortality, morbidity, lapse rates, expenses and future yield on related investments established when the policy was issued. Amortization is adjusted each period to reflect policy lapse or termination rates as compared to anticipated experience. DAC related to universal life products and deferred annuities is amortized over the estimated lives of the contracts in proportion to actual and expected future gross profits, investment, mortality, expense margins and surrender charges. Both historical and anticipated investment returns, including realized gains and losses, are considered in determining the amortization of DAC.

Estimated gross profits are adjusted monthly to reflect actual experience to date and/or for the unlocking of underlying key assumptions based upon experience studies. DAC is periodically reviewed for recoverability. For traditional life products, if the benefit reserves plus anticipated future premiums and interest earnings for a line of business are less than the current estimate of future benefits and expenses (including any unamortized DAC), a charge to income is recorded for additional DAC amortization or for increased benefit reserves. For universal life and deferred annuities, if the current present value of future expected gross profits is less than the unamortized DAC, a charge to income is recorded for additional DAC amortization.

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Basic earnings per share are calculated under the two-class method, which allocates earnings to each class of stock based on its dividend rights. Class B shares are convertible into Class A shares at a conversion ratio of 2,400 to 1. Class A diluted earnings per share are calculated under the if-converted method, which reflects the conversion of Class B shares and the effect of any potentially dilutive outstanding vested and not yet vested awards related to our outside directors' stock compensation plan and any employee stock based awards. In the first quarter of 2012, two shares of Class B common stock were converted into 4,800 shares of Class A common stock. See Note 15. Indemnity Capital Stock .

A reconciliation of the numerators and denominators used in the basic and diluted per-share computations is presented as follows for each class of Indemnity common stock:

<i>(dollars in millions, except per share data)</i>	Indemnity Shareholder Interest Three months ended September 30,					
	Allocated net income (numerator)	2012 Weighted shares (denominator)	Per- share amount	Allocated net income (numerator)	2011 Weighted shares (denominator)	Per- share amount
Class A Basic EPS:						
Income available to Class A stockholders	\$51	47,188,741	\$ 1.08	\$47	48,503,383	\$ 0.97
Dilutive effect of stock-based awards	0	80,505		0	71,238	
Assumed conversion of Class B shares	0	6,105,600		0	6,110,400	
Class A Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	\$51	53,374,846	\$ 0.96	\$47	54,685,021	\$ 0.87
Class B Basic and diluted EPS:						
Income available to Class B stockholders	\$ 0	2,544	\$162.02	\$ 0	2,546	\$146.67

<i>(dollars in millions, except per share data)</i>	Indemnity Shareholder Interest Nine months ended September 30,					
	Allocated net income (numerator)	2012 Weighted shares (denominator)	Per- share amount	Allocated net income (numerator)	2011 Weighted shares (denominator)	Per- share amount
Class A Basic EPS:						
Income available to Class A stockholders	\$129	47,476,693	\$ 2.73	\$142	49,176,124	\$ 2.90
Dilutive effect of stock-based awards	0	80,505		0	71,238	
Assumed conversion of Class B shares	1	6,105,600		1	6,110,400	
Class A Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	\$130	53,662,798	\$ 2.43	\$143	55,357,762	\$ 2.59
Class B Basic and diluted EPS:						

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Income available to Class B
stockholders

\$ 1	2,544	\$410.89	\$ 1	2,546	\$439.39
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Note 4. Variable Interest Entity

Erie Insurance Exchange

The Exchange is a reciprocal insurance exchange domiciled in Pennsylvania, for which Indemnity serves as attorney-in-fact. Indemnity holds a variable interest in the Exchange due to the absence of decision-making capabilities by the equity owners (subscribers/policyholders) of the Exchange and due to the significance of the management fee the Exchange pays to Indemnity as its decision maker. As a result, Indemnity is deemed to have a controlling financial interest in the Exchange and is considered to be its primary beneficiary.

Consolidation of the Exchange's financial results is required given the significance of the management fee to the Exchange and because Indemnity has the power to direct the activities of the Exchange that most significantly impact the Exchange's economic performance. The Exchange's anticipated economic performance is the product of its underwriting results combined with its investment results. The fees paid to Indemnity under the subscriber's agreement impact the anticipated economic performance attributable to the Exchange's results. Indemnity earns a management fee from the Exchange for the services it provides as attorney-in-fact. Indemnity's management fee revenues are based on all premiums written or assumed by the Exchange. Indemnity's Board of Directors determines the management fee rate to be paid by the Exchange to Indemnity. This rate cannot exceed 25% of the direct and affiliated assumed written premiums of the Exchange, as defined by the subscriber's agreement signed by each policyholder. Management fee revenues and management fee expenses are eliminated upon consolidation.

The shareholders of Indemnity have no rights to the assets of the Exchange and no obligations arising from the liabilities of the Exchange. Indemnity has no obligation related to any underwriting and/or investment losses experienced by the Exchange. Indemnity would, however, be adversely impacted if the Exchange incurred significant underwriting and/or investment losses. If the surplus of the Exchange were to decline significantly from its current level, its financial strength ratings could be reduced and, as a consequence, the Exchange could find it more difficult to retain its existing business and attract new business. A decline in the business of the Exchange would have an adverse effect on the amount of the management fees Indemnity receives. In addition, a decline in the surplus of the Exchange from its current level may impact the management fee rate received by Indemnity. Indemnity also has an exposure to a concentration of credit risk related to the unsecured receivables due from the Exchange for its management fee. If any of these events occurred, Indemnity's financial position, financial performance and/or cash flows could be adversely impacted.

On March 31, 2011, Indemnity sold its 21.6% ownership interest in EFL to the Exchange. All property and casualty and life insurance operations are owned by the Exchange, and Indemnity functions solely as the management company.

Indemnity has not provided financial or other support to the Exchange for the reporting periods presented. At September 30, 2012, there are no explicit or implicit arrangements that would require Indemnity to provide future financial support to the Exchange. Indemnity is not liable if the Exchange was to be in violation of its debt covenants or was unable to meet its obligation for unfunded commitments to limited partnerships.

Note 5. Segment Information

Our reportable segments include management operations, property and casualty insurance operations, life insurance operations and investment operations. Accounting policies for segments are the same as those described in the summary of significant accounting policies. See Item 8.

Financial Statements and Supplementary Data, Note 2. Significant Accounting Policies, in our Annual Report on Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission on February 27, 2012. Assets are not allocated to the segments but rather are reviewed in total for purposes of decision-making. No single customer or agent provides 10% or more of revenues.

Management operations

Our management operations segment consists of Indemnity serving as attorney-in-fact for the Exchange. Indemnity operates in this capacity solely for the Exchange. We evaluate profitability of our management operations segment principally on the gross margin from management operations. Indemnity earns a management fee from the Exchange for providing sales, underwriting and policy issuance services. Management fee revenue, which is eliminated in consolidation, is calculated as a percentage not to exceed 25% of all the direct premiums written by the Exchange and the other members of the Property and Casualty Group, which are assumed by the Exchange under an intercompany pooling arrangement. The Property and Casualty Group issues policies with annual terms only. Management fees are recorded upon policy issuance or renewal, as substantially all of the services required to be performed by Indemnity have been satisfied at that time. Certain activities are performed and related costs are incurred by us subsequent to policy issuance in connection with the services provided to the Exchange; however, these activities are inconsequential and perfunctory. Although these management fee revenues and expenses are eliminated upon consolidation, the amount of the fee directly impacts the allocation of our consolidated net income between the noncontrolling interest, which bears the management fee expense and represents the interests of the Exchange subscribers (policyholders), and Indemnity's interest, which earns the management fee revenue and represents the Indemnity shareholder interest in net income.

Additionally, the nine months ended September 30, 2012 include an adjustment that reduced commission expense by \$6 million which occurred in the second quarter of 2012. This amount represents the reimbursement by the North Carolina Reinsurance Facility (NCRF) for commissions Indemnity paid to agents on the surcharges collected on behalf of the NCRF in prior periods. This amount was incorrectly recorded as a benefit to the Exchange in prior periods. If these amounts had been correctly recorded, Indemnity's commission expense would have been lower by \$0.5 million and \$0.7 million, for the years ended December 31, 2011 and 2010, respectively.

Property and casualty insurance operations

Our property and casualty insurance operations segment includes personal and commercial lines. Personal lines consist primarily of personal auto and homeowners and are marketed to individuals. Commercial lines consist primarily of commercial multi-peril, commercial auto and workers compensation and are marketed to small- and medium-sized businesses. Our property and casualty policies are sold by independent agents. Our property and casualty insurance underwriting operations are conducted through the Exchange and its subsidiaries and include assumed voluntary reinsurance from nonaffiliated domestic and foreign sources, assumed involuntary and ceded reinsurance business. The Exchange exited the assumed voluntary reinsurance business effective December 31, 2003, and therefore unaffiliated reinsurance includes only run-off activity of the previously assumed voluntary reinsurance business. We evaluate profitability of the property and casualty insurance operations principally based upon net underwriting results represented by the combined ratio.

Life insurance operations

Our life insurance operations segment includes traditional and universal life insurance products and fixed annuities marketed to individuals using the same independent agency force utilized by our property and casualty insurance operations. We evaluate profitability of the life insurance segment principally based upon segment net income, including investments, which for segment purposes are reflected in the investment operations segment. At the same time, we recognize that investment-related income is integral to the evaluation of the life insurance segment.

