

ERIE INDEMNITY CO
Form 10-Q
May 03, 2012

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 March 31, 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 47,593,343 at April 19, 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 April 19, 2012.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Consolidated Statements of Operations Three months ended March 31, 2012 and 2011

Consolidated Statements of Comprehensive Income Three months ended March 31, 2012 and 2011

Consolidated Statements of Financial Position March 31, 2012 and December 31, 2011

Consolidated Statements of Cash Flows Three months ended March 31, 2012 and 2011

Notes to Consolidated Financial Statements March 31, 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 1A. Risk Factors

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

Item 6. Exhibits

SIGNATURES

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 March 31, | |
|--|---------------------------------|----------------|
| | 2012 | 2011 |
| Revenues | | |
| Premiums earned | \$1,087 | \$1,030 |
| Net investment income | 108 | 105 |
| Net realized investment gains | 296 | 149 |
| Net impairment losses recognized in earnings | 0 | 0 |
| Equity in earnings of limited partnerships | 21 | 72 |
| Other income | 8 | 9 |
| Total revenues | 1,520 | 1,365 |
| Benefits and expenses | | |
| Insurance losses and loss expenses | 716 | 706 |
| Policy acquisition and underwriting expenses | 270 | 247 |
| Total benefits and expenses | 986 | 953 |
| Income from operations before income taxes and noncontrolling interest | 534 | 412 |
| Provision for income taxes | 180 | 138 |
| Net income | \$ 354 | \$ 274 |
| Less: Net income attributable to noncontrolling interest in consolidated entity | Exchange | 318 |
| | | 230 |
| Net income attributable to Indemnity | \$ 36 | \$ 44 |
| Earnings Per Share | | |
| Net income attributable to Indemnity per share | | |
| Class A common stock basic | \$ 0.76 | \$ 0.88 |
| Class A common stock diluted | \$ 0.67 | \$ 0.78 |
| Class B common stock basic and diluted | \$113.56 | \$126.48 |
| Weighted average shares outstanding attributable to Indemnity Basic | | |
| Class A common stock | 47,749,799 | 49,789,056 |
| Class B common stock | 2,545 | 2,546 |
| Weighted average shares outstanding attributable to Indemnity Diluted | | |
| Class A common stock | 53,930,044 | 55,968,838 |
| Class B common stock | 2,545 | 2,546 |
| Dividends declared per share | | |
| Class A common stock | \$ 0.5525 | \$ 0.515 |
| Class B common stock | \$82.8750 | \$ 77.250 |

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

ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in millions)

| | Three months ended March 31, | |
|--|---------------------------------|-------|
| | 2012 | 2011 |
| Net income | \$354 | \$274 |
| Other comprehensive income (loss) | | |
| Change in unrealized holding gains on investments, net of tax expense of \$41 and \$4, respectively | 77 | 8 |
| Reclassification adjustment for gross gains included in net income, net of tax expense of \$2 and \$7, respectively | (5) | (12) |
| Other comprehensive income (loss) | 72 | (4) |
| Unrealized gains transferred to noncontrolling interest on sale of life affiliate, net of tax expense of \$0 and \$4, respectively | | 9 |
| Comprehensive income | 426 | 279 |
| Less: Comprehensive income attributable to noncontrolling interest in consolidated entity | 388 | 236 |
| Total comprehensive income Indemnity | \$ 38 | \$ 43 |

See accompanying notes to Consolidated Financial Statements.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(dollars in millions, except per share data)

| | March 31, 2012 (Unaudited) | December 31, 2011 |
|--|----------------------------------|----------------------|
| Assets | | |
| Investments Indemnity | | |
| Available-for-sale securities, at fair value: | | |
| Fixed maturities (amortized cost of \$479 and \$535, respectively) | \$ 494 | \$ 548 |
| Equity securities (cost of \$24 and \$24, respectively) | 26 | 25 |
| Trading securities, at fair value (cost of \$23 and \$23, respectively) | 29 | 27 |
| Limited partnerships (cost of \$184 and \$185, respectively) | 204 | 208 |
| Other invested assets | 1 | 1 |
| Investments Exchange | | |
| Available-for-sale securities, at fair value: | | |
| Fixed maturities (amortized cost of \$6,939 and \$6,829, respectively) | 7,483 | 7,292 |
| Equity securities (cost of \$561 and \$531, respectively) | 621 | 564 |
| Trading securities, at fair value (cost of \$2,014 and \$2,021, respectively) | 2,596 | 2,308 |
| Limited partnerships (cost of \$1,005 and \$1,003, respectively) | 1,087 | 1,082 |
| Other invested assets | 19 | 19 |
| Total investments | 12,560 | 12,074 |
| Cash and cash equivalents (Exchange portion of \$171 and \$174, respectively) | 199 | 185 |
| Premiums receivable from policyholders Exchange | 1,000 | 976 |
| Reinsurance recoverable Exchange | 167 | 166 |
| Deferred income taxes Indemnity | 18 | 19 |
| Deferred acquisition costs Exchange | 482 | 487 |
| Other assets (Exchange portion of \$291 and \$322, respectively) | 406 | 441 |
| Total assets | \$14,832 | \$14,348 |
| Liabilities and shareholders equity | | |
| Liabilities | | |
| Indemnity liabilities | | |
| Other liabilities | \$ 418 | \$ 455 |
| Exchange liabilities | | |
| Losses and loss expense reserves | 3,451 | 3,499 |
| Life policy and deposit contract reserves | 1,689 | 1,671 |
| Unearned premiums | 2,196 | 2,178 |
| Deferred income taxes | 279 | 147 |
| Other liabilities | 123 | 105 |
| Total liabilities | 8,156 | 8,055 |
| Indemnity s 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; 47,639,083 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 | (103) | (105) |
| Retained earnings | 1,904 | 1,894 |
| Total contributed capital and retained earnings | 1,819 | 1,807 |
| Treasury stock, at cost, 20,655,317 and 20,427,758 shares, respectively | (1,043) | (1,026) |
| Total Indemnity shareholders equity | 776 | 781 |
| Noncontrolling interest in consolidated entity Exchange | 5,900 | 5,512 |
| Total equity | 6,676 | 6,293 |
| Total liabilities, shareholders equity and noncontrolling interest | \$14,832 | \$14,348 |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in millions)

| | Three months ended March 31, | |
|--|---------------------------------|---------------|
| | 2012 | 2011 |
| Cash flows from operating activities | | |
| Premiums collected | \$1,081 | \$1,023 |
| Net investment income received | 110 | 97 |
| Limited partnership distributions | 25 | 32 |
| Service agreement fee received | 7 | 8 |
| Commissions and bonuses paid to agents | (180) | (178) |
| Losses paid | (619) | (598) |
| Loss expenses paid | (119) | (109) |
| Other underwriting and acquisition costs paid | (181) | (162) |
| Income taxes paid | (52) | (21) |
| Net cash provided by operating activities | 72 | 92 |
| Cash flows from investing activities | | |
| Purchase of investments: | | |
| Fixed maturities | (418) | (752) |
| Preferred stock | (37) | (35) |
| Common stock | (258) | (421) |
| Limited partnerships | (23) | (29) |
| Sales/maturities of investments: | | |
| Fixed maturity sales | 163 | 277 |
| Fixed maturity calls/maturities | 217 | 247 |
| Preferred stock | 13 | 25 |
| Common stock | 247 | 400 |
| Sale of and returns on limited partnerships | 81 | 26 |
| (Purchase) disposal of property and equipment | (7) | 7 |
| Net collections on agent loans | 0 | 1 |
| Net cash used in investing activities | (22) | (254) |
| Cash flows from financing activities | | |
| Annuity deposits and interest | 25 | 22 |
| Annuity surrenders and withdrawals | (18) | (21) |
| Universal life deposits and interest | 5 | 12 |
| Universal life surrenders | (3) | (8) |
| Purchase of treasury stock | (18) | (36) |
| Dividends paid to shareholders | (27) | (26) |
| Net cash used in financing activities | (36) | (57) |
| Net increase (decrease) in cash and cash equivalents | 14 | (219) |
| Cash and cash equivalents at beginning of period | 185 | 430 |
| Cash and cash equivalents at end of period | \$ 199 | \$ 211 |

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

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 three month period ended March 31, 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.

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 is 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 quarter ended March 31, 2012 totaled \$172 million. Acquisition costs that would have been capitalized during the quarter ended March 31, 2012 using the previous method of capitalization totaled \$177 million. 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 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 is effective for interim and annual periods beginning after December 15, 2011. The adoption

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

of this new guidance does 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 .

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 is 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 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. The DAC 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.

Note 3. Earnings Per Share

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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. During the three months ended March 31, 2012, two shares of Class B common stock were converted into 4,800 shares of Class A common stock. See Note 15, Capital Stock . 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 potentially dilutive outstanding employee stock-based awards and awards vested and not yet vested related to the outside directors stock compensation plan.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 March 31, | | | | | |
|---|--|---|-------------------------|--|---|-------------------------|
| | 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 | \$36 | 47,749,799 | \$ 0.76 | \$44 | 49,789,056 | \$ 0.88 |
| Dilutive effect of stock-based awards | 0 | 72,245 | | 0 | 69,382 | |
| Assumed conversion of Class B shares | 0 | 6,108,000 | | 0 | 6,110,400 | |
| Class A Diluted EPS: | | | | | | |
| Income available to Class A stockholders on Class A equivalent shares | \$36 | 53,930,044 | \$ 0.67 | \$44 | 55,968,838 | \$ 0.78 |
| Class B Basic and diluted EPS: | | | | | | |
| Income available to Class B stockholders | \$ 0 | 2,545 | \$113.56 | \$ 0 | 2,546 | \$126.48 |

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 March 31, 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.

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 because of the long duration of life products. For the first quarters of 2012 and 2011, investment activities on life insurance related assets generated revenues of \$24 million and \$27 million, respectively, resulting in EFL reporting income before income taxes of \$9 million and \$13 million, respectively, before intercompany eliminations.

