ERIE INDEMNITY CO
Form 10-Q
July 30, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

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)

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

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 46,189,068 at July 17, 2015.

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 2,542 at July 17, 2015.

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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 June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Revenues				
Premiums earned	$1,434	$1,319	$2,836	$2,607
Net investment income	127	111	240	220
Net realized investment (losses) gains	(7)	133	49	189
Net impairment losses recognized in earnings	(2)	0	(4)	0
Equity in earnings of limited partnerships	72	27	100	77
Other income	8	8	16	16
Total revenues	1,632	1,598	3,237	3,109
Benefits and expenses				
Insurance losses and loss expenses	976	1,126	2,036	2,160
Policy acquisition and underwriting expenses	361	325	709	646
Total benefits and expenses	1,337	1,451	2,745	2,806
Income from operations before income taxes and noncontrolling interest	295	147	492	303
Provision for income taxes	98	44	159	91
Net income	$197	$103	$333	$212
Less: Net income attributable to noncontrolling interest in consolidated entity – Exchange	141	54	238	117
Net income attributable to Indemnity	$56	$49	$95	$95
Earnings Per Share				
Net income attributable to Indemnity per share				
Class A common stock – basic	$1.21	$1.05	$2.04	$2.04
Class A common stock – diluted	$1.07	$0.94	$1.81	$1.82
Class B common stock – basic	$181	$158	$306	$307
Class B common stock – diluted	$180	$158	$305	$307
Weighted average shares outstanding attributable to Indemnity – Basic				
Class A common stock	46,189,068	46,214,153	46,189,068	46,307,659
Class B common stock	2,542	2,542	2,542	2,542
Weighted average shares outstanding attributable to Indemnity – Diluted				
Class A common stock	52,562,514	52,411,414	52,598,633	52,504,920

Class B common stock	2,542	2,542	2,542	2,542
Dividends declared per share				
Class A common stock	$0.6810	$0.6350	$1.3620	$1.2700
Class B common stock	$102.1500	$95.2500	$204.3000	$190.5000

See accompanying notes to Consolidated Financial Statements. See Note 12. "Indemnity Accumulated Other Comprehensive Loss," for amounts reclassified out of accumulated other comprehensive income (loss) into the Consolidated Statements of Operations. See Note 15. “Indemnity Supplemental Information,” for supplemental statements of operations information.

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ERIE INDEMNITY COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(in millions)

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Net income	$197	$103	$333	$212
Other comprehensive (loss) income				
Change in unrealized holding (losses) gains on available-for-sale securities, net of tax benefit (expense) of $73, $(37), $45 and $(80), respectively	(136)	68	(83)	148
Reclassification adjustment for gross gains included in net income, net of tax benefit of $2, $2, $4 and $7, respectively	(4)	(3)	(7)	(11)
Other comprehensive (loss) income	(140)	65	(90)	137
Comprehensive income	$57	$168	$243	$349
Less: Comprehensive income attributable to noncontrolling interest in consolidated entity – Exchange	3	118	150	250
Total comprehensive income – Indemnity	$54	$50	$93	$99

See accompanying notes to Consolidated Financial Statements. See Note 12. "Indemnity Accumulated Other Comprehensive Loss," for supplemental statements of comprehensive income (loss) information.

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ERIE INDEMNITY COMPANY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(dollars in millions, except per share data)

Assets	June 30, 2015 (Unaudited)	December 31, 2014
Investments – Indemnity		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of $553 and $555, respectively)	$561	$564
Equity securities (cost of $22 and $24, respectively)	22	25
Limited partnerships (cost of $85 and $89, respectively)	101	113
Other invested assets	1	1
Investments – Exchange		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of $9,040 and $8,540, respectively)	9,372	9,007
Equity securities (cost of $766 and $788, respectively)	817	850
Trading securities, at fair value (cost of $2,319 and $2,289, respectively)	3,144	3,223
Limited partnerships (cost of $676 and $694, respectively)	842	866
Other invested assets	21	20
Total investments	14,881	14,669
Cash and cash equivalents (Exchange portion of $344 and $422, respectively)	421	514
Premiums receivable from policyholders – Exchange	1,384	1,281
Reinsurance recoverable – Exchange	162	161
Deferred income taxes – Indemnity	44	37
Deferred acquisition costs – Exchange	635	595
Other assets (Exchange portion of $419 and $374, respectively)	542	501
Total assets	$18,069	$17,758
Liabilities and shareholders’ equity		
Liabilities		
Indemnity liabilities		
Other liabilities	$589	$611
Exchange liabilities		
Losses and loss expense reserves	3,963	3,853
Life policy and deposit contract reserves	1,837	1,812
Unearned premiums	3,007	2,834
Deferred income taxes	413	490
Other liabilities	98	175
Total liabilities	9,907	9,775
Indemnity shareholders’ equity		
Class A common stock, stated value $0.0292 per share; 74,996,930 shares authorized; 68,299,200 shares issued; 46,189,068 shares outstanding	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; 3,070 shares authorized; 2,542 shares issued and outstanding	0	0
Additional paid-in-capital	16	16

Accumulated other comprehensive loss	(120)	(118)
Retained earnings	1,980	1,949
Total contributed capital and retained earnings	1,878	1,849
Treasury stock, at cost, 22,110,132 shares held	(1,146)	(1,146)
Total Indemnity shareholders’ equity	732	703
Noncontrolling interest in consolidated entity – Exchange	7,430	7,280
Total equity	8,162	7,983
Total liabilities, shareholders’ equity, and noncontrolling interest	$18,069	$17,758

See accompanying notes to Consolidated Financial Statements. See Note 15. “Indemnity Supplemental Information,” for supplemental consolidating statements of financial position information.