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because of the long duration of life products. For the third quarters of 2012 and 2011, investment activities on life insurance related assets generated revenues of \$25 million and \$29 million, respectively, resulting in EFL reporting income before income taxes of \$12 million and \$13 million, respectively, before intercompany eliminations. For the nine months ended September 30, 2012 and 2011, investment activities on life insurance related assets generated revenues of \$77 million and \$83 million, respectively, resulting in EFL reporting income before taxes of \$34 million and \$38 million, respectively, before intercompany eliminations.

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Investment operations

The investment operations segment performance is evaluated based upon appreciation of assets, rate of return and overall return. Investment related income for the life operations is included in the investment segment results.

The following tables summarize the components of the Consolidated Statements of Operations by reportable business segment:

Erie Insurance Group						
For the three months ended September 30, 2012						
<i>(in millions)</i>	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		\$1,118	\$19			\$1,137
Net investment income				\$108	\$ (3)	105
Net realized investment gains				169		169
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				41		41
Management fee revenue	\$305				(305)	
Service agreement and other revenue	8		0			8
Total revenues	313	1,118	19	318	(308)	1,460
Cost of management operations	247				(247)	
Insurance losses and loss expenses		890	24		(2)	912
Policy acquisition and underwriting expenses		329	8		(59)	278
Total benefits and expenses	247	1,219	32		(308)	1,190
Income (loss) before income taxes	66	(101)	(13)	318		270
Provision for income taxes	23	(36)	(4)	103		86
Net income (loss)	\$ 43	\$ (65)	\$ (9)	\$215	\$	\$ 184

Erie Insurance Group						
For the three months ended September 30, 2011						
<i>(in millions)</i>	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		\$1,045	\$ 16			\$1,061
Net investment income				\$ 111	\$ (3)	108
Net realized investment losses				(422)		(422)
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				40		40
Management fee revenue	\$280				(280)	
Service agreement and other revenue	8		1			9
Total revenues (losses)	288	1,045	17	(271)	(283)	796
Cost of management operations	226				(226)	
Insurance losses and loss expenses		823	26		(1)	848
Policy acquisition and underwriting expense		302	7		(56)	253
Total benefits and expenses	226	1,125	33		(283)	1,101
Income (loss) before income taxes	62	(80)	(16)	(271)		(305)
Provision for income taxes	22	(28)	(6)	(113)		(125)
Net income (loss)	\$ 40	\$ (52)	\$(10)	\$(158)	\$	\$ (180)

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Erie Insurance Group
For the nine months ended September 30, 2012

(in millions)

	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		\$3,279	\$ 55		\$ (1)	\$3,333
Net investment income				\$334	(8)	326
Net realized investment gains				358		358
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				99		99
Management fee revenue	\$882				(882)	
Service agreement and other revenue	23		1			24
Total revenues	905	3,279	56	791	(891)	4,140
Cost of management operations	734				(734)	
Insurance losses and loss expenses		2,501	74		(4)	2,571
Policy acquisition and underwriting expenses		963	25		(153)	835
Total benefits and expenses	734	3,464	99		(891)	3,406
Income (loss) before income taxes	171	(185)	(43)	791		734
Provision for income taxes	60	(65)	(15)	254		234
Net income (loss)	\$111	\$ (120)	\$(28)	\$537	\$	\$ 500

Erie Insurance Group
For the nine months ended September 30, 2011

(in millions)

	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		\$3,089	\$ 50		\$ (1)	\$3,138
Net investment income				\$ 334	(8)	326
Net realized investment losses				(234)		(234)
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				150		150
Management fee revenue	\$816				(816)	
Service agreement and other revenue	25		1			26
Total revenues	841	3,089	51	250	(825)	3,406
Cost of management operations	667				(667)	
Insurance losses and loss expenses		2,653	75		(4)	2,724
Policy acquisition and underwriting expenses		882	21		(154)	749
Total benefits and expenses	667	3,535	96		(825)	3,473
Income (loss) before income taxes	174	(446)	(45)	250		(67)
Provision for income taxes	61	(156)	(16)	57		(54)
Net income (loss)	\$113	\$ (290)	\$(29)	\$ 193	\$	\$ (13)

See the Results of the Erie Insurance Group's Operations by Interest table in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for the composition of income attributable to the Indemnity shareholder interest and income attributable to the noncontrolling interest (Exchange).

Note 6. Fair Value

Our available-for-sale and trading securities are recorded at fair value, which is the price that would be received to sell the asset in an orderly transaction between willing market participants as of the measurement date.

Valuation techniques used to derive the fair value of our available-for-sale and trading securities are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources. Unobservable inputs reflect our own assumptions regarding fair market value for these securities. Although the majority of our prices are obtained from third party sources, we also perform an internal pricing review for securities with low trading volumes in the current market conditions. Financial instruments are categorized based upon the following characteristics or inputs to the valuation techniques:

- Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.
- Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 Unobservable inputs for the asset or liability.

Estimates of fair values for our investment portfolio are obtained primarily from a nationally recognized pricing service. Our Level 1 category includes those securities valued using an exchange traded price provided by the pricing service. The methodologies used by the pricing service that support a Level 2 classification of a financial instrument include multiple verifiable, observable inputs including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. Pricing service valuations for Level 3 securities are based upon proprietary models and are used when observable inputs are not available or in illiquid markets.

In limited circumstances we adjust the price received from the pricing service when, in our judgment, a better reflection of fair value is available based upon corroborating information and our knowledge and monitoring of market conditions such as a disparity in price of comparable securities and/or non-binding broker quotes. In other circumstances, certain securities are internally priced because prices are not provided by the pricing service.

We perform continuous reviews of the prices obtained from the pricing service. This includes evaluating the methodology and inputs used by the pricing service to ensure that we determine the proper classification level of the financial instrument. Price variances, including large periodic changes, are investigated and corroborated by market data. We have reviewed the pricing methodologies of our pricing service as well as other observable inputs, such as data, and transaction volumes and believe that their prices adequately consider market activity in determining fair value. Our review process continues to evolve based upon accounting guidance and requirements.

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When a price from the pricing service is not available, values are determined by obtaining non-binding broker quotes and/or market comparables. When available, we obtain multiple quotes for the same security. The ultimate value for these securities is determined based upon our best estimate of fair value using corroborating market information. Our evaluation includes the consideration of benchmark yields, reported trades, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data.

For certain structured securities in an illiquid market, there may be no prices available from a pricing service and no comparable market quotes available. In these situations, we value the security using an internally-developed, risk-adjusted discounted cash flow model.

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The following table represents the fair value measurements on a recurring basis for our consolidated available-for-sale and trading securities by asset class and level of input at September 30, 2012:

<i>(in millions)</i>	Total	Erie Insurance Group September 30, 2012 Fair value measurements using:		
		Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3
Indemnity				
Available-for-sale securities:				
States & political subdivisions	\$ 195	\$ 0	\$ 195	\$ 0
Corporate debt securities	335	0	334	1
Commercial mortgage-backed securities (CMBS)	6	0	6	0
Collateralized debt obligations (CDO)	3	0	0	3
Other debt securities	8	0	8	0
Total fixed maturities	547	0	543	4
Nonredeemable preferred stock	29	8	21	0
Total available-for-sale securities	576	8	564	4
Trading securities:				
Common stock	30	30	0	0
Total trading securities	30	30	0	0
Total available-for-sale and trading securities Indemnity	\$ 606	\$ 38	\$ 564	\$ 4
Exchange				
Available-for-sale securities:				
U.S. government & agencies	\$ 17	\$ 5	\$ 12	\$ 0
States & political subdivisions	1,348	0	1,344	4
Foreign government securities	16	0	16	0
Corporate debt securities	5,886	6	5,846	34
Residential mortgage-backed securities (RMBS)	174	0	174	0
Commercial mortgage-backed securities (CMBS)	72	0	72	0
Collateralized debt obligations (CDO)	62	0	16	46
Other debt securities	48	0	43	5
Total fixed maturities	7,623	11	7,523	89
Nonredeemable preferred stock	624	263	355	6
Total available-for-sale securities	8,247	274	7,878	95
Trading securities:				
Common stock	2,639	2,626	0	13
Total trading securities	2,639	2,626	0	13
Total available-for-sale and trading securities Exchange	\$10,886	\$2,900	\$7,878	\$108
Total available-for-sale and trading securities Erie Insurance Group	\$11,492	\$2,938	\$8,442	\$112

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Level 3 Assets Quarterly Change:

Erie Insurance Group

<i>(in millions)</i>	Beginning balance at June 30, 2012	Included in earnings (1)	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 (2)	Ending balance at September 30, 2012
Indemnity							
Available-for-sale securities:							
Corporate debt securities	\$ 1	\$ 0	\$0	\$0	\$ 0	\$ 0	\$ 1
Collateralized debt obligations (CDO)	4	0	0	0	(1)	0	3
Total fixed maturities	5	0	0	0	(1)	0	4
Total available-for-sale securities	5	0	0	0	(1)	0	4
Trading securities:							
Common stock	0	0	0	0	0	0	0
Total trading securities	0	0	0	0	0	0	0
Total Level 3 assets Indemnity	\$ 5	\$ 0	\$0	\$0	\$(1)	\$ 0	\$ 4
Exchange							
Available-for-sale securities:							
States & political subdivisions	\$ 4	\$ 0	\$0	\$0	\$ 0	\$ 0	\$ 4
Corporate debt securities	23	0	1	0	0	10	34
Collateralized debt obligations (CDO)	27	0	0	0	(4)	23	46
Other debt securities	5	0	0	0	0	0	5
Total fixed maturities	59	0	1	0	(4)	33	89
Nonredeemable preferred stock	5	0	1	0	0	0	6
Total available-for-sale securities	64	0	2	0	(4)	33	95
Trading securities:							
Common stock	14	(1)	0	0	0	0	13
Total trading securities	14	(1)	0	0	0	0	13
Total Level 3 assets Exchange	\$78	\$(1)	\$2	\$0	\$(4)	\$33	\$108
Total Level 3 assets Erie Insurance Group	\$83	\$(1)	\$2	\$0	\$(5)	\$33	\$112

(1) Includes losses as a result of other-than-temporary impairments and accrual of discount and amortization of premium. These amounts are reported in the Consolidated Statements of Operations. There were no unrealized gains included in earnings for the three months ended September 30, 2012 on Level 3 securities.