Investment operations

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

Erie Insurance Group
For the three months ended March 31, 2012

(in millions)

| | Management operations | Property and casualty insurance operations | Life insurance operations | Investment operations | Eliminations | Consolidated |
|--|-----------------------|--|---------------------------|-----------------------|--------------|--------------|
| Premiums earned/life policy revenue | | \$1,069 | \$ 18 | | \$ 0 | \$1,087 |
| Net investment income | | | | \$111 | (3) | 108 |
| Net realized investment gains | | | | 296 | | 296 |
| Net impairment losses recognized in earnings | | | | 0 | | 0 |
| Equity in earnings of limited partnerships | | | | 21 | | 21 |
| Management fee revenue | \$269 | | | | (269) | |
| Service agreement and other revenue | 7 | | 1 | | | 8 |
| Total revenues | 276 | 1,069 | 19 | 428 | (272) | 1,520 |
| Cost of management operations | 230 | | | | (230) | |
| Insurance losses and loss expenses | | 692 | 25 | | (1) | 716 |
| Policy acquisition and underwriting expenses | | 302 | 9 | | (41) | 270 |
| Total benefits and expenses | 230 | 994 | 34 | | (272) | 986 |
| Income (loss) before income taxes | 46 | 75 | (15) | 428 | | 534 |
| Provision for income taxes | 16 | 26 | (5) | 143 | | 180 |
| Net income (loss) | \$ 30 | \$ 49 | \$ (10) | \$285 | \$ | \$ 354 |

Erie Insurance Group
For the three months ended March 31, 2011

(in millions)

| | Management operations | Property and casualty insurance operations | Life insurance operations | Investment operations | Eliminations | Consolidated |
|--|-----------------------|--|---------------------------|-----------------------|--------------|--------------|
| Premiums earned/life policy revenue | | \$1,014 | \$ 16 | | \$ 0 | \$1,030 |
| Net investment income | | | | \$108 | (3) | 105 |
| Net realized investment gains | | | | 149 | | 149 |
| Net impairment losses recognized in earnings | | | | 0 | | 0 |
| Equity in earnings of limited partnerships | | | | 72 | | 72 |
| Management fee revenue | \$251 | | | | (251) | |
| Service agreement and other revenue | 8 | | 1 | | | 9 |
| Total revenues | 259 | 1,014 | 17 | 329 | (254) | 1,365 |
| Cost of management operations | 211 | | | | (211) | |
| Insurance losses and loss expenses | | 683 | 24 | | (1) | 706 |
| Policy acquisition and underwriting expense | | 282 | 7 | | (42) | 247 |
| Total benefits and expenses | 211 | 965 | 31 | | (254) | 953 |
| Income (loss) before income taxes | 48 | 49 | (14) | 329 | | 412 |
| Provision for income taxes | 17 | 17 | (5) | 109 | | 138 |
| Net income (loss) | \$ 31 | \$ 32 | \$ (9) | \$220 | \$ | \$ 274 |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 services. 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 March 31, 2012:

Erie Insurance Group
March 31, 2012
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 | \$ 217 | \$ 0 | \$ 217 | \$ 0 |
| Corporate debt securities | 258 | 0 | 257 | 1 |
| Commercial mortgage-backed securities (CMBS) | 10 | 0 | 10 | 0 |
| Collateralized debt obligations (CDO) | 4 | 0 | 0 | 4 |
| Other debt securities | 5 | 0 | 5 | 0 |
| Total fixed maturities | 494 | 0 | 489 | 5 |
| Nonredeemable preferred stock | 26 | 11 | 15 | 0 |
| Total available-for-sale securities | 520 | 11 | 504 | 5 |
| Trading securities: | | | | |
| Common stock | 29 | 29 | 0 | 0 |
| Total trading securities | 29 | 29 | 0 | 0 |
| Total Indemnity | \$ 549 | \$ 40 | \$ 504 | \$ 5 |
| Exchange | | | | |
| Available-for-sale securities: | | | | |
| U.S. government & agencies | \$ 20 | \$ 6 | \$ 14 | \$ 0 |
| States & political subdivisions | 1,361 | 0 | 1,356 | 5 |
| Foreign government securities | 15 | 0 | 15 | 0 |
| Corporate debt securities | 5,711 | 20 | 5,665 | 26 |
| Residential mortgage-backed securities (RMBS) | 179 | 0 | 179 | 0 |
| Commercial mortgage-backed securities (CMBS) | 71 | 0 | 71 | 0 |
| Collateralized debt obligations (CDO) | 65 | 0 | 38 | 27 |
| Other debt securities | 61 | 0 | 56 | 5 |
| Total fixed maturities | 7,483 | 26 | 7,394 | 63 |
| Nonredeemable preferred stock | 621 | 226 | 389 | 6 |
| Total available-for-sale securities | 8,104 | 252 | 7,783 | 69 |
| Trading securities: | | | | |
| Common stock | 2,596 | 2,582 | 0 | 14 |
| Total trading securities | 2,596 | 2,582 | 0 | 14 |
| Total Exchange | \$10,700 | \$2,834 | \$7,783 | \$83 |
| Total Erie Insurance Group | \$11,249 | \$2,874 | \$8,287 | \$88 |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Level 3 Assets Quarterly 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 March 31, 2012 |
|---|---|--------------------------------|---|-----------|-------|--|---|
| Indemnity | | | | | | | |
| Available-for-sale securities: | | | | | | | |
| Corporate debt securities | \$ 0 | \$0 | \$0 | \$0 | \$ 0 | \$ 1 | \$ 1 |
| Collateralized debt obligations (CDO) | 4 | 0 | 0 | 0 | 0 | 0 | 4 |
| Total fixed maturities | 4 | 0 | 0 | 0 | 0 | 1 | 5 |
| Total available-for-sale securities | 4 | 0 | 0 | 0 | 0 | 1 | 5 |
| 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 | \$ 1 | \$ 5 |
| Exchange | | | | | | | |
| Available-for-sale securities: | | | | | | | |
| States & political subdivisions | \$ 4 | \$0 | \$1 | \$0 | \$ 0 | \$ 0 | \$ 5 |
| Corporate debt securities | 12 | 0 | 0 | 0 | 0 | 14 | 26 |
| Collateralized debt obligations (CDO) | 29 | 0 | 0 | 0 | (4) | 2 | 27 |
| Other debt securities | 5 | 0 | 0 | 0 | 0 | 0 | 5 |
| Total fixed maturities | 50 | 0 | 1 | 0 | (4) | 16 | 63 |
| Nonredeemable preferred stock | 5 | 0 | 1 | 0 | 0 | 0 | 6 |
| Total available-for-sale securities | 55 | 0 | 2 | 0 | (4) | 16 | 69 |
| Trading securities: | | | | | | | |
| Common stock | 12 | 2 | 0 | 0 | 0 | 0 | 14 |
| Total trading securities | 12 | 2 | 0 | 0 | 0 | 0 | 14 |
| Total Level 3 assets Exchange | \$67 | \$2 | \$2 | \$0 | \$(4) | \$16 | \$83 |
| Total Level 3 assets Erie Insurance Group | \$71 | \$2 | \$2 | \$0 | \$(4) | \$17 | \$88 |

(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 three months ended March 31, 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.

There were no transfers between Levels 1 and 2 for the three months ended March 31, 2012.

Transfers into Level 3 are primarily the result of using non-binding broker quotes to determine fair value at March 31, 2012.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Quantitative and Qualitative Disclosures about Unobservable Inputs

Erie Insurance Group
March 31, 2012

(dollars in millions)

| | Fair value | No. of holdings | Valuation techniques | Unobservable input | Range | weighted average |
|---------------------------------------|------------|-----------------|----------------------|--|---------------------|------------------|
| Indemnity | | | | | | |
| Corporate debt securities | \$ 1 | 1 | Consensus pricing | Non-binding broker quote | 115.86 | |
| Collateralized debt obligations (CDO) | 4 | 2 | Present value | Projected maturity date | Jun 2014 - Feb 2015 | |
| | | | | Repayment at maturity | 45-100% | 90.6% |
| | | | | Discount rate | 7.5-15.0% | 10.8% |
| | | | | Projected LIBOR rate | 0.48% | |
| Total Indemnity | \$ 5 | 3 | | | | |
| Exchange | | | | | | |
| States & political subdivisions | 5 | 1 | Comparable pricing | Comparable security yield | 0.48% | |
| | | | | Added yield due to lack of marketability | 1.00% | |
| Corporate debt securities | 15 | 3 | Consensus pricing | Non-binding broker quote | 102.00 - 117.00 | |
| | 1 | 2 | Held at cost | Private securities with no observable market | 100.00 | |
| | 10 | 2 | Comparable pricing | Comparable private transaction EBITDA multiples | 7.5 - 17.1x | 7.5x |
| | | | | Average comparable publicly traded EBITDA multiple | 7.8x | 7.5x |
| Collateralized debt obligations (CDO) | 24 | 6 | Present value | Projected maturity date | Dec 2012 - Dec 2035 | |
| | | | | Repayment at maturity | 45-100% | 94.4% |
| | | | | Discount rate | 7.0-15% | 9.2% |
| | | | | Projected LIBOR rate | 0.48% | |
| | 3 | 4 | Consensus pricing | Non-binding broker quote | 3.00 - 85.00 | 64.70 |
| Other debt securities | 5 | 1 | Held at cost | Private securities with no observable market | 100.00 | |
| Nonredeemable preferred stock | 6 | 1 | Comparable pricing | Comparable security yield | 7.68% | |
| Common stock | 14 | 3 | Comparable pricing | Comparable private transaction EBITDA multiples | 7.5 - 17.1x | 7.5x |
| | | | | Average comparable publicly traded EBITDA multiple | 7.8x | 7.5x |
| | | | | Discount for lack of marketability | 5 - 30% | 30% |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

| | | | |
|-------|----------------|------|----|
| Total | Exchange | \$83 | 23 |
| Total | Erie Insurance | \$88 | |
| Group | | | |

Securities valued using unobservable inputs totaled \$88 million at March 31, 2012. These securities represent less than 0.8% 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. In other cases, the securities may be held at cost provided no adverse changes have occurred in the financial condition of the underlying entity.

