

ERIE INDEMNITY CO
Form 10-Q
November 01, 2012
[Table of Contents](#)

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)

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Consolidated Statements of Operations Three and Nine months ended September 30, 2012 and 2011

Consolidated Statements of Comprehensive Income Three and Nine months ended September 30, 2012 and 2011

Consolidated Statements of Financial Position September 30, 2012 and December 31, 2011

Consolidated Statements of Cash Flows Nine months ended September 30, 2012 and 2011

Notes to Consolidated Financial Statements September 30, 2012

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 6. Exhibits

SIGNATURES

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ERIE INDEMNITY COMPANY****CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)***(dollars in millions, except per share data)*

	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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Table of Contents

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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.

Table of Contents

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.

Table of Contents

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.

Table of Contents

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 .

Table of Contents

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.

Table of Contents**Note 3. Indemnity Earnings Per Share**

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:						

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Income available to Class B
stockholders

\$ 1	2,544	\$410.89	\$ 1	2,546	\$439.39
------	-------	----------	------	-------	----------

Table of Contents

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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)

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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:

		Erie Insurance Group September 30, 2012		
		Fair value measurements using:		
(in millions)	Total	Quoted prices in active markets for identical assets	Observable inputs	Unobservable inputs
		Level 1	Level 2	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	\$ 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	\$10,886	\$2,900	\$7,878	\$108
Total available-for-sale and trading securities	\$11,492	\$2,938	\$8,442	\$112

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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%

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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	\$7,360	\$545	\$49	\$7,856	
Total available-for-sale securities	Exchange				
	Erie Insurance Group	\$7,919	\$560	\$50	\$8,429

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

Table of Contents

<i>(dollars in millions)</i>	Erie Insurance Group December 31, 2011						No. of holdings
	Less than 12 months		12 months or longer		Fair	Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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:				

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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)

Table of Contents

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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.

Table of Contents

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

Table of Contents**Note 11. Indemnity Shareholders Equity and Noncontrolling Interest**

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	
	net	associated	
	appreciation	with	
	of investments	postretirement	Total
	\$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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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)

Table of Contents

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

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)

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

Table of Contents

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.

Table of Contents

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.

INDEX

	Page Number
<u>Cautionary Statement Regarding Forward-Looking Information</u>	39
<u>Recent Accounting Pronouncements</u>	40
<u>Operating Overview</u>	41
<u>Results of Operations</u>	47
<u>Management Operations</u>	47
<u>Property and Casualty Insurance Operations</u>	49
<u>Life Insurance Operations</u>	53
<u>Investment Operations</u>	54
<u>Financial Condition</u>	56
<u>Investments</u>	56
<u>Liabilities</u>	60
<u>Impact of Inflation</u>	61
<u>Liquidity and Capital Resources</u>	61
<u>Critical Accounting Estimates</u>	64

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:

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

- 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.

Table of Contents

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Table of Contents

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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
Property and casualty insurance operations:										
Net premiums earned				100.0%	1,118	1,045			1,118	1,045
Losses and loss expenses				100.0%	890	823	(2)	(1)	888	822
Policy acquisition and underwriting expenses				100.0%	329	302	(59)	(56)	270	246
Loss from property and casualty insurance operations before taxes					(101)	(80)	61	57	(40)	(23)
Life insurance operations:										
(1)										
Total revenue				100.0%	44	46	0	0	44	46
Total benefits and expenses				100.0%	32	33	0	0	32	33
Income from life insurance operations before taxes					12	13	0	0	12	13
Investment operations:										
Net investment income		4	4		81	83	(3)	(3)	82	84
Net realized gains (losses) on investments		2	(6)		165	(421)			167	(427)
Net impairment losses recognized in earnings		0	0		0	0			0	0
Equity in earnings of limited partnerships		6	7		35	33			41	40
Income (loss) from investment operations before taxes		12	5		281	(305)	(3)	(3)	290	(303)
Income (loss) from operations before income taxes and noncontrolling interest										
		78	67		192	(372)			270	(305)
Provision for income taxes		27	20		59	(145)			86	(125)
Net income (loss)		\$51	\$ 47		\$ 133	\$ (227)	\$	\$	\$ 184	\$ (180)

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

(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 as part of the Exchange's investment results.*

Operating results in the third quarter of 2012 were impacted primarily by improved earnings from our investment operations, offset slightly by increased losses in our property and casualty insurance operations, compared to the third quarter of 2011. Our investment operations improved as a result of net realized gains on investments compared to losses in the third quarter of 2011. The Exchange's property and casualty insurance operations experienced a 7.0% increase in earned premium, driven by increases in policies in force and the average premium per policy. The Exchange's losses from its property and casualty insurance operations increased primarily due to less favorable development on prior accident year loss reserves, offset somewhat by lower catastrophe losses compared to the third quarter of 2011.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

(in millions)	Percent	Indemnity shareholder interest		Noncontrolling interest (Exchange)			Eliminations of related party transactions		Erie Insurance Group	
		Nine months ended September 30,		Nine months ended September 30,			Nine months ended September 30,		Nine months ended September 30,	
		2012	2011	Percent	2012	2011	2012	2011	2012	2011
Management operations:										
Management fee revenue, net	100.0%	\$882	\$816		\$	\$	\$(882)	\$(816)	\$	\$
Service agreement revenue	100.0%	23	25						23	25
Total revenue from management operations		905	841				(882)	(816)	23	25
Cost of management operations	100.0%	734	667				(734)	(667)		
Income from management operations before taxes		171	174				(148)	(149)	23	25
Property and casualty insurance operations:										
Net premiums earned				100.0%	3,279	3,089			3,279	3,089
Losses and loss expenses				100.0%	2,501	2,653	(4)	(4)	2,497	2,649
Policy acquisition and underwriting expenses				100.0%	963	882	(153)	(154)	810	728
Loss from property and casualty insurance operations before taxes					(185)	(446)	157	158	(28)	(288)
Life insurance operations:										
(1) (2)										
Total revenue	21.6% (2)		10	78.4% (2)	133	124	(1)	(1)	132	133
Total benefits and expenses	21.6% (2)		7	78.4% (2)	99	89	0	0	99	96
Income from life insurance operations before taxes			3		34	35	(1)	(1)	33	37
Investment operations:										
Net investment income		12	12		251	252	(8)	(8)	255	256
Net realized gains (losses) on investments		4	1		348	(247)			352	(246)
Net impairment losses recognized in earnings		0	0		0	0			0	0
Equity in earnings of limited partnerships		10	25		89	124			99	149
Income from investment operations before taxes		26	38		688	129	(8)	(8)	706	159
Income (loss) from operations before income taxes and noncontrolling interest										
		197	215		537	(282)			734	(67)
Provision for income taxes		67	72		167	(126)			234	(54)
Net income (loss)		\$130	\$143		\$ 370	\$ (156)	\$	\$	\$ 500	\$ (13)

(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 as part of the Exchange's investment results.

(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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after March 31, 2011.

Operating results in the first nine months of 2012 were impacted primarily by increased earnings from our investment operations and lower losses from our property and casualty insurance operations, compared to the first nine months of 2011. Our investment operations improved primarily as a result of net realized gains on investments, compared to losses in the first nine months of 2011, offset somewhat by lower equity in earnings of limited partnerships. The Exchange's property and casualty insurance operations experienced a 6.1% increase in earned premium, driven by increases in policies in force and the average premium per policy. The Exchange's losses from its property and casualty insurance operations decreased primarily due to lower catastrophe losses, offset by less favorable development on prior accident year loss reserves compared to the first nine months of 2011.

Table of Contents

Reconciliation of Operating Income to Net Income (Unaudited)

We disclose operating income, a non-GAAP financial measure, to enhance our investors' understanding of our performance related to the Indemnity shareholder interest. Our method of calculating this measure may differ from those used by other companies, and therefore comparability may be limited.

Indemnity defines operating income as net income excluding realized capital gains and losses, impairment losses and related federal income taxes.

Indemnity uses operating income to evaluate the results of its operations. It reveals trends that may be obscured by the net effects of realized capital gains and losses including impairment losses. Realized capital gains and losses, including impairment losses, may vary significantly between periods and are generally driven by business decisions and economic developments such as capital market conditions which are not related to our ongoing operations. We are aware that the price to earnings multiple commonly used by investors as a forward-looking valuation technique uses operating income as the denominator. Operating income should not be considered as a substitute for net income prepared in accordance with U.S. generally accepted accounting principles (GAAP) and does not reflect Indemnity's overall profitability.

The following table reconciles operating income and net income for the Indemnity shareholder interest:

<i>(in millions, except per share data)</i>	Indemnity Shareholder Interest			
	Three months ended		Nine months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
	(Unaudited)		(Unaudited)	
Operating income attributable to Indemnity	\$ 50	\$ 51	\$ 128	\$ 142
Net realized gains (losses) and impairments on investments	2	(6)	4	1
Income tax (expense) benefit	(1)	2	(2)	0
Realized gains (losses) and impairments, net of income taxes	1	(4)	2	1
Net income attributable to Indemnity	\$ 51	\$ 47	\$ 130	\$ 143
Per Indemnity Class A common share-diluted:				
Operating income attributable to Indemnity	\$0.93	\$0.93	\$2.38	\$2.57
Net realized gains (losses) and impairments on investments	0.05	(0.09)	0.08	0.03
Income tax (expense) benefit	(0.02)	0.03	(0.03)	(0.01)
Realized gains (losses) and impairments, net of income taxes	0.03	(0.06)	0.05	0.02
Net income attributable to Indemnity	\$0.96	\$0.87	\$2.43	\$2.59

Summary of Results Indemnity Shareholder Interest

Three months ended September 30, 2012

Net income attributable to Indemnity per share-diluted was \$0.96 per share in the third quarter of 2012, compared to \$0.87 per share in the third quarter of 2011.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Operating income attributable to Indemnity per share-diluted (excluding net realized gains or losses, impairments on investments and related taxes) was \$0.93 per share in both the third quarters of 2012 and 2011.

Nine months ended September 30, 2012

Net income attributable to Indemnity per share-diluted was \$2.43 per share for the nine months ended September 30, 2012, compared to \$2.59 per share for the nine months ended September 30, 2011. The nine months ended September 30, 2011 net income per share-diluted amount includes \$0.02 per share related to the life insurance operations sold to the Exchange.