(2) Transfers in and out of Level 3 are attributable to changes in the availability of market observable information for individual securities within the respective categories. Transfers in and out of levels are recognized at the start of the period.

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Level 3 Assets Year-to-Date Change:

Erie Insurance Group

<i>(in millions)</i>	Beginning balance at December 31, 2011	Included in earnings (1)	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 (2)	Ending balance at September 30, 2012
Indemnity							
Available-for-sale securities:							
Corporate debt securities	\$ 0	\$0	\$0	\$0	\$ 0	\$ 1	\$ 1
Collateralized debt obligations (CDO)	4	0	0	0	(1)	0	3
Total fixed maturities	4	0	0	0	(1)	1	4
Total available-for-sale securities	4	0	0	0	(1)	1	4
Trading securities:							
Common stock	0	0	0	0	0	0	0
Total trading securities	0	0	0	0	0	0	0
Total Level 3 assets Indemnity	\$ 4	\$0	\$0	\$0	\$ (1)	\$ 1	\$ 4
Exchange							
Available-for-sale securities:							
States & political subdivisions	\$ 4	\$0	\$0	\$0	\$ 0	\$ 0	\$ 4
Corporate debt securities	12	0	1	1	(5)	25	34
Collateralized debt obligations (CDO)	29	1	3	0	(7)	20	46
Other debt securities	5	0	0	0	0	0	5
Total fixed maturities	50	1	4	1	(12)	45	89
Nonredeemable preferred stock	5	0	1	0	0	0	6
Total available-for-sale securities	55	1	5	1	(12)	45	95
Trading securities:							
Common stock	12	2	0	0	(1)	0	13
Total trading securities	12	2	0	0	(1)	0	13
Total Level 3 assets Exchange	\$67	\$3	\$5	\$1	\$(13)	\$45	\$108
Total Level 3 assets Erie Insurance Group	\$71	\$3	\$5	\$1	\$(14)	\$46	\$112

(1) Includes losses as a result of other-than-temporary impairments and accrual of discount and amortization of premium. These amounts are reported in the Consolidated Statements of Operations. There was \$2 million in unrealized gains included in earnings for the nine months ended September 30, 2012 on Level 3 securities.

(2) Transfers in and out of Level 3 are attributable to changes in the availability of market observable information for individual securities within the respective categories. Transfers in and out of levels are recognized at the start of the period.

We review the fair value hierarchy classifications each reporting period. Transfers between hierarchy levels may occur due to changes in the available market observable inputs. Transfers in and out of level classifications are reported as having occurred at the beginning of the quarter in which the transfers occurred.

For the three months ended September 30, 2012, transfers of \$44 million from Level 1 to Level 2 and transfers of \$36 million from Level 2 to Level 1 occurred. Trading activity levels for these seven preferred stock securities and one fixed maturity security necessitated reclassification between Level 1 and Level 2. Similarly, for the nine months ended September 30, 2012, transfers of \$59 million from Level 1 to Level 2 and transfers of \$54 million from Level 2 to Level 1 occurred. Trading activity levels for these 12 preferred stock securities necessitated reclassification between Level 1 and Level 2.

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Quantitative and Qualitative Disclosures about Unobservable Inputs

<i>(dollars in millions)</i>	Fair value	No. of holdings	Valuation techniques	Erie Insurance Group September 30, 2012		Weighted average
				Unobservable input	Range	
Indemnity						
Corporate debt securities	\$ 1	1	Market approach	Non-binding broker quote	115.33	
Collateralized debt obligations (CDO)	3	2	Income approach	Projected maturity date	Jun 2014	
				Repayment at maturity	Aug 2015	88.2%
				Discount rate	42-100%	10.8%
				Projected LIBOR rate	7.5-15.0%	
Total Level 3 assets Indemnity	\$ 4	3			0.42%	
Exchange						
States & political subdivisions	\$ 4	1	Market approach	Comparable security yield	0.43%	
				Added yield due to lack of marketability	1.00%	
Corporate debt securities	34	9	Market approach	Non-binding broker quote	107.16 120.00	110.66
				Comparable transaction EBITDA multiples	6.7 17.1x	7.5x
				Comparable security yield	6.00%	
Collateralized debt obligations (CDO)	22	6	Income approach	Projected maturity date	Dec 2012	
				Repayment at maturity	Oct 2035	93.7%
				Discount rate	42-100%	9.1%
				Projected LIBOR rate	7.0-15%	
	24	3	Market approach	Comparable security yield	0-0.55%	
				Added yield due to lack of marketability	1.00-2.80%	
				Non-binding broker quote	8.50	
Other debt securities	5	1	Income approach	Projected maturity date	Jan 2029	
				Repayment at maturity	100%	
				Discount rate	1.83%	
Nonredeemable preferred stock	6	1	Market approach	Comparable security yield	7.21%	
Common stock	13	4	Market approach	Comparable transaction EBITDA multiples	6.7 17.1x	7.5x
				Discount for lack of marketability	5 30%	30%

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Total Level 3 assets	Exchange	\$108	25
Total Level 3 assets	Erie		
Insurance Group		\$112	28

Securities valued using unobservable inputs totaled \$112 million at September 30, 2012. These securities represent less than 0.9% of the total portfolio of the Erie Insurance Group.

Collateralized-debt-obligation securities The unobservable inputs used in the fair value measurement of certain collateralized-debt-obligation securities are the repayment at maturity of underlying collateral available to pay note holders, the projected maturity of the underlying security, an expectation that the London Inter-Bank Offer Rates (LIBOR) do not change until maturity and a discount rate appropriate for the security. Significant changes in any of those inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, a change in the assumption used for the performance of the underlying collateral is accompanied by an opposite change in the maturity and a directionally opposite change in the discount rate used to value the security. LIBOR assumptions are independent of collateral performance.

States and political subdivisions and Nonredeemable preferred stock The unobservable inputs used in the fair value measurement of certain states and political subdivisions and nonredeemable preferred stock are the yields on comparable securities used to provide a basis of valuation and the amount of discount applied to the price due to the illiquidity of the securities being valued. Significant changes in any of those inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, a change in the yield used for the comparable security or a change in the discount for illiquidity would result in a directionally similar change in the yield used to calculate the fair value of the securities being valued.

Corporate debt securities and Other debt securities The unobservable input used in the fair value measurement of certain corporate debt securities and other debt securities is the likelihood of repayment by the underlying entity when there is no market for trading these securities. When available, we obtain non-binding broker quotes to value such securities.

Common stock investments and Corporate debt securities The unobservable inputs used in the fair value measurement of direct private equity common stock investments and certain corporate debt securities are comparable private transaction earnings before interest, taxes, depreciation and amortization (EBITDA) multiples, the average EBITDA multiple for comparable publicly traded companies and the amount of discount applied to the price due to the illiquidity of the securities being valued. Significant changes in any of those inputs in isolation could result in a significantly higher or lower fair value measurement.