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

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 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 Exchange | \$10,164 | \$2,510 | \$7,587 | \$67 |
| Total Erie Insurance Group | \$10,764 | \$2,547 | \$8,146 | \$71 |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Level 3 Assets Quarterly Change:

Erie Insurance Group

| <i>(in millions)</i> | 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 March 31, 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 | 0 | 0 | 0 | 11 |
| Collateralized debt obligations (CDO) | 30 | 0 | 0 | 0 | 0 | 0 | 30 |
| Other debt securities | 10 | 0 | 0 | 0 | (5) | 0 | 5 |
| Total fixed maturities | 55 | 0 | 0 | 0 | (5) | 0 | 50 |
| Nonredeemable preferred stock | 7 | 0 | 1 | 0 | 0 | 0 | 8 |
| Total available-for-sale securities | 62 | 0 | 1 | 0 | (5) | 0 | 58 |
| 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 | \$1 | \$1 | \$0 | \$(5) | \$0 | \$71 |
| Total Level 3 assets Erie Insurance Group | \$78 | \$1 | \$1 | \$0 | \$(5) | \$0 | \$75 |

(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 three months ended March 31, 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 months ended March 31, 2011.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 March 31, 2012:

| <i>(in millions)</i> | Total | Erie Insurance Group March 31, 2012 | | |
|--|----------|--|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Indemnity | | | | |
| Fixed maturities: | | | | |
| Priced via pricing services | \$ 489 | \$ 0 | \$ 489 | \$ 0 |
| Priced via market comparables/non-binding broker quotes (1) | 1 | 0 | 0 | 1 |
| Priced via unobservable inputs | 4 | 0 | 0 | 4 |
| Total fixed maturities | 494 | 0 | 489 | 5 |
| Nonredeemable preferred stock: | | | | |
| Priced via pricing services | 24 | 11 | 13 | 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 | 26 | 11 | 15 | 0 |
| Common stock: | | | | |
| Priced via pricing services | 29 | 29 | 0 | 0 |
| Priced via market comparables/non-binding broker quotes (1) | 0 | 0 | 0 | 0 |
| Priced unobservable inputs | 0 | 0 | 0 | 0 |
| Total common stock | 29 | 29 | 0 | 0 |
| Total available-for-sale and trading securities Indemnity | \$ 549 | \$ 40 | \$ 504 | \$ 5 |
| Exchange | | | | |
| Fixed maturities: | | | | |
| Priced via pricing services | \$ 7,324 | \$ 26 | \$7,298 | \$ 0 |
| Priced via market comparables/non-binding broker quotes (1) | 114 | 0 | 96 | 18 |
| Priced via unobservable inputs | 45 | 0 | 0 | 45 |
| Total fixed maturities | 7,483 | 26 | 7,394 | 63 |
| Nonredeemable preferred stock: | | | | |
| Priced via pricing services | 600 | 226 | 374 | 0 |
| Priced via market comparables/non-binding broker quotes(1) | 15 | 0 | 15 | 0 |
| Priced via unobservable inputs | 6 | 0 | 0 | 6 |
| Total nonredeemable preferred stock | 621 | 226 | 389 | 6 |
| Common stock: | | | | |
| Priced via pricing services | 2,582 | 2,582 | 0 | 0 |
| Priced via market comparables/non-binding broker quotes(1) | 0 | 0 | 0 | 0 |
| Priced via unobservable inputs | 14 | 0 | 0 | 14 |
| Total common stock | 2,596 | 2,582 | 0 | 14 |
| Total available-for-sale and trading securities Exchange | \$10,700 | \$2,834 | \$7,783 | \$83 |
| Total available-for-sale and trading securities Erie Insurance Group | \$11,249 | \$2,874 | \$8,287 | \$88 |

(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.

We have no assets that were measured at fair value on a nonrecurring basis during the three months ended March 31, 2012.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Note 7. Investments

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

| <i>(in millions)</i> | Erie Insurance Group March 31, 2012 | | | |
|--|--|---------------------------|----------------------------|-------------------------|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| Indemnity | | | | |
| Available-for-sale securities: | | | | |
| States & political subdivisions | \$ 205 | \$ 12 | \$ 0 | \$ 217 |
| Corporate debt securities | 256 | 2 | 0 | 258 |
| Commercial mortgage-backed securities (CMBS) | 10 | 0 | 0 | 10 |
| Collateralized debt obligations (CDO) | 3 | 1 | 0 | 4 |
| Other debt securities | 5 | 0 | 0 | 5 |
| Total fixed maturities | 479 | 15 | 0 | 494 |
| Nonredeemable preferred stock | 24 | 2 | 0 | 26 |
| Total available-for-sale securities Indemnity | \$ 503 | \$ 17 | \$ 0 | \$ 520 |
| Exchange | | | | |
| Available-for-sale securities: | | | | |
| U.S. government & agencies | \$ 19 | \$ 1 | \$ 0 | \$ 20 |
| States & political subdivisions | 1,272 | 89 | 0 | 1,361 |
| Foreign government securities | 15 | 0 | 0 | 15 |
| Corporate debt securities | 5,277 | 443 | 9 | 5,711 |
| Residential mortgage-backed securities (RMBS) | 169 | 10 | 0 | 179 |
| Commercial mortgage-backed securities (CMBS) | 67 | 4 | 0 | 71 |
| Collateralized debt obligations (CDO) | 62 | 5 | 2 | 65 |
| Other debt securities | 58 | 3 | 0 | 61 |
| Total fixed maturities | 6,939 | 555 | 11 | 7,483 |
| Nonredeemable preferred stock | 561 | 65 | 5 | 621 |
| Total available-for-sale securities Exchange | \$7,500 | \$620 | \$16 | \$8,104 |
| Total available-for-sale securities Erie Insurance Group | \$8,003 | \$637 | \$16 | \$8,624 |

| <i>(in millions)</i> | Erie Insurance Group December 31, 2011 | | | |
|---|---|---------------------------|----------------------------|-------------------------|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| 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 |
| Residential mortgage-backed securities (RMBS) | 178 | 11 | 0 | 189 |
| Commercial mortgage-backed securities (CMBS) | 62 | 4 | 0 | 66 |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

The amortized cost and estimated fair value of fixed maturities at March 31, 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 | |
|---|----------------------|----------------------|
| | Amortized cost | Estimated fair value |
| Indemnity | | |
| Due in one year or less | \$ 150 | \$ 151 |
| Due after one year through five years | 204 | 209 |
| Due after five years through ten years | 48 | 51 |
| Due after ten years | 77 | 83 |
| Total fixed maturities Indemnity | \$ 479 | \$ 494 |
| Exchange | | |
| Due in one year or less | 509 | 516 |
| Due after one year through five years | 2,404 | 2,559 |
| Due after five years through ten years | 2,743 | 3,016 |
| Due after ten years | 1,283 | 1,392 |
| Total fixed maturities Exchange | \$6,939 | \$7,483 |
| Total fixed maturities Erie Insurance Group | \$7,418 | \$7,977 |

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

| | | | | | | | |
|--|-------|-----|-------|-----|-------|------|----|
| Available-for-sale securities: | | | | | | | |
| Corporate debt securities | \$ 50 | \$0 | \$ 6 | \$0 | \$ 56 | \$ 0 | 10 |
| Commercial mortgage-backed securities (CMBS) | | | | | | | |
| Other debt securities | 4 | 0 | 6 | 0 | 10 | 0 | 3 |
| Total fixed maturities Indemnity | 58 | 0 | 13 | 0 | 71 | 0 | 15 |
| Nonredeemable preferred stock | 0 | 0 | 3 | 0 | 3 | 0 | 1 |
| Total available-for-sale securities Indemnity | \$ 58 | \$0 | \$ 16 | \$0 | \$ 74 | \$ 0 | 16 |
| Quality breakdown of fixed maturities: | | | | | | | |
| Investment grade | \$ 58 | \$0 | \$ 13 | \$0 | \$ 71 | \$ 0 | 15 |
| Total fixed maturities Indemnity | \$ 58 | \$0 | \$ 13 | \$0 | \$ 71 | \$ 0 | 15 |
| Exchange | | | | | | | |
| Available-for-sale securities: | | | | | | | |
| States & political subdivisions | \$ 13 | \$0 | \$ 9 | \$0 | \$ 22 | \$ 0 | 4 |
| Corporate debt securities | 342 | 6 | 39 | 3 | 381 | 9 | 59 |
| Residential mortgage-backed securities (RMBS) | | | | | | | |
| Commercial mortgage-backed securities (CMBS) | 3 | 0 | 0 | 0 | 3 | 0 | 2 |
| Collateralized debt obligations (CDO) | 10 | 0 | 0 | 0 | 10 | 0 | 4 |
| Other debt securities | 0 | 0 | 33 | 2 | 33 | 2 | 5 |
| Total fixed maturities Exchange | 373 | 6 | 81 | 5 | 454 | 11 | 75 |
| Nonredeemable preferred stock | 92 | 3 | 26 | 2 | 118 | 5 | 16 |
| Total available-for-sale securities Exchange | \$465 | \$9 | \$107 | \$7 | \$572 | \$16 | 91 |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Quality breakdown of fixed maturities:

| | | | | | | | |
|------------------------|-------|-----|-------|-----|-------|------|----|
| Investment grade | \$321 | \$5 | \$ 73 | \$4 | \$394 | \$ 9 | 64 |
| Non-investment grade | 52 | 1 | 8 | 1 | 60 | 2 | 11 |
| Total fixed maturities | \$373 | \$6 | \$ 81 | \$5 | \$454 | \$11 | 75 |
| Exchange | | | | | | | |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

| | | | | | | | |
|---|-------|------|-------|------|-------|------|-----|
| 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

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 March 31, | |
| | 2012 | 2011 |
| Indemnity | | |
| Fixed maturities | \$ 3 | \$ 3 |
| Equity securities | 1 | 1 |
| Cash equivalents and other | 0 | 0 |
| Total investment income | 4 | 4 |
| Less: investment expenses | 0 | 0 |
| Investment income, net of expenses Indemnity | \$ 4 | \$ 4 |
| Exchange | | |
| Fixed maturities | \$ 90 | \$ 92 |
| Equity securities | 22 | 18 |
| Cash equivalents and other | 1 | 0 |
| Total investment income | 113 | 110 |
| Less: investment expenses | 9 | 9 |
| Investment income, net of expenses Exchange | \$104 | \$101 |
| Investment income, net of expenses Erie Insurance Group | \$108 | \$105 |

Realized gains (losses) on investments were as follows:

| <i>(in millions)</i> | Erie Insurance Group | |
|--|------------------------------|-------|
| | Three months ended March 31, | |
| | 2012 | 2011 |
| Indemnity | | |
| Available-for-sale securities: | | |
| Fixed maturities: | | |
| Gross realized gains | \$ 0 | \$ 0 |
| Gross realized losses | 0 | 0 |
| Net realized gains | 0 | 0 |
| Equity securities: | | |
| Gross realized gains | 0 | 1 |
| Gross realized losses | 0 | 0 |
| Net realized gains | 0 | 1 |
| Trading securities: | | |
| Common stock: | | |
| Gross realized gains | 1 | 1 |
| Gross realized losses | 0 | 0 |
| Valuation adjustments | 2 | (1) |
| Net realized gains | 3 | 0 |
| Net realized investment gains Indemnity | \$ 3 | \$ 1 |
| Exchange | | |
| Available-for-sale securities: | | |
| Fixed maturities: | | |
| Gross realized gains | \$ 9 | \$ 25 |
| Gross realized losses | (3) | (12) |
| Net realized gains | 6 | 13 |
| Equity securities: | | |
| Gross realized gains | 1 | 6 |
| Gross realized losses | 0 | (1) |
| Net realized gains | 1 | 5 |
| Trading securities: | | |
| Common stock: | | |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

| | | | |
|-------------------------------|----------------------|-------|-------|
| Gross realized gains | | 41 | 56 |
| Gross realized losses | | (12) | (8) |
| Valuation adjustments | | 257 | 82 |
| Net realized gains | | 286 | 130 |
| Net realized investment gains | Exchange | \$293 | \$148 |
| Net realized investment gains | Erie Insurance Group | \$296 | \$149 |

There were no impairment losses for Indemnity for the quarter ended March 31, 2012 and 2011. Impairment losses for the Exchange totaled \$0.1 million in the first quarter of 2012 and there were no impairments in the first quarter of 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 limited partnership results for the three months ended March 31, 2012 are comprised of partnership financial results for the fourth quarter of 2011. Given the lag in reporting, our limited partnership results do not reflect the market conditions of the first 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 three months ended March 31, 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

As these investments are generally reported on a one-quarter lag, our limited partnership results through March 31, 2012 include partnership financial results for the fourth quarter of 2011.