Operating income attributable to Indemnity per share-diluted (excluding net realized gains or losses, impairments on investments and related taxes) was \$2.38 per share for the nine months ended September 30, 2012, compared to \$2.57 per share for the nine months ended September 30, 2011. The nine months ended September 30, 2011 operating income per share-diluted amount includes \$0.02 per share related to the life insurance operations sold to the Exchange.

Table of Contents

Operating Segments

Our reportable segments include management operations, property and casualty insurance operations, life insurance operations and investment operations.

Management operations

Management operations generate internal management fee revenue, which accrues to the Indemnity shareholder interest, as Indemnity provides services relating to the sales, underwriting and issuance of policies on behalf of the Exchange. Management fee revenue is based upon all premiums written or assumed by the Exchange and the management fee rate, which is not to exceed 25%. Our Board of Directors establishes the management fee rate at least annually, generally in December for the following year, and considers factors such as the relative financial strength of Indemnity and the Exchange and projected revenue streams. The management fee rate was set at 25% for both 2012 and 2011. Management fee revenue is eliminated upon consolidation.

Property and casualty insurance operations

The property and casualty insurance business is driven by premium growth, the combined ratio and investment returns. The property and casualty insurance industry is cyclical, with periods of rising premium rates and shortages of underwriting capacity followed by periods of substantial price competition and excess capacity. The cyclical nature of the insurance industry has a direct impact on the direct written premium of the Property and Casualty Group.

The property and casualty insurance operation's premium growth strategy focuses on growth by expansion of existing operations including a careful agency selection process and increased market penetration in existing operating territories. Expanding the size of our existing agency force of nearly 2,200 independent agencies, with almost 10,000 licensed property and casualty representatives, will contribute to future growth as new agents build their books of business with the Property and Casualty Group.

The property and casualty insurance operations insure preferred and standard risks while maintaining a disciplined underwriting approach. Based upon direct written premium in 2011, approximately 50% of our premiums were derived from personal auto, 20% from homeowners and 30% from commercial lines. Pennsylvania, Maryland and Virginia made up 63% of the property and casualty lines insurance business 2011 direct written premium.

Members of the Property and Casualty Group pool their underwriting results under an intercompany pooling agreement. Under the pooling agreement, the Exchange retains a 94.5% interest in the net underwriting results of the Property and Casualty Group, while EIC retains a 5.0% interest and ENY retains a 0.5% interest.

The key measure of underwriting profitability traditionally used in the property and casualty insurance industry is the combined ratio, which is expressed as a percentage. It is the sum of the ratio of losses and loss expenses to premiums earned (loss ratio) plus the ratio of policy acquisition and other underwriting expenses to premiums earned (expense ratio). When the combined ratio is less than 100%, underwriting results are generally considered profitable; when the combined ratio is greater than 100%, underwriting results are generally considered unprofitable.

Factors affecting losses and loss expenses include the frequency and severity of losses, the nature and severity of catastrophic losses, the quality of risks underwritten and underlying claims and settlement expenses.

Investments held by the Property and Casualty Group are reported in the investment operations segment, separate from the underwriting business.

Life insurance operations

EFL generates revenues through the sale of its individual and group life insurance policies and fixed annuities. These products provide our property and casualty agency force an opportunity to cross-sell both personal and commercial accounts. EFL's profitability depends principally on the ability to develop, price and distribute insurance products, attract and retain deposit funds, generate investment returns and manage expenses. Other drivers include mortality and morbidity experience, persistency experience to enable the recovery of acquisition costs, maintenance of interest spreads over the amounts credited to deposit funds and the maintenance of strong ratings from rating agencies.

Table of Contents

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 segment discussion includes the life insurance related investment results. However, also for presentation purposes, the segment footnote and the investment operations segment discussion also include the life insurance investment results as part of the Exchange's investment results.

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.

Investment operations

We generate revenues from our fixed maturity, equity security and limited partnership investment portfolios to support our underwriting business. The portfolios are managed with the objective of maximizing after-tax returns on a risk-adjusted basis. Management actively evaluates the portfolios for impairments. We record impairment writedowns on investments in instances where the fair value of the investment is substantially below cost, and we conclude that the decline in fair value is other-than-temporary.

Earnings from our investment operations increased in the third quarter of 2012, compared to the third quarter of 2011, due to net realized gains in the third quarter of 2012. Net realized gains totaled \$169 million, compared to losses of \$422 million in the prior year quarter, primarily reflecting valuation gains on our common stock portfolio in the third quarter of 2012 compared to valuation losses in the third quarter of 2011. Net investment income totaled \$105 million in the third quarter of 2012, compared to \$108 million in the third quarter of 2011. Equity in earnings of limited partnerships was \$41 million in the third quarter of 2012, compared to \$40 million in the third quarter of 2011. The results from our limited partnerships are based upon financial statements received from our general partners, which are generally received on a quarter lag. As a result, our third quarter 2012 partnership earnings reflect the market conditions experienced in the second quarter of 2012 and not in the third quarter of 2012.

General Conditions and Trends Affecting Our Business

Economic conditions

Unfavorable changes in economic conditions, including declining consumer confidence, inflation, high unemployment and the threat of recession, among others, may lead the Property and Casualty Group's customers to modify coverage, not renew policies, or even cancel policies, which could adversely affect the premium revenue of the Property and Casualty Group, and consequently Indemnity's management fee. These conditions could also impair the ability of customers to pay premiums when due, and as a result, the Property and Casualty Group's bad debt write-offs could increase. Our key challenge is to generate profitable revenue growth in a highly competitive market that continues to experience the effects of uncertain economic conditions.

Financial market volatility

Our portfolio of fixed income, preferred and common stocks, and limited partnerships are subject to market volatility especially in periods of instability in the worldwide financial markets. Over time, net investment income could also be impacted by volatility and by the general level of interest rates, which impact reinvested cash flow from the portfolio and business operations. Depending upon market conditions, which are

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

unpredictable and remain uncertain, considerable fluctuation could exist in our reported total investment income, which could have an adverse impact on our financial condition, results of operations and cash flows.

Table of Contents**RESULTS OF OPERATIONS**

The information that follows is presented on a segment basis prior to eliminations.

Management Operations

Management fee revenue is earned by Indemnity from services relating to the sales, underwriting and issuance of policies on behalf of the Exchange as a result of its attorney-in-fact relationship, and is eliminated upon consolidation. A summary of the results of our management operations is as follows:

<i>(dollars in millions)</i>	Indemnity Shareholder Interest					
	Three months ended			Nine months ended		
	2012	2011	% Change	2012	2011	% Change
	September 30,			September 30,		
	(Unaudited)			(Unaudited)		
Management fee revenue, net	\$305	\$280	8.8 %	\$882	\$816	8.1 %
Service agreement revenue	8	8	(7.4)	23	25	(8.1)
Total revenue from management operations	313	288	8.3	905	841	7.6
Cost of management operations	247	226	9.5	734	667	10.1
Income from management operations						
Indemnity ⁽¹⁾	\$ 66	\$ 62	4.0 %	\$171	\$174	(2.2)%
Gross margin	20.9%	21.7%	(0.8)pts.	18.8%	20.7%	(1.9)pts.

(1) Indemnity retains 100% of the income from management operations.

Management fee revenue

Management fee revenue is based upon all premiums written or assumed by the Exchange and the management fee rate, which is determined by our Board of Directors at least annually. Management fee revenue is calculated by multiplying the management fee rate by 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 agreement. The following table presents the calculation of management fee revenue:

<i>(dollars in millions)</i>	Indemnity Shareholder Interest					
	Three months ended			Nine months ended		
	2012	2011	% Change	2012	2011	% Change
	September 30,			September 30,		
	(Unaudited)			(Unaudited)		
Property and Casualty Group direct written premium	\$1,215	\$1,119	8.6 %	\$3,532	\$3,271	8.0 %
Management fee rate	25.00%	25.00%		25.00%	25.00%	

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Management fee revenue, gross	304	280	8.6	883	818	8.0
Change in allowance for management fee returned on cancelled policies (1)	1		NM	(1)	(2)	NM
Management fee revenue, net of allowance	\$ 305	\$ 280	8.8 %	\$ 882	\$ 816	8.1 %

NM = not meaningful

(1) Management fees are returned to the Exchange when policies are cancelled mid-term and unearned premiums are refunded. We record an estimated allowance for management fees returned on mid-term policy cancellations.

Direct written premium of the Property and Casualty Group increased 8.6% in the third quarter of 2012, compared to the third quarter of 2011, due to a 3.4% increase in policies in force and a 4.1% increase in the year-over-year average premium per policy for all lines of business. The year-over-year policy retention ratio was 90.8% at September 30, 2012, compared to 90.7% at December 31, 2011, and 90.8% at September 30, 2011. See the Property and Casualty Insurance Operations segment that follows for a complete discussion of property and casualty direct written premium, which has a direct bearing on Indemnity's management fee.

The management fee rate was set at 25%, the maximum rate, for both 2012 and 2011. Changes in the management fee rate can affect the segment's revenue and net income significantly.

Table of ContentsService agreement revenue

Service agreement revenue includes service charges Indemnity collects from policyholders for providing extended payment terms on policies written by the Property and Casualty Group and late payment and policy reinstatement fees. The service charges are fixed dollar amounts per billed installment. Service agreement revenue totaled \$8 million in both the third quarters of 2012 and 2011, and \$23 million and \$25 million for the nine months ended September 30, 2012 and 2011, respectively. The decrease in service agreement revenue resulted from a slight decline in late payment and policy reinstatement fees and a continued shift in policies to the monthly direct debit payment plan, which does not incur service charges, and the no-fee single payment plan, which offers a premium discount. The shift to these plans is driven by the consumers' desire to avoid paying service charges and to take advantage of the discount in pricing offered for paid-in-full policies.

Cost of management operations

(in millions)	Indemnity Shareholder Interest					
	Three months ended September 30,			Nine months ended September 30,		
	2012	2011	% Change	2012	2011	% Change
	(Unaudited)			(Unaudited)		
Commissions	\$163	\$151	8.2 %	\$477	\$446	7.0 %
Non-commission expense	84	75	12.2	257	221	16.3
Total cost of management operations	\$247	\$226	9.5 %	\$734	\$667	10.1 %

Commissions Commissions increased \$12 million in the third quarter of 2012 and \$31 million for the nine months ended September 30, 2012, compared to the same respective periods in 2011, primarily as a result of the 8.6% and 8.0%, respectively, increase in direct written premium of the Property and Casualty Group. Impacting this increase for the nine months ended September 30, 2012, was an adjustment that reduced commission expense by \$6 million that 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.