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The following table represents the fair value measurements on a recurring basis for our consolidated available-for-sale and trading securities by asset class and level of input at December 31, 2011:

Erie Insurance Group December 31, 2011				
Fair value measurements using:				
<i>(in millions)</i>	Total	Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3
Indemnity				
Available-for-sale securities:				
States & political subdivisions	\$ 221	\$ 0	\$ 221	\$ 0
Corporate debt securities	303	0	303	0
Commercial mortgage-backed securities (CMBS)	13	0	13	0
Collateralized debt obligations (CDO)	4	0	0	4
Other debt securities	7	0	7	0
Total fixed maturities	548	0	544	4
Nonredeemable preferred stock	25	10	15	0
Total available-for-sale securities	573	10	559	4
Trading securities:				
Common stock	27	27	0	0
Total trading securities	27	27	0	0
Total available-for-sale and trading securities Indemnity	\$ 600	\$ 37	\$ 559	\$ 4
Exchange				
Available-for-sale securities:				
U.S. government & agencies	\$ 17	\$ 6	\$ 11	\$ 0
States & political subdivisions	1,379	0	1,375	4
Foreign government securities	15	0	15	0
Corporate debt securities	5,499	20	5,467	12
Residential mortgage-backed securities (RMBS)	189	0	189	0
Commercial mortgage-backed securities (CMBS)	66	0	66	0
Collateralized debt obligations (CDO)	65	0	36	29
Other debt securities	62	0	57	5
Total fixed maturities	7,292	26	7,216	50
Nonredeemable preferred stock	564	188	371	5
Total available-for-sale securities	7,856	214	7,587	55
Trading securities:				
Common stock	2,308	2,296	0	12
Total trading securities	2,308	2,296	0	12
Total available-for-sale and trading securities Exchange	\$10,164	\$2,510	\$7,587	\$67
Total available-for-sale and trading securities Erie Insurance Group	\$10,764	\$2,547	\$8,146	\$71

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Level 3 Assets Quarterly Change:

(in millions)	Erie Insurance Group						Ending balance at September 30, 2011
	Beginning balance at June 30, 2011	Included in earnings (1)	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 (2)	
Indemnity							
Available-for-sale securities:							
Collateralized debt obligations (CDO)	\$ 4	\$0	\$ 0	\$0	\$0	\$0	\$ 4
Total fixed maturities	4	0	0	0	0	0	4
Total available-for-sale securities	4	0	0	0	0	0	4
Trading securities:							
Common stock	0	0	0	0	0	0	0
Total trading securities	0	0	0	0	0	0	0
Total Level 3 assets Indemnity	\$ 4	\$0	\$ 0	\$0	\$0	\$0	\$ 4
Exchange							
Available-for-sale securities:							
States & political subdivisions	\$ 4	\$0	\$ 0	\$0	\$0	\$0	\$ 4
Corporate debt securities	11	0	0	1	0	0	12
Collateralized debt obligations (CDO)	30	0	(1)	0	0	0	29
Other debt securities	5	0	0	0	0	0	5
Total fixed maturities	50	0	(1)	1	0	0	50
Nonredeemable preferred stock	7	0	(1)	0	0	0	6
Total available-for-sale securities	57	0	(2)	1	0	0	56
Trading securities:							
Common stock	13	0	0	0	0	0	13
Total trading securities	13	0	0	0	0	0	13
Total Level 3 assets Exchange	\$70	\$0	\$(2)	\$1	\$0	\$0	\$69
Total Level 3 assets Erie Insurance Group	\$74	\$0	\$(2)	\$1	\$0	\$0	\$73

(1) Includes losses as a result of other-than-temporary impairments and accrual of discount and amortization of premium. These amounts are reported in the Consolidated Statements of Operations. There were no unrealized gains included in earnings for the three months ended September 30, 2011 on Level 3 securities.

(2) Transfers in and out of Level 3 are attributable to changes in the availability of market observable information for individual securities within the respective categories. Transfers in and out of levels are recognized at the start of the period.

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Level 3 Assets Year-to-Date Change:

(in millions)	Erie Insurance Group						
	Beginning balance at December 31, 2010	Included in earnings (1)	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 (2)	Ending balance at September 30, 2011
Indemnity							
Available-for-sale securities:							
Collateralized debt obligations (CDO)	\$ 4	\$0	\$ 0	\$0	\$ 0	\$0	\$ 4
Total fixed maturities	4	0	0	0	0	0	4
Total available-for-sale securities	4	0	0	0	0	0	4
Trading securities:							
Common stock	0	0	0	0	0	0	0
Total trading securities	0	0	0	0	0	0	0
Total Level 3 assets Indemnity	\$ 4	\$0	\$ 0	\$0	\$ 0	\$0	\$ 4
Exchange							
Available-for-sale securities:							
States & political subdivisions	\$ 4	\$0	\$ 0	\$0	\$ 0	\$0	\$ 4
Corporate debt securities	11	0	0	1	0	0	12
Collateralized debt obligations (CDO)	30	1	(1)	0	(1)	0	29
Other debt securities	10	0	0	0	(5)	0	5
Total fixed maturities	55	1	(1)	1	(6)	0	50
Nonredeemable preferred stock	7	0	(1)	0	0	0	6
Total available-for-sale securities	62	1	(2)	1	(6)	0	56
Trading securities:							
Common stock	12	1	0	0	0	0	13
Total trading securities	12	1	0	0	0	0	13
Total Level 3 assets Exchange	\$74	\$2	\$(2)	\$1	\$(6)	\$0	\$69
Total Level 3 assets Erie Insurance Group	\$78	\$2	\$(2)	\$1	\$(6)	\$0	\$73

(1) Includes losses as a result of other-than-temporary impairments and accrual of discount and amortization of premium. These amounts are reported in the Consolidated Statements of Operations. There was \$1 million in unrealized gains included in earnings for the nine months ended September 30, 2011 on Level 3 securities.

(2) Transfers in and out of Level 3 are attributable to changes in the availability of market observable information for individual securities within the respective categories. Transfers in and out of levels are recognized at the start of the period.

There were no transfers between Levels 1 and 2 for the three and nine months ended September 30, 2011.

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The following table sets forth the fair value measurements on a recurring basis for our consolidated available-for-sale and trading securities by pricing source at September 30, 2012:

<i>(in millions)</i>	Erie Insurance Group September 30, 2012			
	Total	Level 1	Level 2	Level 3
Indemnity				
Fixed maturities:				
Priced via pricing services	\$ 543	\$ 0	\$ 543	\$ 0
Priced via market comparables/non-binding broker quotes (1)	1	0	0	1
Priced via unobservable inputs	3	0	0	3
Total fixed maturities	547	0	543	4
Nonredeemable preferred stock:				
Priced via pricing services	27	8	19	0
Priced via market comparables/non-binding broker quotes (1)	2	0	2	0
Priced via unobservable inputs	0	0	0	0
Total nonredeemable preferred stock	29	8	21	0
Common stock:				
Priced via pricing services	30	30	0	0
Priced via market comparables/non-binding broker quotes (1)	0	0	0	0
Priced via unobservable inputs	0	0	0	0
Total common stock	30	30	0	0
Total available-for-sale and trading securities Indemnity	\$ 606	\$ 38	\$ 564	\$ 4
Exchange				
Fixed maturities:				
Priced via pricing services	\$ 7,497	\$11	\$7,486	\$ 0
Priced via market comparables/non-binding broker quotes (1)	92	0	37	55
Priced via unobservable inputs	34	0	0	34
Total fixed maturities	7,623	11	7,523	89
Nonredeemable preferred stock:				
Priced via pricing services	585	263	322	0
Priced via market comparables/non-binding broker quotes (1)	39	0	33	6
Priced via unobservable inputs	0	0	0	0
Total nonredeemable preferred stock	624	263	355	6
Common stock:				
Priced via pricing services	2,626	2,626	0	0
Priced via market comparables/non-binding broker quotes (1)	13	0	0	13
Priced via unobservable inputs	0	0	0	0
Total common stock	2,639	2,626	0	13
Total available-for-sale and trading securities Exchange	\$10,886	\$ 2,900	\$7,878	\$108
Total available-for-sale and trading securities Erie Insurance Group	\$11,492	\$ 2,938	\$8,442	\$112

(1) All broker quotes obtained for securities were non-binding. When a non-binding broker quote was the only price available, the security was classified as Level 3.

There were no assets measured at fair value on a nonrecurring basis during the nine months ended September 30, 2012.

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Note 7. Investments

The following tables summarize the cost and fair value of our available-for-sale securities at September 30, 2012 and December 31, 2011:

<i>(in millions)</i>	Erie Insurance Group September 30, 2012			Estimated fair value
	Amortized cost	Gross unrealized gains	Gross unrealized losses	
Indemnity				
Available-for-sale securities:				
States & political subdivisions	\$ 181	\$ 14	\$ 0	\$ 195
Corporate debt securities	333	2	0	335
Commercial mortgage-backed securities (CMBS)	6	0	0	6
Collateralized debt obligations (CDO)	3	0	0	3
Other debt securities	8	0	0	8
Total fixed maturities	531	16	0	547
Nonredeemable preferred stock	27	2	0	29
Total available-for-sale securities Indemnity	\$ 558	\$ 18	\$ 0	\$ 576
Exchange				
Available-for-sale securities:				
U.S. government & agencies	\$ 16	\$ 1	\$ 0	\$ 17
States & political subdivisions	1,238	111	1	1,348
Foreign government securities	15	1	0	16
Corporate debt securities	5,306	584	4	5,886
Residential mortgage-backed securities (RMBS)	166	8	0	174
Commercial mortgage-backed securities (CMBS)	67	5	0	72
Collateralized debt obligations (CDO)	57	5	0	62
Other debt securities	44	4	0	48
Total fixed maturities	6,909	719	5	7,623
Nonredeemable preferred stock	543	83	2	624
Total available-for-sale securities Exchange	\$7,452	\$802	\$ 7	\$8,247
Total available-for-sale securities Erie Insurance Group	\$8,010	\$820	\$ 7	\$8,823