Erie Insurance Group
As of and for the three months ended March 31, 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 | \$ 73 | \$ 0 | \$ 1 |
| Greater than or equal to 10% but less than 50% | 3 | 9 | 0 | 0 |
| Greater than 50% | 0 | 0 | 0 | 0 |
| Total private equity | 29 | 82 | 0 | 1 |
| Mezzanine debt: | | | | |
| Less than 10% | 11 | 22 | (2) | 3 |
| Greater than or equal to 10% but less than 50% | 3 | 11 | 0 | 1 |
| Greater than 50% | 1 | 1 | 0 | 0 |
| Total mezzanine debt | 15 | 34 | (2) | 4 |
| Real estate: | | | | |
| Less than 10% | 12 | 60 | (1) | (1) |
| Greater than or equal to 10% but less than 50% | 3 | 18 | 0 | 0 |
| Greater than 50% | 3 | 10 | 0 | 0 |
| Total real estate | 18 | 88 | (1) | (1) |
| Total limited partnerships Indemnity | 62 | \$ 204 | \$ (3) | \$ 4 |
| Exchange | | | | |
| Private equity: | | | | |
| Less than 10% | 41 | \$ 463 | \$ 3 | \$10 |
| Greater than or equal to 10% but less than 50% | 3 | 44 | 1 | 0 |
| Greater than 50% | 0 | 0 | 0 | 0 |
| Total private equity | 44 | 507 | 4 | 10 |
| Mezzanine debt: | | | | |
| Less than 10% | 17 | 131 | (6) | 14 |
| Greater than or equal to 10% but less than 50% | 3 | 30 | (1) | 2 |
| Greater than 50% | 3 | 36 | 0 | 1 |
| Total mezzanine debt | 23 | 197 | (7) | 17 |
| Real estate: | | | | |
| Less than 10% | 25 | 287 | (8) | 5 |
| Greater than or equal to 10% but less than 50% | 5 | 58 | 0 | (1) |
| Greater than 50% | 3 | 38 | 0 | 0 |
| Total real estate | 33 | 383 | (8) | 4 |
| Total limited partnerships Exchange | 100 | \$1,087 | \$(11) | \$31 |
| Total limited partnerships Erie Insurance Group | | \$1,291 | \$(14) | \$35 |

Per the limited partnership financial statements, total partnership assets were \$53 billion and total partnership liabilities were \$6 billion at March 31, 2012 (as recorded in the December 31, 2011 limited partnership financial statements). For the three month period comparable to that presented in the preceding table (fourth quarter 2011), total partnership valuation adjustment losses were \$81 million and total partnership net income was \$2 billion.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 billion and total partnership net income was \$3 billion.

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

Note 8. Bank Line of Credit

As of March 31, 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 March 31, 2012. Bonds with a fair value of \$112 million were pledged as collateral on the line at March 31, 2012.

As of March 31, 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 March 31, 2012. Bonds with a fair value of \$328 million were pledged as collateral on the line at March 31, 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 March 31, 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 March 31, 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 March 31, 2012, we recorded a net deferred tax liability of \$261 million on our Consolidated Statements of Financial Position. Of this amount, \$18 million is a deferred tax asset attributable to Indemnity and \$279 million is a deferred tax liability attributable to the Exchange. There was no deferred tax valuation allowance recorded at March 31, 2012. Our effective tax rate is calculated after consideration of permanent differences related to our investment revenues. Given that these amounts represent 99% 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 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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

| <i>(in millions)</i> | Erie Insurance Group Three months ended March 31, | |
|------------------------------------|---|------|
| | 2012 | 2011 |
| Service cost | \$ 5 | \$ 4 |
| Interest cost | 6 | 6 |
| Expected return on plan assets | (7) | (7) |
| Amortization of prior service cost | 0 | 0 |
| Amortization of actuarial loss | 3 | 2 |
| Net periodic benefit cost | \$ 7 | \$ 5 |

Note 11. 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 three months ended March 31, 2012:

| <i>(in millions, except per share data)</i> | Indemnity shareholder interest | Erie Insurance Group Exchange noncontrolling interest | Erie Insurance Group |
|---|--------------------------------------|--|----------------------------|
| 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 | 36 | 318 | 354 |
| Change in other comprehensive income, net of tax | 2 | 70 | 72 |
| Net purchase of treasury stock | (17) | | (17) |
| Dividends declared: | | | |
| Class A \$0.5525 per share | (26) | | (26) |
| Class B \$82.875 per share | 0 | | 0 |
| Balance at March 31, 2012 | \$776 | \$5,900 | \$6,676 |

Note 12. Accumulated Other Comprehensive Income (Loss)

A rollforward of accumulated other comprehensive loss attributable to the Indemnity shareholder interest is presented as follows for the three months ended March 31, 2012:

| <i>(in millions)</i> | Indemnity Shareholder Interest Three months ended March 31, 2012 | | |
|--|--|--|----------------|
| | Unrealized net appreciation of investments | Net losses associated with postretirement benefits | Total |
| Balance at December 31, 2011 | \$11 | \$(116) | \$(105) |
| Change in other comprehensive income, net of tax: | | | |
| Unrealized appreciation of investments, net of tax | 2 | | 2 |
| Reclassification adjustment for gross gains included in income, net of tax | 0 | | 0 |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

| | | | |
|--|-------------|----------------|----------------|
| Change in other comprehensive income, net of tax | 2 | | 2 |
| Balance at March 31, 2012 | \$13 | \$(116) | \$(103) |

Note 13. Commitments and Contingencies

Indemnity has contractual commitments to invest up to \$39 million related to its limited partnership investments at March 31, 2012. These commitments are split between private equity securities of \$17 million, mezzanine debt securities of \$10 million, and real estate activities of \$12 million. These commitments will be funded as required by the partnership agreements.

The Exchange, including EFL, has contractual commitments to invest up to \$373 million related to its limited partnership investments at March 31, 2012. These commitments are split between private equity securities of \$159 million, mezzanine debt securities of \$119 million, and real estate activities of \$95 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. 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.

For certain legal proceedings, we cannot reasonably estimate losses or a range of loss, 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. The outcome of this pending litigation is uncertain, but in our opinion the outcome of each case, individually and in the aggregate, is 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.

Note 14. Indemnity Supplemental InformationConsolidating Statement of Financial Position

| <i>(in millions)</i> | Erie Insurance Group March 31, 2012 | | | |
|---|--|--|--|----------------------------|
| | Indemnity shareholder interest | Exchange noncontrolling interest | Reclassifications and eliminations | Erie Insurance Group |
| Assets | | | | |
| Investments | | | | |
| Available-for-sale securities, at fair value: | | | | |
| Fixed maturities | \$ 494 | \$ 7,483 | \$ | \$ 7,977 |
| Equity securities | 26 | 621 | | 647 |
| Trading securities, at fair value | 29 | 2,596 | | 2,625 |
| Limited partnerships | 204 | 1,087 | | 1,291 |
| Other invested assets | 1 | 19 | | 20 |
| Total investments | 754 | 11,806 | | 12,560 |
| Cash and cash equivalents | 28 | 171 | | 199 |
| Premiums receivable from policyholders | | 1,000 | | 1,000 |
| Reinsurance recoverable | | 167 | | 167 |
| Deferred income taxes | 18 | | | 18 |
| Deferred acquisition costs | | 482 | | 482 |
| Other assets | 115 | 291 | | 406 |
| Receivables from the Exchange and other affiliates | 256 | | (256) | |
| Note receivable from EFL | 25 | | (25) | |
| Total assets | \$1,196 | \$13,917 | \$(281) | \$14,832 |
| Liabilities | | | | |
| Losses and loss expense reserves | \$ | \$3,451 | \$ | \$3,451 |
| Life policy and deposit contract reserves | | 1,689 | | 1,689 |
| Unearned premiums | | 2,196 | | 2,196 |
| Deferred income taxes | | 279 | | 279 |
| Other liabilities | 420 | 402 | (281) | 541 |
| Total liabilities | 420 | 8,017 | (281) | 8,156 |
| Shareholders' equity and noncontrolling interest | | | | |
| Total Indemnity shareholders' equity | 776 | | | 776 |
| Noncontrolling interest in consolidated entity | | 5,900 | | 5,900 |
| Total equity | 776 | 5,900 | | 6,676 |
| Total liabilities, shareholders' equity and noncontrolling interest | \$1,196 | \$13,917 | \$(281) | \$14,832 |

Consolidating Statement of Financial Position

| <i>(in millions)</i> | Erie Insurance Group December 31, 2011 | | | |
|--|---|--|--|----------------------------|
| | 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. EFL accrued interest payable to Indemnity of \$0.4 million in each of the three months ended March 31, 2012 and 2011.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Income attributable to Indemnity shareholder interest

| (in millions) | Percent | Indemnity Shareholder Interest | |
|---|-----------|---------------------------------|-------|
| | | Three months ended March 31, | |
| | | 2012 | 2011 |
| Management operations: | | | |
| Management fee revenue, net | 100.0% | \$269 | \$251 |
| Service agreement revenue | 100.0% | 7 | 8 |
| Total revenue from management operations | | 276 | 259 |
| Cost of management operations | 100.0% | 230 | 211 |
| Income from management operations before taxes | | 46 | 48 |
| 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 |
| Net realized gains on investments | | 3 | 1 |
| Net impairment losses recognized in earnings | | 0 | 0 |
| Equity in earnings of limited partnerships | | 1 | 11 |
| Income from investment operations before taxes | | 8 | 16 |
| Income from operations before income taxes | | 54 | 67 |
| Provision for income taxes | | 18 | 23 |
| Net income | | \$ 36 | \$ 44 |