Non-commission expense Non-commission expense increased \$9 million in the third quarter of 2012, compared to the third quarter of 2011. Sales, policy issuance, advertising, and underwriting costs increased \$2 million primarily due to increased levels of applications and policies and increased agent related advertising and support. Information technology costs increased \$3 million, which included \$1 million of personnel costs, \$1 million of software costs and \$1 million of professional fees. Personnel and all other operating costs, excluding information technology related costs, increased \$4 million as a result of a \$2 million increase related to higher staffing levels primarily associated with policy acquisition and customer service functions, a \$1 million increase in pension costs, and a \$1 million increase in the estimate for annual incentive plan compensation related to growth and underwriting performance.

For the nine months ended September 30, 2012, non-commission expense increased \$36 million, compared to the nine months ended September 30, 2011. Sales, policy issuance, advertising, and underwriting costs increased \$8 million primarily due to increased levels of applications and policies and increased agent related advertising and support. Information technology costs increased \$13 million, which included \$4 million of personnel costs, \$5 million of software costs and \$4 million of professional fees. Personnel and all other operating costs, excluding information technology related costs, increased \$15 million as a result of a \$7 million increase related to higher staffing levels primarily associated with policy acquisition and customer service functions, a \$4 million increase in pension and health care costs, and a \$4 million increase in the estimate for annual incentive plan compensation related to growth and underwriting performance.

Gross margin

The gross margin in the third quarter of 2012 was 20.9%, compared to 21.7% in the third quarter of 2011, and was 18.8% for the nine months ended September 30, 2012, compared to 20.7% for the nine months ended September 30, 2011, as a result of expense increases outpacing revenue growth. Excluding the adjustment that reduced commission expense by \$6 million that occurred in the second quarter of 2012, the gross margin would have been 18.2% for the nine months ended September 30, 2012.

Table of Contents**Property and Casualty Insurance Operations**

The Property and Casualty Group operates in 11 Midwestern, Mid-Atlantic and Southeastern states and the District of Columbia and primarily writes private passenger automobile, homeowners, commercial multi-peril, commercial automobile, and workers compensation lines of insurance. A summary of the results of our property and casualty insurance operations is as follows:

<i>(dollars in millions)</i>	Property and Casualty Group					
	Three months ended September 30,			Nine months ended September 30,		
	2012	2011	% Change	2012	2011	% Change
	(Unaudited)			(Unaudited)		
Premiums:						
Direct written premium	\$1,215	\$1,119	8.6 %	\$3,532	\$3,271	8.0 %
Reinsurance assumed and ceded	(8)	(4)	(81.1)	(22)	(12)	(82.3)
Net written premium	1,207	1,115	8.4	3,510	3,259	7.7
Change in unearned premium	89	70	28.7	231	170	36.2
Net premiums earned	1,118	1,045	7.0	3,279	3,089	6.1
Losses and loss expenses:						
Current accident year, excluding catastrophe losses	794	746	6.2	2,200	2,092	5.1
Current accident year catastrophe losses	114	174	(34.4)	343	777	(55.8)
Prior accident years, including prior year catastrophe losses	(18)	(97)	73.1	(42)	(216)	80.6
Losses and loss expenses	890	823	7.9	2,501	2,653	(5.8)
Policy acquisition and other underwriting expenses	329	302	8.7	963	882	9.0
Total losses and expenses	1,219	1,125	8.1	3,464	3,535	(2.1)
Underwriting loss Exchange ⁽¹⁾	\$ (101)	\$ (80)	(22.6)%	\$ (185)	\$ (446)	58.9 %
Loss and loss expense ratios:						
Current accident year loss ratio, excluding catastrophe losses	70.9 %	71.4 %	(0.5)pts.	67.0 %	67.7 %	(0.7)pts.
Current accident year catastrophe loss ratio	10.2	16.7	(6.5)	10.5	25.1	(14.6)
Prior accident year loss ratio, including prior year catastrophe losses	(1.6)	(9.3)	7.7	(1.3)	(6.9)	5.6
Total loss and loss expense ratio	79.5	78.8	0.7	76.2	85.9	(9.7)
Policy acquisition and other underwriting expense ratio	29.4	28.9	0.5	29.4	28.6	0.8
Combined ratio	108.9 %	107.7 %	1.2 pts.	105.6 %	114.5 %	(8.9)pts.

(1) The Exchange retains 100% of the income from the property and casualty insurance operations.

We measure profit or loss from our property and casualty insurance segment based upon its underwriting results, which are represented by net premiums earned less losses and loss expenses and policy acquisition and other underwriting expenses on a pre-tax basis. The loss and loss expense ratio and combined ratio are key performance indicators that we use to assess business trends and to make comparisons to industry results. The investment results related to our property and casualty insurance operations are included in our investment operations segment discussion.

Premiums

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Direct written premium Direct written premium of the Property and Casualty Group increased 8.6% to \$1.2 billion in the third quarter of 2012, from \$1.1 billion in the third quarter of 2011, driven by an increase in policies in force and increases in average premium per policy. Year-over-year policies in force for all lines of business increased by 3.4% in the third quarter of 2012 as the result of continuing strong policyholder retention, compared to an increase of 2.6% in the third quarter of 2011. The year-over-year average premium per policy for all lines of business increased 4.1% at September 30, 2012, compared to an increase of 2.9% at September 30, 2011. The combined impact of these increases was seen primarily in our personal lines renewal business premiums and to lesser degrees in our commercial lines renewal business, personal lines new business, and commercial lines new business premiums.

Table of Contents

Premiums generated from new business increased 17.8% to \$142 million in the third quarter of 2012, compared to an increase of 1.8% to \$121 million in the third quarter of 2011. Underlying the trend in new business premiums was a 10.0% increase in new business policies written in the third quarter of 2012, compared to the same period in 2011, while the year-over-year average premium per policy on new business increased 7.5% at September 30, 2012, compared to an increase of 5.8% at September 30, 2011.

Premiums generated from renewal business increased 7.5% to \$1.1 billion in the third quarter of 2012, compared to an increase of 5.8% to \$998 million in the third quarter of 2011. Underlying the trend in renewal business premiums were increases in average premium per policy and steady policy retention trends. The renewal business year-over-year average premium per policy increased 3.7% at September 30, 2012, compared to 2.5% at September 30, 2011. The Property and Casualty Group's year-over-year policy retention ratio was 90.8% at September 30, 2012, 90.7% at December 31, 2011, and 90.8% at September 30, 2011.

Personal lines Total personal lines premiums written increased 7.6% to \$903 million in the third quarter of 2012, from \$840 million in the third quarter of 2011, driven by an increase of 3.3% in the total personal lines policies in force and an increase of 3.2% in the total personal lines year-over-year average premium per policy.

New business premiums written on personal lines increased 17.4% in the third quarter of 2012, compared to an increase of 1.4% in the third quarter of 2011. Personal lines new business policies written increased 12.1% in the third quarter of 2012, compared to the same period in 2011, while the year-over-year average premium per policy on personal lines new business increased 4.8% at September 30, 2012, compared to an increase of 3.8% at September 30, 2011.

- Private passenger auto new business premiums written increased 10.0% in the third quarter of 2012, compared to an increase of 0.6% in the third quarter of 2011. New business policies written for private passenger auto increased 5.3% in the third quarter of 2012, compared to the same period in 2011, while the new business year-over-year average premium per policy for private passenger auto increased 3.6% at September 30, 2012, compared to an increase of 2.1% at September 30, 2011.

- Homeowners new business premiums written increased 30.4% in the third quarter of 2012, compared to an increase of 3.9% in the third quarter of 2011. New business policies written for homeowners increased 18.1% in the third quarter of 2012, compared to the same period in 2011. The new business year-over-year average premium per policy for homeowners increased 9.2% at September 30, 2012, compared to an increase of 5.6% at September 30, 2011.

Renewal premiums written on personal lines increased 6.5% in the third quarter of 2012, compared to an increase of 4.9% in the third quarter of 2011, driven by increases in average premium per policy and steady policy retention trends. The year-over-year average premium per policy on personal lines renewal business increased 3.1% at September 30, 2012, compared to 2.4% at September 30, 2011. The personal lines year-over-year policy retention ratio was 91.5% at September 30, 2012 and December 31, 2011, and 91.6% at September 30, 2011.

- Private passenger auto renewal premiums written increased 3.6% in the third quarter of 2012, compared to 2.0% in the third quarter of 2011. The year-over-year average premium per policy on private passenger auto renewal business increased 0.8% at September 30, 2012, compared to 1.2% at September 30, 2011. The private passenger auto year-over-year policy retention ratio was 92.0% at September 30, 2012,

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

91.6% at December 31, 2011 and 91.7% at September 30, 2011.

- Homeowners renewal premiums written increased 11.8% in the third quarter of 2012, compared to 10.6% in the third quarter of 2011. The year-over-year average premium per policy on homeowners renewal business increased 8.4% at September 30, 2012, compared to 7.1% at September 30, 2011. The homeowners year-over-year policyholder retention ratio was 90.9% at September 30, 2012, 91.0% at December 31, 2011 and 91.2% at September 30, 2011.

Commercial lines Total commercial lines premiums written increased 11.8% to \$312 million in the third quarter of 2012, from \$279 million in the third quarter of 2011, driven by a 4.3% increase in the total commercial lines policies in force and a 6.0% increase in the total commercial lines year-over-year average premium per policy.

New business premiums written on commercial lines increased 18.4% in the third quarter of 2012, compared to 2.6% in the third quarter of 2011, driven by increases in new business policies written and average premium per policy. The

Table of Contents

combined impact of these increases was seen primarily in the commercial multi-peril and workers compensation lines of business. Commercial lines new business policies written increased 0.2% in the third quarter of 2012, compared to the same period in 2011, while the year-over-year average premium per policy on commercial lines new business increased 15.4% at September 30, 2012, compared to 6.1% at September 30, 2011.

Renewal premiums for commercial lines increased 10.6% in the third quarter of 2012, compared to an increase of 8.7% in the third quarter of 2011, driven by increases in average premium per policy and steady policy retention trends. The combined impact of these increases was seen primarily in the commercial multi-peril and workers compensation lines of business. The year-over-year average premium per policy on commercial lines renewal business increased 4.4% at September 30, 2012, compared to 2.5% at September 30, 2011. The year-over-year policy retention ratio for commercial lines was 86.0% at September 30, 2012, 85.5% at December 31, 2011 and 85.3% at September 30, 2011.