<i>(in millions)</i>	Erie Insurance Group December 31, 2011			Estimated fair value
	Amortized cost	Gross unrealized gains	Gross unrealized losses	
Indemnity				
Available-for-sale securities:				
States & political subdivisions	\$ 208	\$ 13	\$ 0	\$ 221
Corporate debt securities	303	1	1	303
Commercial mortgage-backed securities (CMBS)	13	0	0	13
Collateralized debt obligations (CDO)	4	0	0	4
Other debt securities	7	0	0	7
Total fixed maturities	535	14	1	548
Nonredeemable preferred stock	24	1	0	25
Total available-for-sale securities Indemnity	\$ 559	\$ 15	\$ 1	\$ 573
Exchange				
Available-for-sale securities:				
U.S. government & agencies	\$ 16	\$ 1	\$ 0	\$ 17
States & political subdivisions	1,289	91	1	1,379
Foreign government securities	15	0	0	15
Corporate debt securities	5,144	386	31	5,499

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Residential mortgage-backed securities (RMBS)		178	11	0	189
Commercial mortgage-backed securities (CMBS)		62	4	0	66
Collateralized debt obligations (CDO)		66	4	5	65
Other debt securities		59	3	0	62
Total fixed maturities		6,829	500	37	7,292
Nonredeemable preferred stock		531	45	12	564
Total available-for-sale securities	Exchange	\$7,360	\$545	\$49	\$7,856
Total available-for-sale securities	Erie Insurance Group	\$7,919	\$560	\$50	\$8,429

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The amortized cost and estimated fair value of fixed maturities at September 30, 2012 are shown below by remaining contractual term to maturity. Mortgage-backed securities are allocated based upon their stated maturity dates. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

<i>(in millions)</i>	Erie Insurance Group September 30, 2012	
	Amortized cost	Estimated fair value
Indemnity		
Due in one year or less	\$ 168	\$ 169
Due after one year through five years	255	259
Due after five years through ten years	45	49
Due after ten years	63	70
Total fixed maturities Indemnity	\$ 531	\$ 547
Exchange		
Due in one year or less	527	537
Due after one year through five years	2,241	2,427
Due after five years through ten years	2,799	3,165
Due after ten years	1,342	1,494
Total fixed maturities Exchange	\$6,909	\$7,623
Total fixed maturities Erie Insurance Group	\$7,440	\$8,170

Available-for-sale securities in a gross unrealized loss position at September 30, 2012 and December 31, 2011 are as follows. Data is provided by length of time for securities in a gross unrealized loss position.

<i>(dollars in millions)</i>	Erie Insurance Group September 30, 2012				Fair value	Total Unrealized losses	No. of holdings
	Less than 12 months		12 months or longer				
	Fair value	Unrealized losses	Fair value	Unrealized losses			
Indemnity							
Available-for-sale securities:							
Corporate debt securities	\$ 54	\$0	\$ 5	\$0	\$ 59	\$0	12
Commercial mortgage-backed securities (CMBS)	0	0	5	0	5	0	1
Collateralized debt obligations (CDO)	1	0	0	0	1	0	1
Total fixed maturities Indemnity	55	0	10	0	65	0	14
Nonredeemable preferred stock	3	0	3	0	6	0	2
Total available-for-sale securities Indemnity	\$ 58	\$0	\$13	\$0	\$ 71	\$0	16
Quality breakdown of fixed maturities:							
Investment grade	\$ 55	\$0	\$10	\$0	\$ 65	\$0	14
Non-investment grade	0	0	0	0	0	0	0
Total fixed maturities Indemnity	\$ 55	\$0	\$10	\$0	\$ 65	\$0	14
Exchange							
Available-for-sale securities:							
States & political subdivisions	\$ 5	\$1	\$ 0	\$0	\$ 5	\$1	2
Corporate debt securities	90	2	23	2	113	4	24
Residential mortgage-backed securities (RMBS)	10	0	0	0	10	0	1
Collateralized debt obligations (CDO)	6	0	31	0	37	0	4
Other debt securities	5	0	0	0	5	0	1

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Total fixed maturities	Exchange	116	3	54	2	170	5	32
Nonredeemable preferred stock		39	0	33	2	72	2	13
Total available-for-sale securities								
Exchange		\$155	\$3	\$87	\$4	\$242	\$7	45
Quality breakdown of fixed maturities:								
Investment grade		\$ 79	\$2	\$45	\$1	\$124	\$3	24
Non-investment grade		37	1	9	1	46	2	8
Total fixed maturities	Exchange	\$116	\$3	\$54	\$2	\$170	\$5	32

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Erie Insurance Group December 31, 2011							
<i>(dollars in millions)</i>	Less than 12 months		12 months or longer		Fair value	Total Unrealized losses	No. of holdings
	Fair value	Unrealized losses	Fair value	Unrealized losses			
Indemnity							
Available-for-sale securities:							
Corporate debt securities	\$220	\$ 1	\$ 0	\$ 0	\$220	\$ 1	41
Commercial mortgage-backed securities (CMBS)	4	0	9	0	13	0	3
Other debt securities	5	0	2	0	7	0	2
Total fixed maturities Indemnity	229	1	11	0	240	1	46
Nonredeemable preferred stock	4	0	3	0	7	0	3
Total available-for-sale securities Indemnity	\$233	\$ 1	\$ 14	\$ 0	\$247	\$ 1	49
Quality breakdown of fixed maturities:							
Investment grade	\$229	\$ 1	\$ 11	\$ 0	\$240	\$ 1	46
Non-investment grade	0	0	0	0	0	0	0
Total fixed maturities Indemnity	\$229	\$ 1	\$ 11	\$ 0	\$240	\$ 1	46
Exchange							
Available-for-sale securities:							
States & political subdivisions	\$ 7	\$ 0	\$ 6	\$ 1	\$ 13	\$ 1	3
Corporate debt securities	635	27	50	4	685	31	108
Residential mortgage-backed securities (RMBS)	7	0	0	0	7	0	4
Commercial mortgage-backed securities (CMBS)	5	0	0	0	5	0	1
Collateralized debt obligations (CDO)	0	0	32	5	32	5	6
Other debt securities	9	0	0	0	9	0	2
Total fixed maturities Exchange	663	27	88	10	751	37	124
Nonredeemable preferred stock	168	11	34	1	202	12	27
Total available-for-sale securities Exchange	\$831	\$38	\$122	\$11	\$953	\$49	151
Quality breakdown of fixed maturities:							
Investment grade	\$625	\$26	\$ 79	\$ 9	\$704	\$35	109
Non-investment grade	38	1	9	1	47	2	15
Total fixed maturities Exchange	\$663	\$27	\$ 88	\$10	\$751	\$37	124

The above securities for Indemnity and the Exchange have been evaluated and determined to be temporary impairments for which we expect to recover our entire principal plus interest. The primary components of this analysis include a general review of market conditions and financial performance of the issuer along with the extent and duration at which fair value is less than cost. Any debt securities that we intend to sell or will more likely than not be required to sell before recovery are included in other-than-temporary impairments with the impairment charges recognized in earnings.

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Interest and dividend income are recognized as earned and recorded to net investment income. Investment income, net of expenses, was generated from the following portfolios:

<i>(in millions)</i>	Erie Insurance Group			
	Three months ended		Nine months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Indemnity				
Fixed maturities	\$ 4	\$ 3	\$ 10	\$ 10
Equity securities	0	1	2	2
Cash equivalents and other	1	0	1	1
Total investment income	5	4	13	13
Less: investment expenses	1	0	1	1
Investment income, net of expenses Indemnity	\$ 4	\$ 4	\$ 12	\$ 12
Exchange				
Fixed maturities	\$ 87	\$ 91	\$266	\$ 275
Equity securities	23	21	72	63
Cash equivalents and other	0	0	2	0
Total investment income	110	112	340	338
Less: investment expenses	9	8	26	24
Investment income, net of expenses Exchange	\$101	\$104	\$314	\$ 314
Investment income, net of expenses Erie Insurance Group	\$105	\$108	\$326	\$ 326

Realized gains (losses) on investments were as follows:

<i>(in millions)</i>	Erie Insurance Group			
	Three months ended		Nine months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Indemnity				
Available-for-sale securities:				
Fixed maturities:				
Gross realized gains	\$ 0	\$ 0	\$ 0	\$ 2
Gross realized losses	0	0	0	0
Net realized gains	0	0	0	2
Equity securities:				
Gross realized gains	0	0	0	3
Gross realized losses	0	0	0	0
Net realized gains	0	0	0	3
Trading securities:				
Common stock:				
Gross realized gains	0	0	1	2
Gross realized losses	0	0	0	0
Valuation adjustments	2	(6)	3	(6)
Net realized gains (losses)	2	(6)	4	(4)
Net realized investment gains (losses) Indemnity	\$ 2	\$ (6)	\$ 4	\$ 1
Exchange				
Available-for-sale securities:				
Fixed maturities:				
Gross realized gains	\$ 22	\$ 15	\$ 47	\$ 66
Gross realized losses	(6)	(5)	(12)	(22)
Net realized gains	16	10	35	44
Equity securities:				
Gross realized gains	5	3	10	19
Gross realized losses	(5)	0	(7)	(1)
Net realized gains	0	3	3	18
Trading securities:				

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Common stock:					
Gross realized gains		37	56	122	183
Gross realized losses		(24)	(35)	(57)	(59)
Valuation adjustments		138	(450)	251	(421)
Net realized gains (losses)		151	(429)	316	(297)
Net realized investment gains (losses)	Exchange	\$167	\$(416)	\$354	\$(235)
Net realized investment gains (losses)	Erie Insurance Group	\$169	\$(422)	\$358	\$(234)

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There were no impairment losses for the Indemnity in the third quarter and nine months ended September 30, 2012 and 2011. The Exchange recorded no impairments for the third quarter of 2012, compared to \$0.3 million for the third quarter of 2011. For the nine months ended September 30, 2012, the Exchange recorded impairments of \$0.1 million compared to \$0.3 million for the nine months ended September 30, 2011.