(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 | |
|---|---------------------------------|--------|
| | Three months ended March 31, | |
| | 2012 | 2011 |
| Management fee received | \$ 266 | \$ 252 |
| Service agreement fee received | 7 | 8 |
| Net investment income received | 7 | 4 |
| Limited partnership distributions | 3 | 5 |
| Increase (decrease) in reimbursements collected from affiliates | 0 | (8) |
| Commissions and bonuses paid to agents | (180) | (178) |
| Salaries and wages paid | (34) | (38) |
| Pension contribution and employee benefits paid | (27) | (4) |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

| | | |
|--|-------|-------|
| General operating expenses paid | (33) | (35) |
| Income taxes paid | 0 | 0 |
| Net cash provided by operating activities | 9 | 6 |
| Net cash provided by (used in) investing activities | 53 | (168) |
| Net cash used in financing activities | (45) | (62) |
| Net increase (decrease) in cash and cash equivalents | 17 | (224) |
| Cash and cash equivalents at beginning of period | 11 | 310 |
| Cash and cash equivalents at end of period | \$ 28 | \$ 86 |

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. During the three months ended March 31, 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 \$120 million of repurchase authority remaining under this program at March 31, 2012.

Note 16. Subsequent Events

We have evaluated for recognized and nonrecognized subsequent events through the date of financial statement issuance. No items were identified in this period subsequent to the financial statement date that required adjustment or disclosure.

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> | 35 |
| <u>Recent Accounting Pronouncements</u> | 36 |
| <u>Operating Overview</u> | 37 |
| <u>Results of Operations</u> | 42 |
| <u>Management Operations</u> | 42 |
| <u>Property and Casualty Insurance Operations</u> | 44 |
| <u>Life Insurance Operations</u> | 48 |
| <u>Investment Operations</u> | 49 |
| <u>Financial Condition</u> | 51 |
| <u>Investments</u> | 51 |
| <u>Liabilities</u> | 55 |
| <u>Impact of Inflation</u> | 56 |
| <u>Liquidity and Capital Resources</u> | 56 |
| <u>Critical Accounting Estimates</u> | 59 |

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

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

The following table represents 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.

| (in millions) | Indemnity shareholder interest | | Noncontrolling interest (Exchange) | | Eliminations of related party transactions | | Erie Insurance Group | | | |
|---|--------------------------------|-----------------------------------|------------------------------------|-----------|--|-----------------------------------|-----------------------------------|-----------------------------------|--------|--------|
| | Percent | Three months ended March 31, 2012 | Three months ended March 31, 2011 | Percent | Three months ended March 31, 2012 | Three months ended March 31, 2011 | Three months ended March 31, 2012 | Three months ended March 31, 2011 | | |
| Management operations: | | | | | | | | | | |
| Management fee revenue, net | 100.0% | \$269 | \$251 | | \$ | \$ | \$(269) | \$(251) | \$ | \$ |
| Service agreement revenue | 100.0% | 7 | 8 | | | | | | 7 | 8 |
| Total revenue from management operations | | 276 | 259 | | | | (269) | (251) | 7 | 8 |
| Cost of management operations | 100.0% | 230 | 211 | | | | (230) | (211) | | |
| Income from management operations before taxes | | 46 | 48 | | | | (39) | (40) | 7 | 8 |
| Property and casualty insurance operations: | | | | | | | | | | |
| Net premiums earned | | | | 100.0% | 1,069 | 1,014 | | | 1,069 | 1,014 |
| Losses and loss expenses | | | | 100.0% | 692 | 683 | (1) | (1) | 691 | 682 |
| Policy acquisition and underwriting expenses | | | | 100.0% | 302 | 282 | (41) | (42) | 261 | 240 |
| Income from property and casualty insurance operations before taxes | | | | | 75 | 49 | 42 | 43 | 117 | 92 |
| Life insurance operations: | | | | | | | | | | |
| (1) (2) | | | | | | | | | | |
| Total revenue | 21.6% (2) | | 10 | 78.4% (2) | 43 | 34 | 0 | 0 | 43 | 44 |
| Total benefits and expenses | 21.6% (2) | | 7 | 78.4% (2) | 34 | 24 | 0 | 0 | 34 | 31 |
| Income from life insurance operations before taxes | | | 3 | | 9 | 10 | 0 | 0 | 9 | 13 |
| Investment operations: | | | | | | | | | | |
| Net investment income | | 4 | 4 | | 83 | 81 | (3) | (3) | 84 | 82 |
| Net realized gains on investments | | 3 | 1 | | 293 | 144 | | | 296 | 145 |
| Net impairment losses recognized in earnings | | 0 | 0 | | 0 | 0 | | | 0 | 0 |
| Equity in earnings of limited partnerships | | 1 | 11 | | 20 | 61 | | | 21 | 72 |
| Income from investment operations before taxes | | 8 | 16 | | 396 | 286 | (3) | (3) | 401 | 299 |
| Income from operations before income taxes and noncontrolling interest | | | | | | | | | | |
| | | 54 | 67 | | 480 | 345 | | | 534 | 412 |
| Provision for income taxes | | 18 | 23 | | 162 | 115 | | | 180 | 138 |
| Net income | | \$ 36 | \$ 44 | | \$ 318 | \$ 230 | \$ | \$ | \$ 354 | \$ 274 |

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

Net income in the first quarter of 2012 benefited from improved results in our investment and property and casualty insurance operations compared to the first quarter of 2011. Our investment operations were impacted primarily by increased net realized gains on investments, offset somewhat by decreased equity in earnings on limited partnerships. The Exchange's property and casualty insurance operations experienced a 5.4% increase in earned premium, driven by increases in policies in force and the average premium per policy, and lower catastrophe losses, offset by less favorable development on prior accident year loss reserves compared to the first quarter of 2011.

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 March 31, | |
| | 2012 | 2011 |
| | (Unaudited) | |
| Operating income attributable to Indemnity | \$34 | \$43 |
| Net realized gains and impairments on investments | 3 | 1 |
| Income tax expense | (1) | 0 |
| Realized gains and impairments, net of income taxes | 2 | 1 |
| Net income attributable to Indemnity | \$36 | \$44 |
| Per Indemnity Class A common share-diluted: | | |
| Operating income attributable to Indemnity | \$0.64 | \$0.77 |
| Net realized gains and impairments on investments | 0.05 | 0.02 |
| Income tax expense | (0.02) | (0.01) |
| Realized gains and impairments, net of income taxes | 0.03 | 0.01 |
| Net income attributable to Indemnity | \$0.67 | \$0.78 |

Summary of Results Indemnity Shareholder Interest

Net income attributable to Indemnity per share-diluted was \$0.67 per share in the first quarter of 2012, compared to \$0.78 per share in the first quarter of 2011. The first quarter 2011 net income per share-diluted amount includes \$0.02 per share related to operations sold to the Exchange.

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 \$0.64 per share in the first quarter of 2012, compared to \$0.77 per share in the first quarter of 2011. The first quarter 2011 operating income per share-diluted amount includes \$0.02 per share related to operations sold to the Exchange.

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 over 2,100 independent agencies, with over 9,600 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. Approximately 50% of our premiums are 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 direct written premium in 2011.

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Factors affecting loss 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.

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 in 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.

Our investment operations produced positive results reflecting favorable conditions in the financial markets during the first quarter of 2012. Net investment income totaled \$108 million in the first quarter of 2012, compared to \$105 million in first quarter of 2011. Net realized gains totaled \$296 million in the first quarter of 2012, compared to \$149 million in the first quarter of 2011, primarily reflecting the significant valuation gains on our common stock portfolio in the first quarter of 2012. Equity in earnings of limited partnerships totaled \$21 million in the first quarter of 2012, compared to \$72 million in the first 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 first quarter 2012 partnerships earnings reflect the market conditions experienced in the fourth quarter of 2011 and not in the first 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. Depending upon market conditions, which are 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.

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> | 2012 | Indemnity Shareholder Interest Three months ended March 31, (Unaudited) | |
|--|--------|---|-----------|
| | | 2011 | % Change |
| Management fee revenue, net | \$ 269 | \$ 251 | 6.9 % |
| Service agreement revenue | 7 | 8 | (9.6) |
| Total revenue from management operations | 276 | 259 | 6.4 |
| Cost of management operations | 230 | 211 | 8.7 |
| Income from management operations Indemnity(1) | \$ 46 | \$ 48 | (3.8)% |
| Gross margin | 16.8% | 18.6% | (1.8)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> | 2012 | Indemnity Shareholder Interest Three months ended March 31, (Unaudited) | |
|---|---------|---|----------|
| | | 2011 | % Change |
| Property and Casualty Group direct written premium | \$1,078 | \$1,008 | 6.9 % |
| Management fee rate | 25% | 25% | |
| Management fee revenue, gross | \$ 270 | \$ 252 | 6.9 % |
| Change in allowance for management fee returned on cancelled policies (1) | (1) | (1) | NM |
| Management fee revenue, net of allowance | \$ 269 | \$ 251 | 6.9 % |

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 6.9% in the first quarter of 2012, compared to the first quarter of 2011, due to a 2.6% increase in policies in force and a 3.3% increase in the year-over-year average premium per policy for all lines of business. The policy retention ratio was 90.7% at March 31, 2012, December 31, 2011, and March 31, 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.

Service 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 \$7 million and \$8 million in the first quarters of 2012 and 2011, respectively. The decrease in service agreement revenue in the first quarter of 2012 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 services charges and to take advantage of the discount in pricing offered for paid-in-full policies.

Cost of management operations

| (in millions) | 2012 | Indemnity Shareholder Interest Three months ended March 31, | |
|-------------------------------------|-------|--|----------|
| | | 2011 (Unaudited) | % Change |
| Commissions | \$149 | \$138 | 8.4 % |
| Non-commission expense | 81 | 73 | 9.3 |
| Total cost of management operations | \$230 | \$211 | 8.7 % |

Commissions Commissions increased \$11 million in the first quarter of 2012, compared to the first quarter of 2011, primarily as a result of the 6.9% increase in direct written premium of the Property and Casualty Group. Agent bonuses also increased slightly due to an increase in the profitability component of the bonus as a result of factoring in the most recent year's underwriting data.