Future trends premium revenue We plan to continue our efforts to grow Property and Casualty Group premiums and improve our competitive position in the marketplace. Expanding the size of our agency force through a careful agency selection process and increased market penetration in our existing operating territories will contribute to future growth as existing and new agents build their books of business with the Property and Casualty Group. At September 30, 2012, we had nearly 2,200 agencies with almost 10,000 licensed property and casualty representatives.

Changes in premium levels attributable to the growth in policies in force and rate changes directly affect the profitability of the Property and Casualty Group and have a direct bearing on Indemnity's management fee. Our continued focus on underwriting discipline and the maturing of our pricing sophistication models have contributed to the Property and Casualty Group's growth in new policies in force and steady policy retention ratios.

Losses and loss expenses

Current accident year, excluding catastrophe losses The current accident year loss and loss expense ratio for all lines of business, excluding catastrophe losses, was 70.9% in the third quarter of 2012, compared to 71.4% in the third quarter of 2011, and 67.0% for the nine months ended September 30, 2012, compared to 67.7% for the nine months ended September 30, 2011. The decline during the first nine months of 2012 was driven primarily by a lower volume of claims resulting from mild winter weather in the first quarter of 2012, compared to the first quarter of 2011.

Current accident year catastrophe losses Catastrophic events, destructive weather patterns, or changes in climate conditions are an inherent risk of the property and casualty insurance business and can have a material impact on our property and casualty insurance underwriting results. In addressing this risk, we employ what we believe are reasonable underwriting standards and monitor our exposure by geographic region. The Property and Casualty Group's definition of catastrophes includes those weather related or other loss events that we consider significant to our geographic footprint which, individually or in the aggregate, may not reach the level of a national catastrophe as defined by the Property Claim Service (PCS). The Property and Casualty Group maintains property catastrophe reinsurance coverage from unaffiliated reinsurers to mitigate future potential catastrophe loss exposures and no longer participates in the voluntary assumed reinsurance business, which lowers the variability of the Property and Casualty Group's underwriting results.

Catastrophe losses for the current accident year, as defined by the Property and Casualty Group, totaled \$114 million in the third quarter of 2012, compared to \$174 million in the third quarter of 2011, and contributed 10.2 points and 16.7 points, respectively, to the loss ratios. For the nine months ended September 30, 2012, catastrophe losses totaled \$343 million, compared to \$777 million for the nine months ended September 30, 2011, and contributed 10.5 points and 25.1 points to the respective loss ratios.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Table of Contents

Prior accident years, including prior accident year catastrophe losses The following table provides a breakout of our property and casualty insurance operations prior year loss reserve development, including prior accident year catastrophe loss reserves, by type of business:

<i>(in millions)</i>	Property and Casualty Group			
	Three months ended		Nine months ended	
	September 30,	2011	September 30,	2011
	2012	(Unaudited)	2012	(Unaudited)
Direct business including salvage and subrogation	\$(15)	\$(92)	\$(33)	\$(203)
Assumed reinsurance business	(3)	(5)	(3)	(9)
Ceded reinsurance business	0	0	(6)	(4)
Total prior year loss development	\$(18)	\$(97)	\$(42)	\$(216)

Negative amounts represent a redundancy (decrease in reserves), while positive amounts represent a deficiency (increase in reserves).

Direct business, including reserves for catastrophe losses and salvage and subrogation In the third quarter of 2012, the Property and Casualty Group experienced favorable development on direct prior accident year loss reserves of \$15 million and improved the combined ratio by 1.3 points, compared to \$92 million in the third quarter of 2011 that improved the combined ratio by 8.8 points. For the nine months ended September 30, 2012, favorable development of direct prior accident year loss reserves totaled \$33 million and improved the combined ratio by 1.0 points, compared to \$203 million and 6.6 points for the nine months ended September 30, 2011.

The favorable development in the third quarter and first nine months of 2012 was impacted by better than expected severity trends in the commercial multi-peril line of business and better than expected frequency trends in the homeowners line of business. Offsetting this favorable development in the first nine months of 2012 was adverse development in the personal auto and workers compensation lines of business driven by increased severity trends. In the third quarter and first nine months of 2011, the favorable development was impacted by the closing of massive injury lifetime medical benefits claims in the workers compensation and personal auto lines of business. The first nine months of 2011 was also impacted by better than expected severity trends in the personal auto, commercial multi-peril and homeowners lines of business.

Assumed reinsurance The Property and Casualty Group experienced favorable development on prior accident year loss reserves for its assumed reinsurance business totaling \$3 million and \$5 million in the third quarters of 2012 and 2011, respectively, and \$3 million and \$9 million for the nine months ended September 30, 2012 and 2011, respectively. The favorable development in 2012 and 2011 was due to less than anticipated growth in involuntary reinsurance.

Ceded reinsurance The Property and Casualty Group's ceded reinsurance reserve recoveries remained flat in both the third quarters of 2012 and 2011, and increased by \$6 million and \$4 million for the nine months ended September 30, 2012, and 2011, respectively. The increase in ceded recoveries is reflected as favorable loss development as it represents an increase in recoveries resulting from adverse development on our direct loss reserves. In the first nine months of 2012, the increase in ceded recoveries was primarily the result of adverse development related to the pre-1986 automobile massive injury claims. In the first nine months of 2011, the increase was primarily due to adverse development in the business catastrophe liability and commercial multi-peril lines of business.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Policy acquisition and other underwriting expenses Our policy acquisition and other underwriting expense ratio increased 0.5 points to 29.4% in the third quarter of 2012, compared to 28.9% in the third quarter of 2011, and increased 0.8 points to 29.4% for the nine months ended September 30, 2012, compared to 28.6% for the nine months ended September 30, 2011. These increases were primarily due to a decrease in the amount of policy acquisition expenses deferred under the new accounting guidance effective in 2012. Additionally, the nine months ended September 30, 2012 included an adjustment of \$4 million which contributed 0.1 points to the combined ratio. The adjustment 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. The management fee rate was 25% for the periods ending September 30, 2012 and 2011.

Table of Contents**Life Insurance Operations**

EFL is a Pennsylvania-domiciled life insurance company which underwrites and sells individual and group life insurance policies and fixed annuities and operates in 10 states and the District of Columbia. A summary of the results of our life insurance operations is as follows:

<i>(in millions)</i>	Erie Family Life Insurance Company					
	Three months ended			Nine months ended		
	2012	2011	% Change	2012	2011	% Change
	September 30,			September 30,		
	(Unaudited)			(Unaudited)		
Individual life premiums, net of reinsurance	\$18	\$16	11.9 %	\$ 53	\$ 48	10.0 %
Group life and other premiums	1	0	3.9	2	2	3.8
Other revenue	0	1	NM	1	1	6.4
Total net policy revenue	19	17	11.8	56	51	9.7
Net investment income	23	24	(4.2)	71	70	1.3
Net realized gains on investments	2	5	(68.4)	6	12	(43.1)
Impairment losses recognized in earnings	0	0	NM	0	0	NM
Equity in earnings (losses) of limited partnerships	0	0	NM	0	1	NM
Total revenues	44	46	(1.3)	133	134	(0.3)
Benefits and other changes in policy reserves	24	26	(4.2)	74	75	(0.8)
Amortization of deferred policy acquisition costs	3	3	(0.2)	10	10	(4.3)
Other operating expenses	5	4	42.0	15	11	47.2
Total benefits and expenses	32	33	(3.0)	99	96	4.3
Income before income taxes	\$12	\$13	(8.5)%	\$ 34	\$ 38	(11.7)%
Income before taxes Indemnity(1)	\$	\$		\$	\$ 3	
Income before taxes Exchange(1)	\$12	\$13		\$ 34	\$ 35	

NM = not meaningful

(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.

Policy revenue

Gross policy revenues increased 5.8% to \$29 million in the third quarter 2012, from \$27 million in the third quarter of 2011. EFL reinsures a large portion of its traditional products in order to reduce claims volatility. With the introduction of its new life products, effective June 1, 2011, EFL reinsures new individual life business amounts in excess of its \$1 million per life retention limit. Previously, EFL reinsured 75% of its risk on new term business. Ceded reinsurance premiums totaled \$9 million in both the third quarters of 2012 and 2011. For the nine months ended September 30, 2012 compared to 2011, gross policy revenues totaled \$86 million and \$82 million, respectively, while ceded reinsurance premiums totaled \$30 million and \$31 million, respectively.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Premiums received on annuity and universal life products totaled \$18 million and \$19 million in the third quarters of 2012 and 2011, respectively. Of these amounts, annuity and universal life premiums, which are recorded as deposits and therefore not reflected in revenue on the Consolidated Statements of Operations, totaled \$14 million and \$15 million in the third quarters of 2012 and 2011, respectively. For the nine months ended September 30, 2012 compared to 2011, premiums received on annuity and universal life products totaled \$58 million and \$68 million, respectively, while annuity and universal life deposits totaled \$46 million and \$56 million, respectively.

Investment revenue

EFL's investment revenue in the third quarter and first nine months of 2012 was primarily impacted by a decrease in net realized gains on investments as a result of the third quarter and first nine months of 2011 having gains on disposals of preferred stocks. See the discussion of investments in the Investment Operations segment that follows for further information.

Benefits and expenses

Other operating expenses increased in the third quarter and first nine months of 2012 due to a decrease in the amount of policy acquisition expenses deferred under the new accounting guidance effective in 2012 and lower ceding commissions.

Investment Operations

The investment results related to our life insurance operations are included in the investment operations segment discussion as part of the Exchange's investment results. A summary of the results of our investment operations is as follows:

(in millions)	Erie Insurance Group					
	Three months ended			Nine months ended		
	September 30,			September 30,		
	2012	2011	% Change	2012	2011	% Change
	(Unaudited)			(Unaudited)		
Indemnity						
Net investment income	\$ 4	\$ 4	(1.5)%	\$ 12	\$ 12	1.2%
Net realized gains (losses) on investments	2	(6)	NM	4	1	NM
Net impairment losses recognized in earnings	0	0	NM	0	0	NM
Equity in earnings of limited partnerships	6	7	(18.0)	10	25	(59.4)
Net revenue from investment operations Indemnity	\$ 12	\$ 5	120.1%	\$ 26	\$ 38	(30.9)%
Exchange						
Net investment income	\$104	\$ 106	(1.6)%	\$322	\$322	0.0%
Net realized gains (losses) on investments	167	(416)	NM	354	(235)	NM
Net impairment losses recognized in earnings	0	0	NM	0	0	NM
Equity in earnings of limited partnerships	35	33	4.9%	89	125	(29.3)%
Net revenue from investment operations Exchange ⁽¹⁾	\$306	\$(277)	NM	\$765	\$212	NM

NM = not meaningful

(1) The Exchange's investment results for the third quarter of 2012 and 2011 include net investment revenues from EFL's operations of \$25 million and \$29 million, respectively. The Exchange's investment results for the first nine months of 2012 and 2011 include net investment revenues from EFL's operations of \$77 million and \$83 million, respectively.