In considering if fixed maturity securities were credit-impaired, some of the factors considered include: potential for the default of interest and/or principal, level of subordination, collateral of the issue, compliance with financial covenants, credit ratings and industry conditions. We have the intent to sell all credit-impaired fixed maturity securities, therefore the entire amount of the impairment charges were included in earnings and no non-credit impairments were recognized in other comprehensive income.

Limited partnerships

Our limited partnership investments are recorded using the equity method of accounting. As these investments are generally reported on a one-quarter lag, our year-to-date limited partnership results through September 30, 2012 are comprised of partnership financial results for the fourth quarter of 2011 and first six months of 2012. Given the lag in reporting, our limited partnership results do not reflect the market conditions of the third quarter of 2012. Cash contributions made to and distributions received from the partnerships are recorded in the period in which the transaction occurs.

We have provided summarized financial information in the following table for the nine months ended September 30, 2012 and for the year ended December 31, 2011. Amounts provided in the table are presented using the latest available financial statements received from the partnerships. Limited partnership financial information has been presented based upon the investment percentage in the partnerships for the Erie Insurance Group consistent with how management evaluates the investments.

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As these investments are generally reported on a one-quarter lag, our limited partnership results through September 30, 2012 include partnership financial results for the fourth quarter of 2011 and first six months of 2012.

Erie Insurance Group
As of and for the nine months ended September 30, 2012

(dollars in millions)

Investment percentage in limited partnerships	Number of partnerships	Asset recorded	Income (loss) recognized due to valuation adjustments by the partnerships	Income (loss) recorded
Indemnity				
Private equity:				
Less than 10%	26	\$ 64	\$ (2)	\$ 3
Greater than or equal to 10% but less than 50%	3	12	3	0
Greater than 50%	0	0	0	0
Total private equity	29	76	1	3
Mezzanine debt:				
Less than 10%	11	19	(2)	5
Greater than or equal to 10% but less than 50%	3	10	0	1
Greater than 50%	1	1	0	0
Total mezzanine debt	15	30	(2)	6
Real estate:				
Less than 10%	12	61	0	0
Greater than or equal to 10% but less than 50%	3	18	1	0
Greater than 50%	3	10	1	0
Total real estate	18	89	2	0
Total limited partnerships Indemnity	62	\$ 195	\$ 1	\$ 9
Exchange				
Private equity:				
Less than 10%	41	\$ 448	\$14	\$17
Greater than or equal to 10% but less than 50%	3	56	14	(1)
Greater than 50%	0	0	0	0
Total private equity	44	504	28	16
Mezzanine debt:				
Less than 10%	17	129	(6)	23
Greater than or equal to 10% but less than 50%	3	26	1	4
Greater than 50%	3	38	(2)	4
Total mezzanine debt	23	193	(7)	31
Real estate:				
Less than 10%	22	294	4	14
Greater than or equal to 10% but less than 50%	5	57	(1)	0
Greater than 50%	3	35	6	(2)
Total real estate	30	386	9	12
Total limited partnerships Exchange	97	\$1,083	\$30	\$59
Total limited partnerships Erie Insurance Group		\$1,278	\$31	\$68

Per the limited partnership financial statements, total partnership assets were \$53 billion and total partnership liabilities were \$5 billion at September 30, 2012 (as recorded in the June 30, 2012 limited partnership financial statements). For the nine month period comparable to that presented in the preceding table (fourth quarter 2011 and first two quarters of 2012), total partnership valuation adjustment gains were \$0.9 billion and total partnership net income was \$4.0 billion.

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As these investments are generally reported on a one-quarter lag, our limited partnership results through December 31, 2011 include partnership financial results for the fourth quarter of 2010 and the first three quarters of 2011.

Erie Insurance Group
As of and for the year ended December 31, 2011

(dollars in millions)

Investment percentage in limited partnerships	Number of partnerships	Asset recorded	Income (loss) recognized due to valuation adjustments by the partnerships	Income (loss) recorded
Indemnity				
Private equity:				
Less than 10%	26	\$ 73	\$ 2	\$ 5
Greater than or equal to 10% but less than 50%	3	9	0	3
Greater than 50%	0	0	0	0
Total private equity	29	82	2	8
Mezzanine debt:				
Less than 10%	11	22	0	6
Greater than or equal to 10% but less than 50%	3	12	1	1
Greater than 50%	1	1	(1)	0
Total mezzanine debt	15	35	0	7
Real estate:				
Less than 10%	12	62	5	(1)
Greater than or equal to 10% but less than 50%	3	18	1	0
Greater than 50%	3	11	3	1
Total real estate	18	91	9	0
Total limited partnerships Indemnity	62	\$ 208	\$11	\$15
Exchange				
Private equity:				
Less than 10%	41	\$ 452	\$13	\$30
Greater than or equal to 10% but less than 50%	3	43	(1)	12
Greater than 50%	0	0	0	0
Total private equity	44	495	12	42
Mezzanine debt:				
Less than 10%	17	133	(9)	26
Greater than or equal to 10% but less than 50%	3	33	3	3
Greater than 50%	3	35	(2)	3
Total mezzanine debt	23	201	(8)	32
Real estate:				
Less than 10%	25	284	31	(1)
Greater than or equal to 10% but less than 50%	5	59	3	0
Greater than 50%	3	43	2	10
Total real estate	33	386	36	9
Total limited partnerships Exchange	100	\$1,082	\$40	\$83
Total limited partnerships Erie Insurance Group		\$1,290	\$51	\$98

Per the limited partnership financial statements, total partnership assets were \$54 billion and total partnership liabilities were \$6 billion at December 31, 2011 (as recorded in the September 30, 2011 limited partnership financial statements). For the twelve month period comparable to that presented in the preceding table (fourth quarter of 2010 and first three quarters of 2011), total partnership valuation adjustment gains were \$2.5 billion and total partnership net income was \$3.1 billion.

See also Note 13. Commitments and Contingencies, for investment commitments related to limited partnerships.

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Note 8. Bank Line of Credit

As of September 30, 2012, Indemnity has available a \$100 million bank revolving line of credit that expires on November 3, 2016. There were no borrowings outstanding on the line of credit as of September 30, 2012. Bonds with a fair value of \$111 million were pledged as collateral on the line at September 30, 2012.

As of September 30, 2012, the Exchange has available a \$300 million bank revolving line of credit that expires on October 28, 2016. There were no borrowings outstanding on the line of credit as of September 30, 2012. Bonds with a fair value of \$328 million were pledged as collateral on the line at September 30, 2012.

Securities pledged as collateral on both lines have no trading restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position as of September 30, 2012. The banks require compliance with certain covenants, which include minimum net worth and leverage ratios for Indemnity's line of credit and statutory surplus and risk based capital ratios for the Exchange's line of credit. We are in compliance with all covenants at September 30, 2012.

Note 9. Income Taxes

Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the financial statements or tax returns. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

At September 30, 2012, we recorded a net deferred tax liability of \$351 million on our Consolidated Statements of Financial Position. Of this amount, \$16 million is a net deferred tax asset attributable to Indemnity and \$367 million is a net deferred tax liability attributable to the Exchange. There was no deferred tax valuation allowance recorded at September 30, 2012. Our effective tax rate is calculated after consideration of permanent differences related to our investment revenues. Given that these amounts represent 98% of the total permanent differences, the effective tax rate is approximately 35% for both Indemnity and the Exchange when the investment related permanent differences are excluded.

Note 10. Postretirement Benefits

The liabilities for the postretirement plans described in this note are presented in total for all employees of the Erie Insurance Group. The gross liability for postretirement benefits is presented in the Consolidated Statements of Financial Position as part of other liabilities. A portion of

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annual expenses related to our postretirement benefit plans is allocated to related entities within the Erie Insurance Group.

We offer a noncontributory defined benefit pension plan that covers substantially all employees. This is the largest postretirement benefit plan we offer. We also offer an unfunded supplemental employee retirement plan (SERP) for certain members of executive and senior management of the Erie Insurance Group.