Non-commission expense Non-commission expense increased \$8 million in the first quarter of 2012, compared to the first quarter of 2011. Personnel costs, the second largest component in the cost of management operations, increased \$4 million primarily as a result of increases in salaries and benefits. Software costs and technology related professional fees increased \$2 million and \$1 million, respectively.

The gross margin in the first quarter of 2012 was 16.8%, compared to 18.6% in the first quarter of 2011, as a result of expense increases slightly outpacing revenue growth.

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 March 31, (Unaudited) | | |
|---|--|---------|-----------|
| | 2012 | 2011 | % Change |
| Premiums: | | | |
| Direct written premium | \$1,078 | \$1,008 | 6.9 % |
| Reinsurance assumed and ceded | (6) | (4) | (70.6) |
| Net written premium | 1,072 | 1,004 | 6.7 |
| Change in unearned premium | 3 | (10) | NM |
| Net premiums earned | 1,069 | 1,014 | 5.4 |
| Losses and loss expenses: | | | |
| Current accident year, excluding catastrophe losses | 686 | 677 | (1.3) |
| Current accident year catastrophe losses | 25 | 65 | (62.0) |
| Prior accident years, including prior year catastrophe losses | (19) | (59) | 67.4 |
| Losses and loss expenses | 692 | 683 | 1.2 |
| Policy acquisition and other underwriting expenses | 302 | 282 | 7.3 |
| Total losses and expenses | 994 | 965 | 3.0 |
| Underwriting income Exchange ⁽¹⁾ | \$ 75 | \$ 49 | 52.8% |
| Loss and loss expense ratios: | | | |
| Current accident year loss ratio, excluding catastrophe losses | 64.2 % | 66.8 % | (2.6)pts. |
| Current accident year catastrophe loss ratio | 2.3 | 6.4 | (4.1) |
| Prior accident year loss ratio, including prior year catastrophe losses | (1.8) | (5.8) | 4.0 |
| Total loss and loss expense ratio | 64.7 | 67.4 | (2.7) |
| Policy acquisition and other underwriting expense ratio | 28.3 | 27.8 | 0.5 |
| Combined ratio | 93.0 % | 95.2 % | (2.2)pts. |

NM = not meaningful

(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 6.9% to nearly \$1.1 billion in the first quarter of 2012, from \$1.0 billion in the first 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 2.6% in the first quarter of 2012 as the result of continuing strong policyholder retention, compared to an increase of 3.2% in the first quarter of 2011. The year-over-year average premium per policy for all lines of business increased 3.3% at March 31, 2012, compared to an increase of 2.1% at March 31, 2011. The combined impact of these increases was seen primarily in our renewal business premiums.

Premiums generated from new business increased 16.5% to \$129 million in the first quarter of 2012, compared to an increase of 4.2% to \$111 million in the first quarter of 2011. Underlying the trend in new business premiums was an 8.8% increase in new business policies written in the first quarter of 2012, compared to the first quarter of 2011, while the year-over-year average premium per policy on new business increased 5.9% at March 31, 2012, compared to an increase of 4.9% at March 31, 2011.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Premiums generated from renewal business increased 5.8% to \$949 million in the first quarter of 2012, compared to an increase of 6.5% to \$897 million in the first quarter of 2011. Underlying the trend in renewal business premiums was an increase in renewal business policies in force of 3.1% in the first quarter of 2012, compared to 3.7% in the first quarter of 2011, and an increase in the renewal business year-over-year average premium per policy of 3.0% at March 31, 2012, compared to 1.7% at March 31, 2011. The Property and Casualty Group's year-over-year policy retention ratio was 90.7% at March 31, 2012, December 31, 2011, and March 31, 2011.

Personal lines Total personal lines premiums written increased 6.3% to \$746 million in the first quarter of 2012, from \$702 million in the first quarter of 2011, driven by an increase of 2.5% in both the total personal lines policies in force and the total personal lines year-over-year average premium per policy.

New business premiums written on personal lines increased 15.6% in the first quarter of 2012, compared to a decrease of 1.8% in the first quarter of 2011. Personal lines new business policies written increased 10.2% in the first quarter of 2012, compared to the first quarter of 2011, while the year-over-year average premium per policy on personal lines new business increased 4.7% at March 31, 2012, compared to an increase of 2.2% at March 31, 2011.

- Private passenger auto new business premiums written increased 13.1% in the first quarter of 2012, compared to a decrease of 3.6% in the first quarter of 2011. New business policies written for private passenger auto increased 9.1% in the first quarter of 2012, compared to the first quarter of 2011, while the new business year-over-year average premium per policy for private passenger auto increased 2.3% at March 31, 2012, compared to an increase of 2.5% at March 31, 2011.

- Homeowners new business premiums written increased 20.9% in the first quarter of 2012, compared to a decrease of 1.2% in the first quarter of 2011. New business policies written for homeowners increased 11.8% in the first quarter of 2012, compared to the first quarter of 2011. The new business year-over-year average premium per policy for homeowners increased 6.7% at March 31, 2012, compared to an increase of 2.7% at March 31, 2011.

Renewal premiums written on personal lines increased 5.2% in the first quarter of 2012, compared to 6.7% in the first 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 2.2% at March 31, 2012, compared to 2.7% at March 31, 2011. The personal lines year-over-year policy retention ratio was 91.4% at March 31, 2012, and 91.5% at December 31, 2011 and March 31, 2011.

- Private passenger auto renewal premiums written increased 2.7% in the first quarter of 2012, compared to 4.9% in the first quarter of 2011. The year-over-year average premium per policy on private passenger auto renewal business increased 0.3% at March 31, 2012, compared to 2.4% at March 31, 2011. The private passenger auto year-over-year policy retention ratio was 91.7% at March 31, 2012, 91.6% at December 31, 2011, and 91.7% at March 31, 2011.

- Homeowners renewal premiums written increased 11.2% in the first quarter of 2012, compared to 11.3% in the first quarter of 2011. The year-over-year average premium per policy on homeowners renewal business increased 7.4% at March 31, 2012, compared to 5.5% at March 31, 2011. The homeowners year-over-year policyholder retention ratio was 90.9% at March 31, 2012, and 91.0% at December 31, 2011 and March 31, 2011.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Commercial lines Total commercial lines premiums written increased 8.6% to \$332 million in the first quarter of 2012, from \$306 million in the first quarter of 2011, driven by a 3.6% increase in the total commercial lines policies in force and a 5.0% increase in the total commercial lines year-over-year average premium per policy.

New business premiums written on commercial lines increased 18.3% in the first quarter of 2012, compared to 15.9% in the first quarter of 2011. Commercial lines new business policies written increased 3.3% in the first quarter of 2012, compared to the first quarter of 2011, while the year-over-year average premium per policy on commercial lines new business increased 7.2% at March 31, 2012, compared to 6.0% at March 31, 2011.

Renewal premiums for commercial lines increased 7.0% in the first quarter of 2012, compared to an increase of 6.2% in the first 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 March 31, 2012, compared to a decrease of 1.2% at March 31, 2011. The year-over-year policy retention ratio for commercial lines was 85.9% at March 31, 2012, 85.5% at December 31, 2011, and 85.8% at March 31, 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 March 31, 2012, we had over 2,100 agencies with over 9,600 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. We expect our pricing actions to result in a net increase in direct written premium in 2012, however, exposure reductions and/or changes in our mix of business as a result of economic conditions could impact the average premium written by the Property and Casualty Group, as customers may reduce coverages.

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 64.2% in the first quarter of 2012, compared to 66.8% in the first quarter of 2011. This decline 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 which was impacted by more non-catastrophe weather related claims.

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 \$25 million in the first quarter of 2012, compared to \$65 million in the first quarter of 2011, and contributed 2.3 points and 6.4 points to the loss ratios at March 31, 2012 and 2011, respectively.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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:

| (in millions) | Property and Casualty Group Three months ended March 31, | |
|---|--|--------|
| | 2012 | 2011 |
| | (Unaudited) | |
| Direct business including salvage and subrogation | \$(20) | \$(61) |
| Assumed reinsurance business | 3 | 3 |
| Ceded reinsurance business | (2) | (1) |
| Total prior year loss development | \$(19) | \$(59) |

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 first quarter of 2012, the Property and Casualty Group experienced favorable development of prior accident year loss reserves, including the effects of reserves for prior accident year catastrophe losses and salvage and subrogation recoveries, which improved the combined ratio by 1.8 points, compared to 5.8 points in the first quarter of 2011. The favorable development in the first quarter of 2012 was primarily driven by better than expected trends on liability claims in the personal auto and homeowners lines of business and better than expected trends on liability and property claims in the commercial multi-peril line of business, offset somewhat by adverse development in the workers compensation line of business driven by increased severity trends. The favorable development in the first quarter of 2011 was primarily driven by improved annual claim cost expectations on massive injury lifetime medical benefits and the closing of one massive injury lifetime medical claim in the personal auto line of business, and better than expected severity trends on liability claims in the commercial multi-peril and homeowners lines of business.

Assumed reinsurance The Property and Casualty Group experienced adverse development of prior accident year loss reserves on its assumed reinsurance business totaling \$3 million in both the first quarters of 2012 and 2011. The adverse development in both periods was due to growth in involuntary reinsurance.

Ceded reinsurance The Property and Casualty Group's ceded reinsurance reserves increased \$2 million, which is reflected as favorable development of prior accident year loss reserves, compared to an increase of \$1 million in the first quarter of 2011. Ceded reinsurance reserves primarily relate to the pre-1986 automobile massive injury claims.

Policy acquisition and other underwriting expenses Our policy acquisition and other underwriting expense ratio increased 0.5 points to 28.3%, in the first quarter of 2012, compared to 27.8% in the first quarter of 2011, primarily due to a decrease in the amount of policy acquisition expenses deferred under the new accounting guidance effective in 2012. The management fee rate was 25% for the periods ending March 31, 2012 and 2011.