Net investment income

Net investment income primarily includes interest and dividends on our fixed maturity and equity security portfolios net of investment expenses. Indemnity's net investment income was unchanged in the third quarter of 2012, compared to the third quarter of 2011, while the Exchange's net investment income decreased \$2 million during the same period. The decrease in net investment income for the Exchange in the third quarter of 2012 was due to lower investment yields, which more than offset higher invested balances. Net investment income for both Indemnity and the Exchange was unchanged for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011. Net investment income for the Exchange was unchanged for the first nine months of 2012 as lower investment yields were offset by higher invested balances.

Net realized gains on investments

Net realized gains and losses on investments include the changes in fair value of our common stock portfolio, as this portfolio is classified as trading, and gains and losses resulting from the actual sales of all security categories. Indemnity generated net realized gains of \$2 million in the third quarter of 2012, compared to losses of \$6 million in the third quarter of 2011, while the Exchange generated net realized gains of \$167 million, compared to losses of \$416 million during the same periods. Indemnity generated net realized gains of \$4 million for the nine months ended September 30, 2012, compared to gains of \$1 million for the nine months ended September 30, 2011, while the Exchange generated net realized gains of \$354 million, compared to losses of \$235 million for the same respective periods. Net realized gains for Indemnity and the Exchange increased in the third quarter and first nine months of 2012 primarily due to valuation gains on common stocks compared to valuation losses incurred during the same periods in 2011.

Net impairment losses recognized in earnings

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

Equity in earnings of limited partnerships

Indemnity's equity in earnings of limited partnerships decreased \$1 million in the third quarter of 2012, compared to the third quarter of 2011, while the Exchange's equity in earnings of limited partnerships increased \$2 million during the same period. The increase in earnings for the Exchange during the third quarter of 2012 was primarily due to higher earnings from private equity investments. Indemnity's equity in earnings of limited partnerships decreased \$15 million for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, while

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

the Exchange's equity in earnings of limited partnerships decreased \$36 million during the same period. For the first nine months of 2012, the decrease in earnings for both Indemnity and the Exchange was due primarily to lower earnings from the private equity and real estate sectors.

A breakdown of our net realized gains (losses) on investments is as follows:

(in millions)	Erie Insurance Group				
	Three months ended			Nine months ended	
	September 30,			September 30,	
	2012	2011	2012	2011	
	(Unaudited)			(Unaudited)	
Indemnity					
Securities sold:					
Fixed maturities	\$ 0	\$ 0	\$ 0	\$ 2	
Preferred stock equity securities	0	0	0	3	
Common stock equity securities	0	0	1	2	
Common stock valuation adjustments	2	(6)	3	(6)	
Total net realized gains Indemnity(1)	\$ 2	\$ (6)	\$ 4	\$ 1	
Exchange					
Securities sold:					
Fixed maturities	\$ 16	\$ 10	\$ 35	\$ 44	
Preferred stock equity securities	0	3	3	18	
Common stock equity securities	13	21	65	124	
Common stock valuation adjustments	138	(450)	251	(421)	
Total net realized gains Exchange(1) (2)	\$167	\$(416)	\$354	\$(235)	

(1) See Item 1. Financial Statements Note 7. Investments, contained within this report for additional disclosures regarding net realized gains (losses) on investments.

(2) The Exchange's results for the third quarter of 2012 and 2011 include net realized gains from EFL's operations of \$2 million and \$5 million, respectively. The Exchange's results for the first nine months of 2012 and 2011 include net realized gains from EFL of \$6 million and \$12 million, respectively.

The components of equity in earnings (losses) of limited partnerships are as follows:

(in millions)	Erie Insurance Group					
	Three months ended			Nine months ended		
	September 30,			September 30,		
	2012	2011	% Change	2012	2011	% Change
	(Unaudited)			(Unaudited)		
Indemnity						
Private equity	\$ 2	\$ 2	(40.3)%	\$ 4	\$ 13	(66.4)%
Mezzanine debt	1	2	(7.3)	4	5	(17.7)
Real estate	3	3	(3.6)	2	7	(75.4)
Total equity in earnings of limited partnerships Indemnity	\$ 6	\$ 7	(18.0)%	\$10	\$ 25	(59.4)%
Exchange						
Private equity	\$16	\$12	27.0%	\$44	\$ 69	(36.5)%
Mezzanine debt	7	6	23.2	24	21	11.0
Real estate	12	15	(20.1)	21	35	(40.0)
Total equity in earnings of limited partnerships Exchange	\$35	\$33	4.9%	\$89	\$125	(29.3)%
(1)						

NM = not meaningful

(1) The Exchange's results include equity in earnings of limited partnerships from EFL of \$0.2 million for the third quarter of 2012 and \$0.4 million for the third quarter of 2011. The Exchange's results for the first nine months of 2012 did not include any equity in earnings of limited partnerships from EFL and included earnings of \$1.4 million for the first nine months of 2011.

Limited partnership earnings pertain to investments in U.S. and foreign private equity, mezzanine debt and real estate partnerships. Valuation adjustments are recorded to reflect the changes in fair value of the underlying investments held by the limited partnerships. These adjustments are recorded as a component of equity in earnings of limited partnerships in the Consolidated Statements of Operations. Limited partnership earnings tend to be cyclical based upon market conditions, the age of the partnership, and the nature of the investments. Generally, limited partnership earnings are recorded on a quarter lag from financial statements we receive from our general partners. As a consequence, earnings from limited partnerships reported at September 30, 2012 reflect investment valuation changes resulting from the financial markets and the economy in the second quarter of 2012 and not the third quarter of 2012.

FINANCIAL CONDITION**Investments**

Our investment strategy takes a long-term perspective emphasizing investment quality, diversification, and superior investment returns. Investments are managed on a total return approach that focuses on current income and capital appreciation. Our investment strategy also provides for liquidity to meet our short- and long-term commitments.

Distribution of investments

<i>(in millions)</i>	Erie Insurance Group			
	Carrying value at September 30, 2012 (Unaudited)	% to total	Carrying value at December 31, 2011	% to total
Indemnity				
Fixed maturities	\$ 547	68%	\$ 548	68%
Equity securities:				
Preferred stock	29	4	25	3
Common stock	30	4	27	4
Limited partnerships:				
Private equity	76	9	82	10
Mezzanine debt	30	4	35	4
Real estate	89	11	91	11
Real estate mortgage loans	1	0	1	0
Total investments Indemnity	\$ 802	100%	\$ 809	100%
Exchange				
Fixed maturities	\$ 7,623	64%	\$ 7,292	65%
Equity securities:				
Preferred stock	624	5	564	5
Common stock	2,639	22	2,308	21
Limited partnerships:				
Private equity	504	4	495	4
Mezzanine debt	193	2	201	2
Real estate	386	3	386	3
Life policy loans	16	0	15	0
Real estate mortgage loans	4	0	4	0
Total investments Exchange	\$11,989	100%	\$11,265	100%
Total investments Erie Insurance Group	\$12,791		\$12,074	

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

We individually analyze all positions with emphasis on those that have, in management's opinion, declined significantly below cost. In compliance with impairment guidance for debt securities, we perform further analysis to determine if a credit-related impairment has occurred. Some of the factors considered in determining whether a debt security is credit impaired 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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

the intent to sell all credit-impaired debt securities, therefore the entire amount of the impairment charges are included in earnings and no credit impairments are recorded in other comprehensive income. For available-for-sale equity securities, a charge is recorded in the Consolidated Statements of Operations for positions that have experienced other-than-temporary impairments due to credit quality or other factors. (See the Investment Operations section herein for further information.) Management believes its investment valuation philosophy and accounting practices result in appropriate and timely measurement of value and recognition of impairment.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Fixed maturities

Under our investment strategy, we maintain a fixed maturity portfolio that is of high quality and well diversified within each market sector. This investment strategy also achieves a balanced maturity schedule. Our fixed maturity portfolio is managed with the goal of achieving reasonable returns while limiting exposure to risk. Our municipal bond portfolio accounts for \$195 million, or 36%, of the total fixed maturity portfolio for Indemnity and \$1.3 billion, or 18%, of the fixed maturity portfolio for the Exchange at September 30, 2012. The overall credit rating of the municipal portfolio without consideration of the underlying insurance is AA. Although some of our municipal holdings are insured, the underlying insurance does not improve the overall credit rating.

Fixed maturities classified as available-for-sale are carried at fair value with unrealized gains and losses, net of deferred taxes, included in shareholders equity. Indemnity's net unrealized gains on fixed maturities, net of deferred taxes, amounted to \$11 million at September 30, 2012, compared to \$8 million at December 31, 2011. At September 30, 2012, the Exchange had net unrealized gains on fixed maturities of \$464 million, compared to net unrealized gains of \$301 million at December 31, 2011.

The following table presents a breakdown of the fair value of our fixed maturities portfolio by sector and rating for Indemnity and the Exchange, respectively:

(in millions)	Erie Insurance Group (1)					Non-investment grade	Fair value
	At September 30, 2012						
Industry Sector	AAA	AA	A	BBB			
Indemnity							
Basic materials	\$ 0	\$ 0	\$ 5	\$ 14		\$ 0	\$ 19
Communications	0	0	18	0		0	18
Consumer	0	0	28	16		0	44
Energy	0	0	10	20		0	30
Financial	0	34	80	43		4	161
Government-municipal	89	78	19	9		0	195
Industrial	0	4	6	0		0	10
Structured securities (2)	13	0	1	2		0	16
Technology	0	0	5	14		0	19
Utilities	0	0	8	27		0	35
Total Indemnity	\$102	\$ 116	\$ 180	\$ 145		\$ 4	\$ 547
Exchange							
Basic materials	\$ 0	\$ 0	\$ 48	\$ 171		\$ 19	\$ 238
Communications	0	0	218	310		25	553
Consumer	0	31	296	540		20	887
Diversified	0	0	22	0		0	22
Energy	16	17	154	391		19	597
Financial	1	215	1,099	1,097		160	2,572
Foreign government	0	0	16	0		0	16
Funds	0	0	0	6		0	6
Government-municipal	411	764	140	33		0	1,348
Government sponsored entity	0	9	2	0		0	11
Industrial	0	6	75	215		15	311
Structured securities (2)	59	242	34	19		2	356
Technology	0	0	45	103		0	148
U.S. Treasury	0	6	0	0		0	6
Utilities	0	0	89	421		42	552

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Total	Exchange	\$487	\$1,290	\$2,238	\$3,306	\$302	\$7,623
-------	----------	-------	---------	---------	---------	-------	---------

(1) *Ratings are supplied by S&P, Moody's, and Fitch. The table is based upon the lowest rating for each security.*

(2) *Structured securities include asset-backed securities, collateral, lease and debt obligations, commercial mortgage-backed securities and residential mortgage-backed securities.*

Equity securities

Our equity securities consist of common stock and nonredeemable preferred stock. Investment characteristics of common stock and non-redeemable preferred stock differ from one another. Our nonredeemable preferred stock portfolio provides a source of current income that is competitive with investment-grade bonds.