The components of net periodic benefit cost for our postretirement benefits are as follows:

<i>(in millions)</i>	Erie Insurance Group			
	Three months ended		Nine months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Service cost	\$ 5	\$ 4	\$ 16	\$ 13
Interest cost	6	6	18	17
Expected return on plan assets	(6)	(7)	(20)	(20)
Amortization of prior service cost	1	1	1	1
Amortization of actuarial loss	2	1	8	4
Net periodic benefit cost	\$ 8	\$ 5	\$ 23	\$ 15

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A reconciliation of the beginning and ending balances of shareholders equity and noncontrolling interest is presented as follows for the year ended December 31, 2011 and for the nine months ended September 30, 2012:

	Indemnity	Erie Insurance Group	Erie
	shareholder	noncontrolling	Insurance
	interest	interest	Group
<i>(in millions, except per share data)</i>			
Balance at December 31, 2010	\$912	\$5,422	\$6,334
Net income	169	99	268
Change in other comprehensive loss, net of tax	(52)	(9)	(61)
Realized gain on sale of life affiliate, net of tax	8		8
Net purchase of treasury stock	(154)		(154)
Dividends declared:			
Class A \$2.0975 per share	(101)		(101)
Class B \$314.625 per share	(1)		(1)
Balance at December 31, 2011	\$781	\$5,512	\$6,293
Net income	130	370	500
Change in other comprehensive income, net of tax	4	179	183
Net purchase of treasury stock	(54)		(54)
Dividends declared:			
Class A \$1.6575 per share	(78)		(78)
Class B \$248.625 per share	(1)		(1)
Balance at September 30, 2012	\$782	\$6,061	\$6,843

Note 12. Indemnity Accumulated Other Comprehensive Income (Loss)

A rollforward of accumulated other comprehensive loss attributable to the Indemnity shareholder interest is presented as follows for the nine months ended September 30, 2012:

	Indemnity Shareholder Interest		
	Nine months ended September 30, 2012		
	Unrealized	Net losses	Total
	net	associated	
	appreciation	with	
	of investments	postretirement	
	\$11	benefits	\$ (105)
<i>(in millions)</i>			
Balance at December 31, 2011		\$ (116)	
Change in other comprehensive income, net of tax:			
Unrealized appreciation of investments, net of tax	4		4

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Reclassification adjustment for gross gains included in income, net of tax	0		0
Change in other comprehensive income, net of tax	4		4
Balance at September 30, 2012	\$15	\$(116)	\$(101)

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Note 13. Commitments and Contingencies

Indemnity has contractual commitments to invest up to \$36 million related to its limited partnership investments at September 30, 2012. These commitments are split between private equity securities of \$16 million, mezzanine debt securities of \$10 million, and real estate activities of \$10 million. These commitments will be funded as required by the partnership agreements.

The Exchange, including EFL, has contractual commitments to invest up to \$338 million related to its limited partnership investments at September 30, 2012. These commitments are split between private equity securities of \$144 million, mezzanine debt securities of \$110 million, and real estate activities of \$84 million. These commitments will be funded as required by the partnership agreements.

We are involved in litigation arising in the ordinary course of conducting business. In accordance with current accounting standards for loss contingencies and based upon information currently known to us, we establish reserves for litigation when it is probable that a loss associated with a claim or proceeding has been incurred and the amount of the loss or range of loss can be reasonably estimated. When no amount within the range of loss is a better estimate than any other amount, we accrue the minimum amount of the estimable loss. To the extent that such litigation against us may have an exposure to a loss in excess of the amount we have accrued, we believe that such excess would not be material to our consolidated financial condition, operations or cash flows. Legal fees are expensed as incurred. We believe that our accruals for legal proceedings are appropriate and, individually and in the aggregate, are not expected to be material to our consolidated financial condition, operations or cash flows.

We review all litigation on an ongoing basis when making accrual and disclosure decisions. For certain legal proceedings, we cannot reasonably estimate losses or a range of loss, if any, particularly for proceedings that are in their early stages of development or where the plaintiffs seek indeterminate damages. Various factors, including, but not limited to, the outcome of potentially lengthy discovery and the resolution of important factual questions, may need to be determined before probability can be established or before a loss or range of loss can be reasonably estimated. If the loss contingency in question is not both probable and reasonably estimable, we do not establish an accrual and the matter will continue to be monitored for any developments that would make the loss contingency both probable and reasonably estimable. In the event that a legal proceeding results in a substantial judgment against, or settlement by, us, there can be no assurance that any resulting liability or financial commitment would not have a material adverse effect on the financial condition, results of operations or cash flows of the Indemnity shareholder interest or the consolidated financial statements of Erie Indemnity Company.

Table of Contents**Note 14. Indemnity Supplemental Information**Consolidating Statement of Financial Position

<i>(in millions)</i>	Erie Insurance Group September 30, 2012			
	Indemnity shareholder interest	Exchange noncontrolling interest	Reclassifications and eliminations	Erie Insurance Group
Assets				
Investments				
Available-for-sale securities, at fair value:				
Fixed maturities	\$ 547	\$ 7,623	\$	\$ 8,170
Equity securities	29	624		653
Trading securities, at fair value	30	2,639		2,669
Limited partnerships	195	1,083		1,278
Other invested assets	1	20		21
Total investments	802	11,989		12,791
Cash and cash equivalents	12	392		404
Premiums receivable from policyholders		1,100		1,100
Reinsurance recoverable		165		165
Deferred income taxes	16			16
Deferred acquisition costs		505		505
Other assets	115	448		563
Receivables from the Exchange and other affiliates	286		(286)	
Note receivable from EFL	25		(25)	
Total assets	\$1,256	\$14,599	\$(311)	\$15,544
Liabilities				
Losses and loss expense reserves	\$	\$ 3,598	\$	\$ 3,598
Life policy and deposit contract reserves		1,721		1,721
Unearned premiums		2,420		2,420
Deferred income taxes		367		367
Other liabilities	474	432	(311)	595
Total liabilities	474	8,538	(311)	8,701
Shareholders' equity and noncontrolling interest				
Total Indemnity shareholders' equity	782			782
Noncontrolling interest in consolidated entity - Exchange		6,061		6,061
Total equity	782	6,061		6,843
Total liabilities, shareholders' equity and noncontrolling interest	\$1,256	\$14,599	\$(311)	\$15,544

Table of ContentsConsolidating Statement of Financial Position

	Erie Insurance Group December 31, 2011			
<i>(in millions)</i>	Indemnity shareholder interest	Exchange noncontrolling interest	Reclassifications and eliminations	Erie Insurance Group
Assets				
Investments				
Available-for-sale securities, at fair value:				
Fixed maturities	\$ 548	\$ 7,292	\$	\$ 7,840
Equity securities	25	564		589
Trading securities, at fair value	27	2,308		2,335
Limited partnerships	208	1,082		1,290
Other invested assets	1	19		20
Total investments	809	11,265		12,074
Cash and cash equivalents	11	174		185
Premiums receivable from policyholders		976		976
Reinsurance recoverable		166		166
Deferred income taxes	19			19
Deferred acquisition costs		487		487
Other assets	119	322		441
Receivables from the Exchange and other affiliates	254		(254)	
Note receivable from EFL	25		(25)	
Total assets	\$1,237	\$13,390	\$(279)	\$14,348
Liabilities				
Losses and loss expense reserves	\$	\$ 3,499	\$	\$ 3,499
Life policy and deposit contract reserves		1,671		1,671
Unearned premiums		2,178		2,178
Deferred income taxes		147		147
Other liabilities	456	383	(279)	560
Total liabilities	456	7,878	(279)	8,055
Shareholders' equity and noncontrolling interest				
Total Indemnity shareholders' equity	781			781
Noncontrolling interest in consolidated entity - Exchange		5,512		5,512
Total equity	781	5,512		6,293
Total liabilities, shareholders' equity and noncontrolling interest	\$1,237	\$13,390	\$(279)	\$14,348

Note receivable from EFL Indemnity is due \$25 million from EFL in the form of a surplus note that was issued in 2003. The note may be repaid only out of unassigned surplus of EFL. Both principal and interest payments are subject to prior approval by the Pennsylvania Insurance Commissioner. The note bears an annual interest rate of 6.7% and will be payable on demand on or after December 31, 2018, with interest scheduled to be paid semi-annually, subject to prior approval by the Pennsylvania Insurance Commissioner. For both of the nine month periods ended September 30, 2012 and 2011, Indemnity recognized interest income on the note of \$1.3 million.

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Income attributable to Indemnity shareholder interest

(in millions)	Percent	Indemnity Shareholder Interest			
		Three months ended September 30,		Nine months ended September 30,	
		2012	2011	2012	2011
Management operations:					
Management fee revenue, net	100.0%	\$305	\$280	\$882	\$816
Service agreement revenue	100.0%	8	8	23	25
Total revenue from management operations		313	288	905	841
Cost of management operations	100.0%	247	226	734	667
Income from management operations before taxes		66	62	171	174
Life insurance operations: (1) (2)					
Total revenue	21.6% (2)				10
Total benefits and expenses	21.6% (2)				7
Income from life insurance operations before taxes					3
Investment operations:					
Net investment income		4	4	12	12
Net realized gains (losses) on investments		2	(6)	4	1
Net impairment losses recognized in earnings		0	0	0	0
Equity in earnings of limited partnerships		6	7	10	25
Income from investment operations before taxes		12	5	26	38
Income from operations before income taxes		78	67	197	215
Provision for income taxes		27	20	67	72
Net income		\$ 51	\$ 47	\$130	\$143

(1) Earnings on life insurance related invested assets are integral to the evaluation of the life insurance operations because of the long duration of life products. On that basis, for presentation purposes, the life insurance operations in the table above include life insurance related investment results. However, the life insurance investment results are included in the investment operations segment discussion in Note 5. Segment Information .

(2) Prior to and through March 31, 2011, Indemnity retained a 21.6% ownership interest in EFL, which accrued to the Indemnity shareholder interest, and the Exchange retained a 78.4% ownership interest in EFL, which accrued to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest. Due to the sale of Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, 100% of EFL's life insurance results accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after March 31, 2011.