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:

| (in millions) | Erie Family Life Insurance Company | | |
|---|---|-------|----------|
| | 2012 | 2011 | % Change |
| | Three months ended March 31, (Unaudited) | | |
| Individual life premiums, net of reinsurance | \$17 | \$15 | 8.8 % |
| Group life and other premiums | 1 | 1 | 1.8 |
| Other revenue | 1 | 1 | (6.5) |
| Total net policy revenue | 19 | 17 | 8.2 |
| Net investment income | 24 | 23 | 2.3 |
| Net realized gains on investments | 0 | 4 | (80.8) |
| Impairment losses recognized in earnings | 0 | 0 | NM |
| Equity in (losses) earnings of limited partnerships | 0 | 0 | NM |
| Total revenues | 43 | 44 | (4.3) |
| Benefits and other changes in policy reserves | 25 | 24 | 5.4 |
| Amortization of deferred policy acquisition costs | 3 | 3 | (15.2) |
| Other operating expenses | 6 | 4 | 49.4 |
| Total benefits and expenses | 34 | 31 | 8.5 |
| Income before income taxes | \$ 9 | \$ 13 | (34.8)% |
| Income before taxes Indemnity(1) | \$ | \$ 3 | |
| Income before taxes Exchange(1) | \$ 9 | \$10 | |

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 4.3% to \$28 million in the first quarter 2012, compared to \$26 million in the first 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 \$10 million in both the first quarter of 2012 and 2011.

Premiums received on annuity and universal life products totaled \$20 million in the first quarter of 2012, compared to \$24 million in the first quarter of 2011. Of this amount, annuity and universal life premiums, which are recorded as deposits and therefore not reflected in revenue on the Consolidated Statements of Operations, totaled \$16 million and \$21 million in the first quarters of 2012 and 2011, respectively.

Investment revenue

EFL experienced a decrease in net realized gains on investments in the first quarter of 2012 due to lower levels of bond calls and sale activity, offset by a slight increase in net investment income compared to the first quarter of 2011. See the discussion of investments in the Investment Operations segment that follows for further information.

Benefits and expenses

The first quarter of 2012 benefits and other changes in policy reserves were impacted by an increase in death benefits and interest on annuity deposits, compared to the first quarter of 2011. Other operating expenses increased 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:

| <i>(in millions)</i> | Erie Insurance Group Three months ended March 31, | | |
|--|--|-------|----------|
| | 2012 | 2011 | % Change |
| Net investment income | \$ 4 | \$ 4 | 3.8% |
| Net realized gains on investments | 3 | 1 | NM |
| Net impairment losses recognized in earnings | 0 | 0 | NM |
| Equity in earnings of limited partnerships | 1 | 11 | (89.8%) |
| Net revenue from investment operations - Indemnity | \$ 8 | \$ 16 | (48.5%) |
| Exchange | | | |
| Net investment income | \$107 | \$104 | 2.5% |
| Net realized gains on investments | 293 | 148 | 97.3% |
| Net impairment losses recognized in earnings | 0 | 0 | NM |
| Equity in earnings of limited partnerships | 20 | 61 | (67.5%) |
| Net revenue from investment operations - Exchange ⁽¹⁾ | \$420 | \$313 | 34.3% |

NM = not meaningful

(1) The Exchange's investment results for the first quarter of 2012 and 2011 include net investment revenues from EFL's operations of \$24 million and \$27 million, respectively.

Net investment income

Net investment income primarily includes interest and dividends on our fixed maturity and equity security portfolios. Indemnity's net investment income was unchanged in the first quarter of 2012, compared to the first quarter of 2011, while the Exchange's net investment income increased \$3 million during the same period due to higher invested balances.

Net realized gains on investments

Indemnity generated net realized gains of \$3 million in the first quarter of 2012, compared to gains of \$1 million in the first quarter of 2011. The Exchange generated net realized gains of \$293 million in the first quarter of 2012, compared to gains of \$148 million in the same period in 2011. The realized gains generated in the first quarter of 2012 for Indemnity and the Exchange were primarily due to increases in the valuation on their common stock portfolios.

Net impairment losses recognized in earnings

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

There were no net impairment losses recognized in earnings for Indemnity in the first quarter of 2012 and 2011, while net impairment losses for the Exchange totaled \$0.1 million in the first quarter of 2012 and there were no impairments in the first quarter of 2011.

Equity in earnings of limited partnerships

Indemnity's equity in earnings of limited partnerships decreased \$10 million in the first quarter of 2012, compared to the first quarter of 2011, while the Exchange's equity in earnings of limited partnerships decreased \$41 million during the same period. The results were due to lower earnings from the private equity and real estate sectors.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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

| (in millions) | Erie Insurance Group | |
|--|--------------------------------------|-------|
| | Three months ended March 31, 2012 | 2011 |
| | (Unaudited) | |
| Indemnity | | |
| Securities sold: | | |
| Fixed maturities | \$ 0 | \$ 0 |
| Preferred stock equity securities | 0 | 1 |
| Common stock equity securities | 1 | 1 |
| Common stock valuation adjustments | 2 | (1) |
| Total net realized gains Indemnity(1) | \$ 3 | \$ 1 |
| Exchange | | |
| Securities sold: | | |
| Fixed maturities | \$ 6 | \$ 13 |
| Preferred stock equity securities | 1 | 5 |
| Common stock equity securities | 29 | 48 |
| Common stock valuation adjustments | 257 | 82 |
| Total net realized gains Exchange(1) (2) | \$293 | \$148 |

(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 first quarter of 2012 and 2011 include net realized gains from EFL's operations of \$0 million and \$4 million, respectively.

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

| (in millions) | Erie Insurance Group | | | % Change |
|--|----------------------|--------------------------------------|--|----------|
| | 2012 | Three months ended March 31, 2011 | | |
| | (Unaudited) | | | |
| Indemnity | | | | |
| Private equity | \$ 1 | \$ 7 | | (76.1%) |
| Mezzanine debt | 2 | 2 | | (8.3%) |
| Real estate | (2) | 2 | | NM |
| Total equity in earnings of limited partnerships Indemnity | \$ 1 | \$11 | | (89.8%) |
| Exchange | | | | |
| Private equity | \$14 | \$40 | | (64.0%) |
| Mezzanine debt | 10 | 8 | | 11.3% |
| Real estate | (4) | 13 | | NM |
| Total equity in earnings of limited partnerships Exchange(1) | \$20 | \$61 | | (67.5%) |

NM = not meaningful

(1) The Exchange's results include equity in earnings (losses) of limited partnerships from EFL of \$(0.4) million for the first quarter of 2012 and \$0.4 million for the first quarter 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 fair value of limited partnerships. These adjustments are recorded as a component of equity in earnings of limited partnerships in the Consolidated Statements of Operations.

We experienced a decrease in earnings as a result of less favorable performance in our private equity and real estate limited partnerships in the first quarter of 2012, compared to the first quarter of 2011. 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 March 31, 2012 reflect investment valuation changes resulting from the financial markets and the economy in the fourth quarter of 2011 and not in the first 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 March 31, 2012 (Unaudited) | % to total | Carrying value at December 31, 2011 | % to total |
| Indemnity | | | | |
| Fixed maturities | \$ 494 | 65% | \$ 548 | 68% |
| Equity securities: | | | | |
| Preferred stock | 26 | 3 | 25 | 3 |
| Common stock | 29 | 4 | 27 | 4 |
| Limited partnerships: | | | | |
| Private equity | 82 | 11 | 82 | 10 |
| Mezzanine debt | 34 | 5 | 35 | 4 |
| Real estate | 88 | 12 | 91 | 11 |
| Real estate mortgage loans | 1 | 0 | 1 | 0 |
| Total investments Indemnity | \$ 754 | 100% | \$ 809 | 100% |
| Exchange | | | | |
| Fixed maturities | \$ 7,483 | 64% | \$ 7,292 | 65% |
| Equity securities: | | | | |
| Preferred stock | 621 | 5 | 564 | 5 |
| Common stock | 2,596 | 22 | 2,308 | 21 |
| Limited partnerships: | | | | |
| Private equity | 507 | 4 | 495 | 4 |
| Mezzanine debt | 197 | 2 | 201 | 2 |
| Real estate | 383 | 3 | 386 | 3 |
| Life policy loans | 15 | 0 | 15 | 0 |
| Real estate mortgage loans | 4 | 0 | 4 | 0 |
| Total investments Exchange | \$11,806 | 100% | \$11,265 | 100% |
| Total investments Erie Insurance Group | \$12,560 | | \$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 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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 \$217 million, or 44%, of the total fixed maturity portfolio for Indemnity and \$1.4 billion, or 18%, of the fixed maturity portfolio for the Exchange at March 31, 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 \$9 million at March 31, 2012, compared to \$8 million at December 31, 2011. At March 31, 2012, the Exchange had net unrealized gains on fixed maturities of \$354 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:

| Industry Sector | Erie Insurance Group (1) | | | | | Non-investment grade | Fair value |
|-----------------------------|--------------------------|----------------|----------------|----------------|----------------------------------|----------------------|----------------|
| | AAA | AA | A | BBB | At March 31, 2012 (Unaudited) | | |
| <i>(in millions)</i> | | | | | | | |
| Indemnity | | | | | | | |
| Communications | \$ 0 | \$ 0 | \$ 13 | \$ 7 | | \$ 0 | \$ 20 |
| Consumer | 0 | 0 | 17 | 11 | | 0 | 28 |
| Energy | 0 | 0 | 0 | 18 | | 0 | 18 |
| Financial | 0 | 43 | 46 | 37 | | 0 | 126 |
| Government-municipal | 95 | 89 | 24 | 9 | | 0 | 217 |
| Industrial | 0 | 4 | 7 | 5 | | 0 | 16 |
| Structured securities (2) | 15 | 0 | 0 | 4 | | 0 | 19 |
| Technology | 0 | 0 | 8 | 15 | | 0 | 23 |
| Utilities | 0 | 0 | 0 | 27 | | 0 | 27 |
| Total Indemnity | \$110 | \$ 136 | \$ 115 | \$ 133 | | \$ 0 | \$ 494 |
| Exchange | | | | | | | |
| Basic materials | \$ 0 | \$ 0 | \$ 50 | \$ 191 | | \$ 5 | \$ 246 |
| Communications | 0 | 0 | 215 | 304 | | 23 | 542 |
| Consumer | 0 | 30 | 283 | 438 | | 24 | 775 |
| Diversified | 0 | 0 | 22 | 0 | | 0 | 22 |
| Energy | 16 | 12 | 125 | 398 | | 33 | 584 |
| Financial | 1 | 332 | 1,153 | 866 | | 156 | 2,508 |
| Foreign government | 0 | 0 | 16 | 0 | | 0 | 16 |
| Funds | 0 | 0 | 0 | 6 | | 0 | 6 |
| Government-municipal | 400 | 768 | 161 | 30 | | 2 | 1,361 |
| Government sponsored entity | 0 | 14 | 0 | 0 | | 0 | 14 |
| Industrial | 0 | 6 | 79 | 205 | | 18 | 308 |
| Structured securities (2) | 55 | 263 | 29 | 26 | | 2 | 375 |
| Technology | 0 | 0 | 38 | 99 | | 0 | 137 |
| U.S. Treasury | 0 | 6 | 0 | 0 | | 0 | 6 |
| Utilities | 0 | 0 | 100 | 432 | | 51 | 583 |
| Total Exchange | \$472 | \$1,431 | \$2,271 | \$2,995 | | \$314 | \$7,483 |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