The following table presents an analysis of the fair value of our preferred and common stock securities by sector for Indemnity and Exchange, respectively:

<i>(in millions)</i>	Erie Insurance Group			
	Fair value at:			
	September 30, 2012 (Unaudited)		December 31, 2011	
Industry sector	Preferred stock	Common stock	Preferred stock	Common stock
Indemnity				
Communications	\$ 1	\$ 2	\$ 1	\$ 2
Consumer	0	16	0	15
Diversified	0	1	0	1
Energy	0	1	0	1
Financial	15	5	11	4
Industrial	0	4	0	3
Technology	3	1	3	1
Utilities	10	0	10	0
Total Indemnity	\$ 29	\$ 30	\$ 25	\$ 27
Exchange				
Basic materials	\$ 0	\$ 96	\$ 0	\$ 72
Communications	10	223	9	168
Consumer	6	865	5	763
Diversified	0	19	0	18
Energy	0	190	0	203
Financial	486	377	408	340
Funds	0	175	0	105
Government	0	0	0	0
Industrial	0	384	0	350
Technology	6	274	15	246
Utilities	116	36	127	43
Total Exchange	\$624	\$2,639	\$564	\$2,308

Our preferred stock equity securities are classified as available-for-sale and are carried at fair value on the Consolidated Statements of Financial Position with all changes in unrealized gains and losses reflected in other comprehensive income. At September 30, 2012, the unrealized gain on preferred stock classified as available-for-sale securities, net of deferred taxes, amounted to \$1 million for Indemnity and \$52 million for the Exchange, compared to \$1 million for Indemnity and \$21 million for the Exchange at December 31, 2011.

Our common stock portfolio is classified as a trading portfolio and is measured at fair value with all changes in unrealized gains and losses reflected in the Consolidated Statements of Operations.

Limited partnerships

In the third quarter of 2012, investments in limited partnerships decreased modestly for Indemnity and remained relatively flat for the Exchange from the investment levels at December 31, 2011. Changes in partnership values are a function of contributions and distributions, adjusted for market value changes in the underlying investments. The results from our limited partnerships are based upon financial statements received from our general partners, which are generally received on a quarter lag. As a result, the market values and earnings recorded during the third quarter of 2012 reflect the partnership activity experienced in the second quarter of 2012.

The components of limited partnership investments are as follows:

<i>(in millions)</i>	Erie Insurance Group	
	At September 30, 2012 (Unaudited)	At December 31, 2011
Indemnity		
Private equity	\$ 76	\$ 82
Mezzanine debt	30	35
Real estate	89	91
Total limited partnerships Indemnity	\$ 195	\$ 208
Exchange		
Private equity	\$ 504	\$ 495
Mezzanine debt	193	201
Real estate	386	386
Total limited partnerships Exchange	\$1,083	\$1,082

Table of Contents**Liabilities**Property and casualty losses and loss expense reserves

Loss reserves are established to account for the estimated ultimate costs of losses and loss expenses for claims that have been reported but not yet settled and claims that have been incurred but not reported. While we exercise professional diligence to establish reserves at the end of each period that are fully reflective of the ultimate value of all claims incurred, these reserves are, by their nature, only estimates and cannot be established with absolute certainty.

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

Losses and loss expense reserves are presented on the Consolidated Statements of Financial Position on a gross basis. The following table represents the direct and assumed losses and loss expense reserves by major line of business for our property and casualty insurance operations. The reinsurance recoverable amount represents the related ceded amounts which results in the net liability attributable to the Property and Casualty Group.

<i>(in millions)</i>	Property and Casualty Group	
	At September 30, 2012 (Unaudited)	At December 31, 2011
Gross reserve liability (1):		
Personal auto	\$1,121	\$1,093
Automobile massive injury	354	356
Homeowners	328	313
Workers compensation	507	461
Workers compensation massive injury	107	99
Commercial auto	337	303
Commercial multi-peril	565	565
All other lines of business	279	309
Gross reserves	3,598	3,499
Reinsurance recoverable	151	151
Net reserve liability Exchange	\$3,447	\$3,348

(1) Loss reserves are set at full expected cost, except for workers compensation loss reserves which have been discounted using an interest rate of 2.5%. This discounting reduced unpaid losses and loss expenses by \$88 million at September 30, 2012 and \$84 million at December 31, 2011.

The reserves that have the greatest potential for variation are the massive injury lifetime medical claim reserves. The Property and Casualty Group is currently reserving for 263 claimants requiring lifetime medical care, of which 111 involve massive injuries. The reserve carried by the Property and Casualty Group for the massive injury claimants, which includes automobile massive injury and workers compensation massive injury reserves, totaled \$320 million at September 30, 2012, which is net of \$141 million of anticipated reinsurance recoverables, compared to \$315 million at December 31, 2011, which is net of \$140 million of anticipated reinsurance recoverables.

Life insurance reserves

EFL's primary commitment is its obligation to pay future policy benefits under the terms of its life insurance and annuity contracts. To meet these future obligations, EFL establishes life insurance reserves based upon the type of policy, the age, gender and risk class of the insured and the number of years the policy has been in force. EFL also establishes annuity and universal life reserves based upon the amount of policyholder deposits (less applicable insurance and expense charges) plus interest earned on those deposits. Life insurance and annuity reserves are supported primarily by EFL's long-term, fixed income investments as the underlying policy reserves are generally also of a long-term nature.

Table of Contents**IMPACT OF INFLATION**

Property and casualty insurance premiums are established before losses occur and before loss expenses are incurred, and therefore, before the extent to which inflation may impact such costs is known. Consequently, in establishing premium rates, we attempt to anticipate the potential impact of inflation, including medical cost inflation, construction and auto repair cost inflation and tort issues. Medical costs are a broad element of inflation that impacts personal and commercial auto, general liability, workers compensation and commercial multi-peril lines of insurance written by the Property and Casualty Group. Inflation assumptions take the form of explicit numerical values in the survival ratio, individual claim, and massive injury lifetime medical reserving methods. Inflation assumptions are implicitly derived through the selection of applicable loss development patterns for all other reserving methods. Occasionally, unusual aberrations in loss development patterns are caused by external and internal factors such as changes in claim reporting, settlement patterns, unusually large losses, process changes, legal or regulatory changes, and other influences. In these instances, analyses of alternate development factor selections are performed to evaluate the effect of these factors and actuarial judgment is applied to make appropriate assumptions needed to develop a best estimate of ultimate losses.

LIQUIDITY AND CAPITAL RESOURCES**Sources and Uses of Cash**

Liquidity is a measure of a company's ability to generate sufficient cash flows to meet the short- and long-term cash requirements of its business operations and growth needs. Our liquidity requirements have been met primarily by funds generated from premiums collected and income from investments. Our insurance operations provide liquidity in that premiums are collected in advance of paying losses under the policies purchased with those premiums. Cash outflows for the property and casualty insurance business are generally variable since settlement dates for liabilities for unpaid losses and the potential for large losses, whether individual or in the aggregate, cannot be predicted with absolute certainty. Accordingly, after satisfying our operating cash requirements, excess cash flows are used to build our investment operation's portfolios in order to increase future investment income, which then may be used as a source of liquidity if cash from our insurance operations would not be sufficient to meet our obligations. Cash provided from these sources is used primarily to fund losses and policyholder benefits, fund the costs of our management operations including commissions, salaries and wages, pension plans, share repurchases, dividends to shareholders and the purchase and development of information technology. We expect that our operating cash needs will be met by funds generated from operations.

Volatility in the financial markets presents challenges to us as we do occasionally access our investment portfolio as a source of cash. Some of our fixed income investments, despite being publicly traded, are illiquid. Volatility in these markets could impair our ability to sell certain of our fixed income securities or cause such securities to sell at deep discounts. Additionally, our limited partnership investments are significantly less liquid. We believe we have sufficient liquidity to meet our needs from other sources even if market volatility persists throughout 2012.

Cash flow activities - Erie Insurance Group

The following table provides condensed consolidated cash flow information for the nine months ended September 30:

<i>(in millions)</i>	Erie Insurance Group	
	2012	2011
Net cash provided by operating activities	\$ 365	\$ 225
Net cash used in investing activities	(34)	(395)

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Net cash used in financing activities	(112)	(184)
Net increase (decrease) in cash and cash equivalents	\$ 219	\$ (354)

Net cash provided by operating activities totaled \$365 million and \$225 million for the first nine months of 2012 and 2011, respectively. Increased cash from operating activities for the first nine months of 2012 was driven primarily by an increase in the premiums collected by the Exchange driven by the increase in premiums written, a decrease in losses and loss expenses paid, and a slight increase in net investment income received. Offsetting this increase somewhat was an increase in income taxes paid and other underwriting and acquisition costs paid compared to the first nine months of 2011.

Table of Contents

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.

Net cash used in investing activities totaled \$34 million and \$395 million for the first nine months of 2012 and 2011, respectively. The first nine months of 2012 investing activities included decreased cash used to purchase certain common stocks and increased cash received from calls and maturities of fixed maturity securities, offset somewhat by decreased cash generated from the sale of other common stocks compared to the first nine months of 2011. At September 30, 2012, we had contractual commitments to invest up to \$374 million related to our limited partnership investments to be funded as required by the partnerships' agreements. Of this amount, the total remaining commitment to fund limited partnerships that invest in private equity securities was \$160 million, mezzanine debt securities was \$120 million, and real estate activities was \$94 million.

For a discussion of net cash used in financing activities, see the following Cash flow activities - Indemnity, for the primary drivers of financing cash flows related to Indemnity.