Indemnity's components of direct cash flows as included in the Consolidated Statements of Cash Flows

(in millions)	Indemnity Shareholder Interest	
	Nine months ended September 30,	
	2012	2011
Management fee received	\$ 851	\$ 791
Service agreement fee received	23	25
Net investment income received	19	17
Limited partnership distributions	11	14
Decrease in reimbursements collected from affiliates	(2)	(13)

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Commissions and bonuses paid to agents	(470)	(450)
Salaries and wages paid	(99)	(95)
Pension contribution and employee benefits paid	(36)	(32)
General operating expenses paid	(99)	(93)
Income taxes paid	(54)	(51)
Net cash provided by operating activities	144	113
Net cash used in investing activities	(8)	(180)
Net cash used in financing activities	(135)	(209)
Net increase (decrease) in cash and cash equivalents	1	(276)
Cash and cash equivalents at beginning of period	11	310
Cash and cash equivalents at end of period	\$ 12	\$ 34

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Note 15. Indemnity Capital Stock

Class A and B common stock

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 per Class B share. In the first quarter of 2012, two shares of Class B common stock were converted into 4,800 shares of Class A common stock. There is no provision for conversion of Class A shares to Class B shares, and, Class B shares surrendered for conversion cannot be reissued.

Stock repurchase program

In October 2011, our Board of Directors approved a continuation of the current stock repurchase program for a total of \$150 million, with no time limitation. Indemnity had approximately \$84 million of repurchase authority remaining under this program at September 30, 2012.

Note 16. Subsequent Events

We have evaluated for recognized and nonrecognized subsequent events through the date of financial statement issuance. With the exception of the below mentioned item, no additional items were identified in this period subsequent to the financial statement date that required adjustment or disclosure.

Our property and casualty insurance operations will likely incur losses arising from or related to Hurricane Sandy. Given the timing of the event and the limited information available as of the date of financial statement issuance, we are unable to reasonably estimate the amount of losses likely to be incurred. The underwriting results, net of any applicable reinsurance, of the property and casualty insurance operations accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest.

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

The following discussion of financial condition and results of operations highlights significant factors influencing the Erie Insurance Group (we, us, our). This discussion should be read in conjunction with the historical financial information and the related notes thereto included in Item 1. Financial Statements of this Quarterly Report on Form 10-Q and with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2011 contained in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 27, 2012.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995:

Statements contained herein that are not historical fact are forward-looking statements and, as such, are subject to risks and uncertainties that could cause actual events and results to differ, perhaps materially, from those discussed herein. Forward-looking statements relate to future trends, events or results and include, without limitation, statements and assumptions on which such statements are based that are related to our plans, strategies, objectives, expectations, intentions and adequacy of resources. Examples of forward-looking statements are discussions relating to premium and investment income, expenses, operating results, agency relationships, and compliance with contractual and regulatory requirements. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Among the risks and uncertainties, in addition to those set forth in our filings with the Securities and Exchange Commission, that could cause actual results and future events to differ from those set forth or contemplated in the forward-looking statements include the following:

Risk factors related to the Erie Indemnity Company (Indemnity) shareholder interest:

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- dependence upon Indemnity's relationship with the Exchange and the management fee under the agreement with the subscribers at the Exchange;
- costs of providing services to the Exchange under the subscriber's agreement;
- ability to attract and retain talented management and employees;
- ability to maintain uninterrupted business operations, including information technology systems;
- factors affecting the quality and liquidity of Indemnity's investment portfolio;
- credit risk from the Exchange;
- Indemnity's ability to meet liquidity needs and access capital; and
- outcome of pending and potential litigation against Indemnity.

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Risk factors related to the non-controlling interest owned by the Erie Insurance Exchange (Exchange), which includes the Property and Casualty Group and Erie Family Life Insurance Company:

- general business and economic conditions;
- dependence upon the independent agency system;
- ability to maintain our reputation for customer service;
- factors affecting insurance industry competition;
- changes in government regulation of the insurance industry;
- premium rates and reserves must be established from forecasts of ultimate costs;
- emerging claims, coverage issues in the industry, and changes in reserve estimates related to the property and casualty business;
- changes in reserve estimates related to the life business;
- severe weather conditions or other catastrophic losses, including terrorism;
- the Exchange s ability to acquire reinsurance coverage and collectability from reinsurers;
- factors affecting the quality and liquidity of the Exchange s investment portfolio;
- the Exchange s ability to meet liquidity needs and access capital;
- the Exchange s ability to maintain an acceptable financial strength rating;
- outcome of pending and potential litigation against the Exchange; and
- dependency upon the service provided by Indemnity.

A forward-looking statement speaks only as of the date on which it is made and reflects our analysis only as of that date. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changes in assumptions, or otherwise.

RECENT ACCOUNTING PRONOUNCEMENTS

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See Item 1. Financial Statements - Note 2. Significant Accounting Policies, contained within this report for a discussion of adopted and/or pending accounting pronouncements, none of which are expected to have a material impact on our future financial condition, results of operations or cash flows.

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OPERATING OVERVIEW

Overview

The Erie Insurance Group represents the consolidated results of Indemnity and the results of its variable interest entity, the Exchange. The Erie Insurance Group operates predominantly as a property and casualty insurer through its regional insurance carriers that write a broad range of personal and commercial coverages. Our property and casualty insurance companies include the Exchange and its wholly owned subsidiaries, Erie Insurance Company (EIC), Erie Insurance Company of New York (ENY), Erie Insurance Property and Casualty Company (EPC), and Flagship City Insurance Company (Flagship). These entities operate collectively as the Property and Casualty Group. The Erie Insurance Group also operates as a life insurer through the Exchange's wholly owned subsidiary, Erie Family Life Insurance Company (EFL), which underwrites and sells individual and group life insurance policies and fixed annuities (1).

The Exchange is a reciprocal insurance exchange, which is an unincorporated association of individuals, partnerships and corporations that agree to insure one another. Each applicant for insurance to the Exchange signs a subscriber's agreement, which contains an appointment of Indemnity as their attorney-in-fact to transact the business of the Exchange on their behalf.

Pursuant to the subscriber's agreement and for its services as attorney-in-fact, Indemnity earns a management fee calculated as a percentage of the direct premiums written by the Exchange and the other members of the Property and Casualty Group, which are assumed by the Exchange under an intercompany pooling arrangement.

The Indemnity shareholder interest includes Indemnity's equity and income, but not the equity or income of the Exchange. The Exchange's equity, which is comprised of its retained earnings and accumulated other comprehensive income, is held for the interest of its subscribers (policyholders) and meets the definition of a noncontrolling interest, which is reflected as such in our consolidated financial statements.

Indemnity shareholder interest refers to the interest in Erie Indemnity Company owned by the Class A and Class B shareholders. Noncontrolling interest refers to the interest in the Erie Insurance Exchange held for the interest of the subscribers (policyholders).

The Indemnity shareholder interest in income generally comprises:

- a management fee of up to 25% of all property and casualty insurance premiums written or assumed by the Exchange, less the costs associated with the sales, underwriting and issuance of these policies;
- a 0% equity interest in the net earnings of EFL after March 31, 2011 (the interest was 21.6% prior to March 31, 2011) (1);
- net investment income and results on investments that belong to Indemnity; and
- other income and expenses, including income taxes, that are the responsibility of Indemnity.

The Exchange's or the noncontrolling interest in income generally comprises:

- a 100% interest in the net underwriting results of the property and casualty insurance operations;
- a 100% equity interest in the net earnings of EFL after March 31, 2011 (the interest was 78.4% prior to March 31, 2011) (1);
- net investment income and results on investments that belong to the Exchange and its subsidiaries, which include EIC, ENY, EPC, Flagship and EFL; and
- other income and expenses, including income taxes, that are the responsibility of the Exchange and its subsidiaries.

(1) Prior to and through March 31, 2011, Indemnity retained a 21.6% ownership interest in EFL, which accrued to the Indemnity shareholder interest, and the Exchange retained a 78.4% ownership interest in EFL, which accrued to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest. Due to the sale of Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, 100% of EFL's life insurance results accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after March 31, 2011.

Table of Contents**Results of the Erie Insurance Group's Operations by Interest (Unaudited)**

The following tables represent a breakdown of the composition of the income attributable to the Indemnity shareholder interest and the income attributable to the noncontrolling interest (Exchange). For purposes of this discussion, EFL's investments are included in the life insurance operations.

<i>(in millions)</i>	Indemnity shareholder interest			Noncontrolling interest (Exchange)			Eliminations of related party transactions		Erie Insurance Group	
	Percent	Three months ended September 30,		Percent	Three months ended September 30,		Three months ended September 30,		Three months ended September 30,	
		2012	2011		2012	2011	2012	2011	2012	2011
Management operations:										
Management fee revenue, net	100.0%	\$305	\$280		\$	\$	\$(305)	\$(280)	\$	\$
Service agreement revenue	100.0%	8	8						8	8
Total revenue from management operations		313	288				(305)	(280)	8	8
Cost of management operations	100.0%	247	226				(247)	(226)		
Income from management operations before taxes		66	62				(58)	(54)	8	8