- (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.*

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Equity securities

Our equity securities consist of common stock and nonredeemable preferred stock. Investment characteristics of common stock and non-redeemable preferred stock differ substantially 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: | | | |
| | March 31, 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 | 12 | 5 | 11 | 4 |
| Industrial | 0 | 3 | 0 | 3 |
| Technology | 3 | 1 | 3 | 1 |
| Utilities | 10 | 0 | 10 | 0 |
| Total Indemnity | \$ 26 | \$ 29 | \$ 25 | \$ 27 |
| Exchange | | | | |
| Basic materials | \$ 0 | \$ 90 | \$ 0 | \$ 72 |
| Communications | 9 | 175 | 9 | 168 |
| Consumer | 6 | 836 | 5 | 763 |
| Diversified | 0 | 21 | 0 | 18 |
| Energy | 0 | 198 | 0 | 203 |
| Financial | 462 | 410 | 408 | 340 |
| Funds | 0 | 116 | 0 | 105 |
| Government | 0 | 0 | 0 | 0 |
| Industrial | 0 | 397 | 0 | 350 |
| Technology | 14 | 313 | 15 | 246 |
| Utilities | 130 | 40 | 127 | 43 |
| Total Exchange | \$621 | \$2,596 | \$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 March 31, 2012, the unrealized gain on preferred stock classified as available-for-sale securities, net of deferred taxes, amounted to \$1 million for Indemnity and \$39 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 first quarter of 2012, investments in limited partnerships remained relatively flat 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 first quarter of 2012 reflect the partnership activity experienced in the fourth quarter of 2011.

The components of limited partnership investments are as follows:

| <i>(in millions)</i> | Erie Insurance Group | |
|--------------------------------------|-------------------------------------|-------------------------|
| | At March 31, 2012 (Unaudited) | At December 31, 2011 |
| Indemnity | | |
| Private equity | \$ 82 | \$ 82 |
| Mezzanine debt | 34 | 35 |
| Real estate | 88 | 91 |
| Total limited partnerships Indemnity | \$ 204 | \$ 208 |
| Exchange | | |
| Private equity | \$ 507 | \$ 495 |
| Mezzanine debt | 197 | 201 |
| Real estate | 383 | 386 |
| Total limited partnerships Exchange | \$1,087 | \$1,082 |

LiabilitiesProperty and casualty loss and loss expense reserves

Loss reserves are established to account for the estimated ultimate costs of loss 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.

Loss 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 loss 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.

| (in millions) | Property and Casualty Group | |
|-------------------------------------|-------------------------------------|-------------------------|
| | At March 31, 2012 (Unaudited) | At December 31, 2011 |
| Gross reserve liability (1): | | |
| Personal auto | \$1,062 | \$1,093 |
| Automobile massive injury | 349 | 356 |
| Homeowners | 313 | 313 |
| Workers compensation | 475 | 461 |
| Workers compensation massive injury | 99 | 99 |
| Commercial auto | 316 | 303 |
| Commercial multi-peril | 568 | 565 |
| All other lines of business | 269 | 309 |
| Gross reserves | 3,451 | 3,499 |
| Reinsurance recoverable | 150 | 151 |
| Net reserve liability Exchange | \$3,301 | \$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 \$85 million at March 31, 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 282 claimants requiring lifetime medical care, of which 114 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 \$309 million at March 31, 2012, which is net of \$139 million of anticipated reinsurance recoverables, compared to \$315 million at December 31, 2011, which is net of \$140 million of anticipated reinsurance recoverables. The slight decrease in the pre-1986

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

automobile massive injury reserves at March 31, 2012, compared to December 31, 2011, was primarily due to claimant aging, while the workers compensation massive injury reserves remained flat.

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.

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. The 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 portfolio 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 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 three months ended March 31:

| <i>(in millions)</i> | Erie Insurance Group | |
|--|----------------------|---------|
| | 2012 | 2011 |
| Net cash provided by operating activities | \$ 72 | \$ 92 |
| Net cash used in investing activities | (22) | (254) |
| Net cash used in financing activities | (36) | (57) |
| Net increase (decrease) in cash and cash equivalents | \$ 14 | \$(219) |

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Net cash provided by operating activities totaled \$72 million and \$92 million in the first quarters of 2012 and 2011, respectively. Decreased cash from operating activities in the first quarter of 2012 was primarily driven by an increase in income taxes, losses and loss expenses, and other underwriting and acquisition costs paid combined with a decrease in limited partnership distributions, compared to the first quarter of 2011. Offsetting this decrease was an increase in the premiums collected by the Exchange, driven by the increase in premiums written, and an increase in net investment income received.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

At March 31, 2012, we recorded a net deferred tax asset of \$18 million related to Indemnity and a net deferred tax liability of \$279 million related to the Exchange. There was no valuation allowance at March 31, 2012.

Net cash used in investing activities totaled \$22 million and \$254 million in the first quarters of 2012 and 2011, respectively. The first quarter 2012 investing activities included decreased cash used to purchase certain fixed maturities and common stocks, offset somewhat by decreased cash generated from the sale of other common stocks and fixed maturities, compared to the first quarter of 2011. At March 31, 2012, we had contractual commitments to invest up to \$412 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 \$176 million, mezzanine debt securities was \$129 million, and real estate activities was \$107 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 three months ended March 31:

| <i>(in millions)</i> | Indemnity Shareholder Interest | |
|--|--------------------------------|---------|
| | 2012 | 2011 |
| Net cash provided by operating activities | \$ 9 | \$ 6 |
| Net cash provided by (used in) investing activities | 53 | (168) |
| Net cash used in financing activities | (45) | (62) |
| Net increase (decrease) in cash and cash equivalents | \$ 17 | \$(224) |

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 \$9 million in the first quarter of 2012, compared to \$6 million in the first quarter of 2011. Increased cash from operating activities in the first quarter of 2012 was primarily due to an increase in management fee revenue received and an increase in reimbursements collected from affiliates, offset by an increase in the pension contribution and employee benefits paid. 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 \$180 million in the first quarter of 2012, compared to \$178 million in the first quarter of 2011, as a result of an increase in cash paid for agent commissions. Indemnity made a contribution to its pension plan for \$16 million in January 2012. In 2011, Indemnity's pension contribution was made in the third quarter. 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 March 31, 2012, Indemnity recorded a net deferred tax asset of \$18 million. There was no valuation allowance at March 31, 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 provided by Indemnity's investing activities totaled \$53 million in the first quarter of 2012, compared to cash used of \$168 million in the first quarter of 2011. Indemnity's first quarter 2012 investing activities included decreased cash used to purchase certain fixed maturities and increased cash generated from other fixed maturity calls/maturities, compared to the first quarter of 2011. Also impacting Indemnity future investing activities are limited partnership commitments, which totaled \$39 million at March 31, 2012, and will 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 \$17 million, mezzanine debt securities was \$10 million, and real estate activities was \$12 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 \$45 million in the first quarter of 2012, compared to \$62 million in the first quarter of 2011. The decrease in cash used in financing activities in the first quarter of 2012 was primarily driven by a decrease in the cash outlay for the purchase of treasury stock. Indemnity repurchased 0.2 million shares of its Class A nonvoting common stock in conjunction with its stock repurchase program at a total cost of \$18 million in the first quarter of 2012. In the first quarter of 2011, shares repurchased under this program totaled 0.5 million at a total cost of \$36 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 \$120 million of repurchase authority remaining under this program at March 31, 2012.

In January 2012, Indemnity also purchased 669 shares 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, to settle a payment due to a retired senior vice president under our long-term incentive plan. These shares were delivered to the plan participant in January 2012.

Dividends paid to shareholders totaled \$27 million in the first quarter of 2012, compared to \$26 million in the first quarter 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

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 \$28 million at March 31, 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 \$437 million at March 31, 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 March 31, 2012. At March 31, 2012, bonds with fair values of \$112 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 March 31, 2012.

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 \$171 million at March 31, 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 \$10.1 billion at March 31, 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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

The Exchange had no borrowings under its line of credit at March 31, 2012. At March 31, 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 March 31, 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. EFL accrued interest payable to Indemnity on the surplus note of \$0.4 million through March 31, 2012 and 2011. Interest payments are scheduled to be paid semi-annually.

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. EFL accrued interest payable to the Exchange on the surplus note of \$0.3 million through March 31, 2012 and 2011. Interest payments are scheduled to be paid semi-annually.

CRITICAL ACCOUNTING ESTIMATES

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 loss 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:

- 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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 Treasury 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 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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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.

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 ended March 31, 2012 related to life insurance and investment-type contracts totaled \$3.7 million. The amount of acquisition costs that would have been capitalized during the quarter ended March 31, 2012 using the previous policy totaled \$4.2 million.

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.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

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 first quarter of 2012 or 2011.

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 three months ended March 31, 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 three months ended March 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION**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 March 31, 2012:

| (dollars in millions, except per share data) | 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 |
|--|----------------------------------|------------------------------|--|--|
| January 1 31, 2012 | 77,709 | \$75.61 | 77,040 | \$132 |
| February 1 29, 2012 | 71,573 | 77.73 | 71,573 | 126 |
| March 1 31, 2012 | 78,946 | 76.75 | 78,946 | 120 |
| Total | 228,228 | | 227,559 | |

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.

The month of January 2012 includes repurchases of 669 shares 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, to settle a payment due to a retired senior vice president under our long-term incentive plan. These shares were delivered to the plan participant in January 2012.

ITEM 6. EXHIBITS

| <u>Exhibit Number</u> | <u>Description of Exhibit</u> |
|---------------------------|---|
| 10.1 | First Amendment to Erie Insurance Group Retirement Plan for Employees (As Amended and Restated Effective December 31, 2009) dated March 27, 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 |

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: May 3, 2012

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

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