Cash flow activities - Indemnity

The following table is a summary of cash flows for Indemnity for the nine months ended September 30:

<i>(in millions)</i>	Indemnity Shareholder Interest	
	2012	2011
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)

See Item 1. Financial Statements - Note 14. Indemnity Supplemental Information, contained within this report for more detail on Indemnity's cash flows.

Net cash provided by Indemnity's operating activities increased to \$144 million for the first nine months of 2012, compared to \$113 million for the first nine months of 2011. Increased cash from operating activities for the first nine months of 2012 was primarily due to an increase in management fee revenue received and reimbursements collected from affiliates. Offsetting this increase were increases in commissions paid to agents, general operating expenses paid, cash paid for the pension contribution and employee benefits, and cash paid for salaries and wages. Management fee revenues were higher reflecting the increase in the premiums written or assumed by the Exchange. Cash paid for agent commissions and bonuses increased to \$470 million in the first nine months of 2012, compared to \$450 million for the first nine months of 2011, as a result of an increase in cash paid for ordinary commissions. Indemnity made a \$16 million contribution to its pension plan in the first quarter of 2012, compared to \$15 million in the third quarter of 2011. Indemnity's policy for funding its pension plan is generally to contribute an amount equal to the greater of the IRS minimum required contribution or the target normal cost for the year plus interest to the date the contribution is made. Indemnity is generally reimbursed approximately 60% of the net periodic benefit cost of the pension plan from its affiliates.

At September 30, 2012, Indemnity recorded a net deferred tax asset of \$16 million. There was no deferred tax valuation allowance recorded at September 30, 2012. Indemnity's capital gain and loss strategies take into consideration its ability to offset gains and losses in future periods, carry-back of capital loss opportunities to the three preceding years, and capital loss carry-forward opportunities to apply against future capital gains over the next five years.

Net cash used in Indemnity's investing activities totaled \$8 million for the first nine months of 2012, compared to cash used of \$180 million for the first nine months of 2011. Indemnity's first nine months of 2012 investing activities included decreased cash used to purchase certain fixed maturities and increased cash generated from the sales of other fixed maturities, compared to the first nine months of 2011. Also impacting Indemnity future investing activities are limited partnership commitments, which totaled \$36 million at September 30, 2012, and will be funded as required by the partnerships' agreements. Of this amount, the total remaining commitment to fund

Table of Contents

limited partnerships that invest in private equity securities was \$16 million, mezzanine debt securities was \$10 million, and real estate activities was \$10 million.

In the first quarter of 2011, Indemnity received cash consideration from the Exchange of \$82 million as a result of the sale of Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, which was based upon an estimated purchase price. Final settlement of this transaction was made on April 25, 2011 for a final purchase price of \$82 million. Net after-tax cash proceeds to Indemnity from this sale were \$58 million. Also in the first quarter of 2011, Indemnity paid \$8 million to the Exchange as final settlement of the sale of Indemnity's wholly owned property and casualty insurance subsidiaries, EIC, ENY and EPC, to the Exchange on December 31, 2010, which was based upon the final purchase price.

Net cash used in Indemnity's financing activities totaled \$135 million for the first nine months of 2012, compared to \$209 million for the first nine months of 2011. The decrease in cash used in financing activities for the first nine months of 2012 was driven primarily by a decrease in the cash outlay for the purchase of treasury stock. Indemnity repurchased 0.2 million shares, based upon settlement date, of its Class A nonvoting common stock in conjunction with its stock repurchase program at a total cost of \$11 million in the third quarter of 2012. During the first nine months of 2012, shares repurchased under this program totaled 0.8 million at a total cost of \$55 million. In the first nine months of 2011, shares repurchased under this program totaled 1.9 million at a total cost of \$132 million. 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. This repurchase authority included, and was not in addition to, any unspent amounts remaining under the prior authorization. Indemnity had approximately \$84 million of repurchase authority remaining under this program at September 30, 2012, based upon trade date.

In January and June 2012, Indemnity also purchased 669 and 1,134 shares, respectively, of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$50,724, or \$75.82 per share, and \$79,125, or \$69.78 per share, respectively, to settle payments due to two retired senior vice presidents under our long-term incentive plan. These shares were delivered to the plan participants in January and June 2012, respectively. In July 2011, Indemnity repurchased 64,095 shares of its outstanding Class A nonvoting common stock outside of its publicly announced share repurchase program at a total cost of \$5 million. Of this amount, 57,695 shares were purchased for \$4.3 million, or \$73.72 per share, in conjunction with our long-term incentive plan, and 6,400 shares were purchased for \$0.5 million, or \$73.74 per share, for the vesting of stock-based awards for executive management. These shares were delivered to plan participants and executive management, respectively, in July 2011.

Dividends paid to shareholders totaled \$80 million for the first nine months of 2012, compared to \$77 million for the first nine months of 2011. Indemnity increased both its Class A and Class B shareholder quarterly dividends by 7.3% for 2012, compared to 2011. There are no regulatory restrictions on the payment of dividends to Indemnity's shareholders.

Capital Outlook

We regularly prepare forecasts evaluating the current and future cash requirements of Indemnity and the Exchange for both normal and extreme risk events. Should an extreme risk event result in a cash requirement exceeding normal cash flows, we have the ability to meet our future funding requirements through various alternatives available to us.

Indemnity

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Outside of Indemnity's normal operating and investing cash activities, future funding requirements could be met through: 1) Indemnity's cash and cash equivalents, which total approximately \$12 million at September 30, 2012, 2) a \$100 million bank revolving line of credit held by Indemnity, and 3) liquidation of assets held in Indemnity's investment portfolio, including common stock, preferred stock and investment grade bonds which totaled approximately \$491 million at September 30, 2012. Volatility in the financial markets could impair Indemnity's ability to sell certain of its fixed income securities or cause such securities to sell at deep discounts. Additionally, Indemnity has the ability to curtail or modify discretionary cash outlays such as those related to shareholder dividends and share repurchase activities.

Indemnity had no borrowings under its line of credit at September 30, 2012. At September 30, 2012, bonds with fair values of \$111 million were pledged as collateral. These securities have no trading restrictions. The bank requires compliance with certain covenants, which include minimum net worth and leverage ratios. Indemnity was in compliance with its bank covenants at September 30, 2012.

Table of Contents

Exchange

Outside of the Exchange's normal operating and investing cash activities, future funding requirements could be met through: 1) the Exchange's cash and cash equivalents, which total approximately \$392 million at September 30, 2012, 2) a \$300 million bank revolving line of credit held by the Exchange, and 3) liquidation of assets held in the Exchange's investment portfolio, including common stock, preferred stock and investment grade bonds which totaled approximately \$10.3 billion at September 30, 2012. Volatility in the financial markets could impair the Exchange's ability to sell certain of its fixed income securities or cause such securities to sell at deep discounts.

The Exchange had no borrowings under its line of credit at September 30, 2012. At September 30, 2012, bonds with fair values of \$328 million were pledged as collateral. These securities have no trading restrictions. The bank requires compliance with certain covenants, which include statutory surplus and risk based capital ratios. The Exchange was in compliance with its bank covenants at September 30, 2012.

Indemnity has no rights to the assets, capital, or line of credit of the Exchange and, conversely, the Exchange has no rights to the assets, capital, or line of credit of Indemnity. We believe we have the funding sources available to us to support our cash flow requirements in 2012.

Off-Balance Sheet Arrangements

Off-balance sheet arrangements include those with unconsolidated entities that may have a material current or future effect on our financial condition or results of operations, including material variable interests in unconsolidated entities that conduct certain activities. We have no material off-balance sheet obligations or guarantees, other than our limited partnership investment commitments.

Surplus Notes

Indemnity holds a surplus note for \$25 million from EFL that is payable on demand on or after December 31, 2018; however, no principal or interest payments may be made without prior approval of the Pennsylvania Insurance Commissioner. Interest payments are scheduled to be paid semi-annually. For the nine month period ended September 30, 2012 and 2011, Indemnity recognized interest income on the note of \$1.3 million.

The Exchange holds a surplus note for \$20 million from EFL that is payable on demand on or after December 31, 2025; however, no principal or interest payments may be made without prior approval of the Pennsylvania Insurance Commissioner. Interest payments are scheduled to be paid semi-annually. For the nine month period ended September 30, 2012 and 2011, the Exchange recognized interest income on the note of \$0.9 million.

CRITICAL ACCOUNTING ESTIMATES

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

We make estimates and assumptions that have a significant effect on the amounts and disclosures reported in the financial statements. The most significant estimates relate to the property and casualty insurance losses and loss expense reserves, life insurance and annuity policy reserves, investment valuation, deferred acquisition costs related to life insurance and investment-type contracts, deferred taxes and retirement benefit plans. While management believes its estimates are appropriate, the ultimate amounts may differ from estimates provided. Our most critical accounting estimates are described in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2011 of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 27, 2012. See Item 1. Financial Statements - Note 6. Fair Value, contained within this report for additional information on our valuation of investments.

Investment Valuation

We make estimates concerning the valuation of all investments. Valuation techniques are used to derive the fair value of the available-for-sale and trading securities we hold. Fair value is the price that would be received to sell an asset in an orderly transaction between willing market participants at the measurement date.

Fair value measurements are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our view of market assumptions in the absence of observable market information. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

For purposes of determining whether the market is active or inactive, the classification of a financial instrument was based upon the following definitions:

Table of Contents

- An active market is one in which transactions for the assets being valued occur with sufficient frequency and volume to provide reliable pricing information.
- An inactive (illiquid) market is one in which there are few and infrequent transactions, where the prices are not current, price quotations vary substantially, and/or there is little information publicly available for the asset being valued.

We continually assess whether or not an active market exists for all of our investments and as of each reporting date re-evaluate the classification in the fair value hierarchy. All assets carried at fair value are classified and disclosed in one of the following three categories:

- 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.

Level 1 primarily consists of publicly traded common stock, nonredeemable preferred stock and certain government securities and reflects market data obtained from independent sources, such as prices obtained from an exchange or a nationally recognized pricing service for identical instruments in active markets.

Level 2 includes those financial instruments that are valued using industry-standard models that consider various inputs, such as the interest rate and credit spread for the underlying financial instruments. All significant inputs are observable, or derived from observable information in the marketplace, or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category primarily include municipal securities, asset backed securities, collateralized-mortgage obligations, foreign and domestic corporate bonds and redeemable preferred stock and certain nonredeemable preferred stock.

Level 3 securities are valued based upon unobservable inputs, reflecting our estimates of value based upon assumptions used by market participants. Securities are assigned to Level 3 in cases where non-binding broker quotes are significant to the valuation and there is a lack of transparency as to whether these quotes are based upon information that is observable in the marketplace. Fair value estimates for securities valued using unobservable inputs require significant judgment due to the illiquid nature of the market for these securities and represent the best estimate of the fair value that would occur in an orderly transaction between willing market participants at the measurement date under current market conditions. Fair value for these securities are generally determined using comparable securities or non-binding broker quotes received from outside broker dealers based upon security type and market conditions. Remaining securities, where a price is not available, are valued using an estimate of fair value based upon indicative market prices that include significant unobservable inputs not based upon, nor corroborated by, market information, including the utilization of discounted cash flow analyses which have been risk-adjusted to take into account illiquidity

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

and other market factors. This category primarily consists of certain private preferred stock and bond securities as well as collateralized debt and loan obligations.

As of each reporting period, financial instruments recorded at fair value are classified based upon the lowest level of input that is significant to the fair value measurement. The presence of at least one unobservable input would result in classification as a Level 3 instrument. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and considers factors specific to the asset, such as the relative impact on the fair value as a result of including a particular input and market conditions. We did not make any other significant judgments except as described above.

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 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.

Table of Contents

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 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 benchmark yields, reported trades, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference 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.

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.

Deferred Acquisition Costs Related to Life Insurance and Investment-Type Contracts

Acquisition costs that vary with and relate to the production of life insurance and investment-type contracts are deferred. Deferred acquisition costs (DAC) are incremental direct costs of contract acquisition. As a result of new accounting guidance effective in 2012, these costs are limited to the successful acquisition of new and renewal contracts. Such costs consist principally of commissions, premium taxes and policy issuance expenses. The change does not affect the Indemnity shareholder interest nor does it affect Indemnity earnings per share. The amount of acquisition costs capitalized during the quarter and nine months ended September 30, 2012 related to life insurance and investment-type contracts totaled \$4.0 million and \$11.7 million, respectively. The amount of acquisition costs that would have been capitalized during the quarter and nine months ended September 30, 2012 using the previous policy totaled \$4.6 million and \$13.3 million, respectively.

DAC on life insurance and investment-type contracts are amortized in proportion to gross premiums, gross margins or gross profits, depending on the type of contract. DAC related to traditional life insurance products is amortized in proportion to premium revenues over the premium-paying period of related policies using assumptions consistent with those used in computing policy liability reserves. These assumptions are not revised after policy issuance unless the DAC balance is deemed to be unrecoverable from future expected profits. In any period where the actual policy terminations are higher (lower) than anticipated policy terminations, DAC amortization will be accelerated (decelerated) in that period.

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, which include investment, mortality and expense margins and surrender charges. Both historical and anticipated investment returns, including realized gains and losses, are considered in determining the amortization of DAC. When the actual gross profits change from previously estimated gross profits, the cumulative DAC amortization is re-estimated and adjusted by a cumulative charge or credit to current operations. When actual gross profits exceed those previously estimated, DAC amortization will increase, resulting in a current period charge to earnings. The opposite result occurs when the actual gross profits are below the previously estimated gross profits. DAC is also adjusted for the impact of unrealized gains or losses on investments as if these gains or losses had been realized, with corresponding credits or charges, net of income taxes, included in EFL s accumulated other comprehensive income, which is presented in the Noncontrolling interest in consolidated entity Exchange, amount in the Consolidated Statements of Financial Position.

The actuarial assumptions used to determine investment, mortality and expense margins and surrender charges are reviewed periodically, are based upon best estimates and do not include any provision for the risk of adverse deviation. If actuarial analysis indicates that expectations have changed, the actuarial assumptions are updated and the investment, mortality and expense margins and surrender charges are unlocked. If this unlocking results in a decrease in the present value of future expected gross profits, DAC amortization for the period will increase. If this unlocking results in an increase in the present value of future expected gross profits, DAC amortization for the current period will decrease.

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 products 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. There were no impairments to DAC in the third quarter of 2012 or 2011.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is primarily related to fluctuations in prices and interest rates. Quantitative and qualitative disclosures about market risk resulting from changes in prices and interest rates for the year ended December 31, 2011 are included in Item 7A. Quantitative and Qualitative Disclosures About Market Risk, of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 27, 2012. There have been no material changes that impact our portfolio or reshape our periodic investment reviews of asset allocations during the nine months ended September 30, 2012. For a recent discussion of conditions surrounding our investment portfolio, see the Operating Overview, Investment Operations, and Financial Condition, Investments discussions contained in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, within this report.

ITEM 4. CONTROLS AND PROCEDURES

We carried out an evaluation, with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

Our management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, any change in our internal control over financial reporting and determined there has been no change in our internal control over financial reporting during the nine months ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As previously reported by Erie Indemnity Company (the Registrant) in a Form 8-K filed with the Securities and Exchange Commission on August 9, 2012, the Registrant received a Complaint on August 6, 2012, that was originally captioned Erie Insurance Exchange, an unincorporated association, by Joseph S. Sullivan and Anita Sullivan, Patricia R. Beltz, and Jenna L. DeBord, trustees ad litem (Plaintiffs) vs. Erie Indemnity Co. (Defendant). The Complaint was filed on August 1, 2012, in the Court of Common Pleas Civil Division of Fayette County, Pennsylvania. The individuals named as Plaintiffs were alleged to be policyholders (subscribers) of the Erie Insurance Exchange (the Exchange).

The original Complaint alleged that, beginning on September 1, 1997, the Registrant retained Service Charges (installment fees) and Added Service Charges (late fees and policy reinstatement charges) on policies written by the Exchange and its insurance subsidiaries, which the original Complaint alleged should have been paid to the Exchange. The original Complaint alleged that the total of the Service Charges and Added Service Charges retained by the Registrant during the period from 1998 through 2011 amounted to approximately \$308 million dollars. The original Complaint acknowledged that this amount may be slightly overstated because an undetermined amount of those dollars, paid by policyholders of insurance companies owned by the Registrant at the times the Service Charges and Added Service Charges were collected, were appropriately retained by the Registrant.

The original Complaint sought compensatory and punitive damages on behalf of all members of the Exchange and certain equitable relief on behalf of the Exchange.

On August 22, 2012, the Registrant removed the case from state court to the United States District Court for the Western District of Pennsylvania, on the basis that it was a class action subject to removal under the Federal Class Action Fairness Act. The Plaintiffs responded on August 31, 2012, by filing a motion to remand the case to the state court in Fayette County, Pennsylvania on the grounds that the case was not a class action.

On September 18, 2012, while their motion for remand was pending, the Plaintiffs filed a First Amended Complaint captioned Erie Insurance Exchange, an unincorporated association, by Joseph S. Sullivan and Anita Sullivan, Jenna L. DeBord, and Patricia R. Beltz, Plaintiff, vs. Erie Indemnity Company, Defendant. In response to the Plaintiffs' motion for remand, the Registrant asserted that the First Amended Complaint was an attempt by Plaintiffs to delete previously asserted class action allegations. Notwithstanding the Registrant's arguments that the U.S. District Court should retain jurisdiction, the U.S. District Court granted the Plaintiffs' motion to remand the case back to the state court on October 5, 2012.

The Registrant has filed a petition with the U.S. Third Circuit Court of Appeals requesting that court to hear Registrant's appeal that the U.S. District Court should not have remanded the case back to state court. As of October 29, 2012, that petition is pending, as is the Registrant's motion with the Pennsylvania state court to stay proceedings until the U.S. Third Circuit Court of Appeals rules on the Registrant's petition.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

The First Amended Complaint alleges many of the same facts set forth in the original Complaint regarding Service Charges and Added Service Charges; however, the First Amended Complaint now seeks relief on behalf of the Exchange and not on behalf of all members of the Exchange. The First Amended Complaint includes three Counts. Count I alleges that Registrant breached the Subscriber's Agreement and the duty of good faith and fair dealing by retaining the Service Charges and Added Service Charges, and requests a sum in excess of \$50,000 plus pre-judgment and post-judgment interest and costs. Count II alleges that the Registrant is an agent of the Exchange and that in entering into certain unspecified transactions with the Exchange it breached fiduciary duties allegedly owed to the Exchange, and requests compensatory and punitive damages in excess of \$50,000 plus post-judgment interest and costs. Count III alleges that the Registrant has entered into certain unspecified transactions with the Exchange, and requests that the Court: (a) require the Registrant to issue an accounting of all so-called intercompany transactions from January 1, 1996, to date; (b) enjoin the Registrant from retaining any future compensation as a result of so-called intercompany transactions not specifically authorized pursuant to the Subscriber's Agreement; (c) order restitution of money damages along with disgorgement of any profits and impose a constructive trust on all profits received by the Registrant on the amounts of Service Charges and Added Service Charges alleged to have been improperly retained by the Registrant, or any other amounts received improperly through so-called intercompany transactions; and (d) order such other relief as may be appropriate.

The Registrant intends to vigorously defend against all of the allegations and requests for relief in both the original Complaint and First Amended Complaint.

Table of Contents**ITEM 1A. RISK FACTORS**

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 as filed with the Securities and Exchange Commission on February 27, 2012.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**Issuer Purchases of Equity Securities**

The following table summarizes Indemnity's Class A common stock repurchased each month, based upon trade date, during the quarter ended September 30, 2012:

<i>(dollars in millions, except per share data)</i>	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
Period				
July 1 - 31, 2012	89,745	\$71.68	89,745	\$88
August 1 - 31, 2012	15,665	67.64	15,665	87
September 1 - 30, 2012	55,438	64.07	55,438	84
Total	160,848		160,848	

In October 2011, our Board of Directors approved a continuation of the current stock repurchase program, authorizing repurchases for a total of \$150 million with no time limitation. This repurchase authority included, and was not in addition to, any unspent amounts remaining under the prior authorization.

Table of Contents

ITEM 6. EXHIBITS

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
10.1	Indemnification Agreement by and between Erie Indemnity Company and Robert C. Ingram, III dated August 13, 2012.
10.2	Indemnification Agreement by and between Erie Indemnity Company and Richard F. Burt, Jr. dated August 22, 2012.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Erie Indemnity Company
(Registrant)

Date: November 1, 2012

By: /s/ Terrence W. Cavanaugh
Terrence W. Cavanaugh, President & CEO

By: /s/ Marcia A. Dall
Marcia A. Dall, Executive Vice President & CFO