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ERIE INDEMNITY COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(in millions)

	Six months ended June 30, 2015	2014
Cash flows from operating activities		
Premiums collected	$2,906	$2,679
Net investment income received	262	235
Limited partnership distributions	74	64
Service agreement fee received	15	15
Commissions and bonuses paid to agents	(436)	(397)
Losses paid	(1,613)	(1,630)
Loss expenses paid	(257)	(251)
Other underwriting and acquisition costs paid	(392)	(372)
Income taxes paid	(248)	(98)
Net cash provided by operating activities	311	245
Cash flows from investing activities		
Purchase of investments:		
Fixed maturities	(1,607)	(1,090)
Preferred stock	(125)	(168)
Common stock	(565)	(550)
Limited partnerships	(63)	(46)
Sales/maturities of investments:		
Fixed maturity sales	625	371
Fixed maturity calls/maturities	469	413
Preferred stock	112	119
Common stock	713	565
Sale of and returns on limited partnerships	118	70
Net purchase of property and equipment	(26)	(17)
Net collections on agent loans	0	1
Net distributions on life policy loans	(1)	0
Net cash used in investing activities	(350)	(332)
Cash flows from financing activities		
Annuity deposits and interest	40	45
Annuity surrenders and withdrawals	(42)	(39)
Universal life deposits and interest	17	14
Universal life surrenders	(6)	(6)
Purchase of treasury stock	0	(20)
Dividends paid to shareholders	(63)	(59)
Net cash used in financing activities	(54)	(65)
Net decrease in cash and cash equivalents	(93)	(152)
Cash and cash equivalents at beginning of period	514	452
Cash and cash equivalents at end of period	$421	$300

See accompanying notes to Consolidated Financial Statements. See Note 15. "Indemnity Supplemental Information," for supplemental cash flow information.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Nature of Operations

Erie Indemnity Company ("Indemnity") is a publicly held Pennsylvania business corporation that has since its incorporation in 1925 served as the attorney-in-fact for the subscribers (policyholders) at the Erie Insurance Exchange ("Exchange"). The Exchange, which also commenced business in 1925, is a Pennsylvania-domiciled reciprocal insurer that writes property and casualty insurance.

Indemnity's primary function, as attorney-in-fact, 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 individually by each subscriber (policyholder), which appoints Indemnity as their common attorney-in-fact to transact certain 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 12 Midwestern, Mid-Atlantic and Southeastern states and the District of Columbia.

Erie Family Life Insurance Company ("EFL"), a wholly owned subsidiary of the Exchange, operates as a life insurer that underwrites and sells individual and group life insurance policies and fixed annuities.

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.

Use of estimates

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 six months ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ended December 31, 2015. 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, 2014 as filed with the Securities and Exchange Commission on February 26, 2015.

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Principles of consolidation
We consolidate the Exchange as a variable interest entity for which Indemnity is the primary beneficiary under Accounting Standards Codification ("ASC 810"), Consolidation which was adopted January 1, 2010. 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 are 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. ASC 810 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, 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 as defined in ASC 810 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.

Recently issued accounting standards
In February 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-02, "Consolidation", which changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. ASU 2015-02 modifies the evaluation of whether limited partnerships are variable interest entities and the consolidation analysis of reporting entities that are involved in variable interest entities, particularly those that have fee arrangements and related party relationships. All legal entities are subject to reevaluation under this revised consolidation model. ASU 2015-02 is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. We are currently evaluating this new guidance and we will determine its impact on our consolidated financial statements by the end of the year. It is possible that Indemnity would no longer be required to consolidate the results of the Exchange upon adoption of the new guidance.

In May 2015, the FASB issued ASU 2015-07, "Fair Value Measurement", which removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient and limits the disclosure requirements. ASU 2015-07 is effective for annual and interim periods beginning after December 15, 2015. Early adoption is permitted. We expect to implement these amended disclosure requirements at December 31, 2015.

In May 2015, the FASB issued ASU 2015-09, "Financial Services - Insurance", which requires additional disclosures about the liability for losses and loss adjustment expenses, including incurred and paid claims development activity and reconciliations of that information to the financial statements. ASU 2015-09 is effective for annual periods beginning after December 15, 2015, and interim periods beginning after December 15, 2016. Early adoption is permitted. We expect to include the applicable disclosures as required.

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Note 3. Indemnity Earnings Per Share

Class A and Class B basic earnings per share and Class B diluted earnings per share are calculated under the two-class method. The two-class method allocates earnings to each class of stock based upon its dividend rights. Class B shares are convertible into Class A shares at a conversion ratio of 2,400 to 1. See Note 11. “Indemnity Capital Stock”.

Class A diluted earnings per share are calculated under the if-converted method, which reflects the conversion of Class B shares to Class A shares. Diluted earnings per share calculations include the dilutive effect of assumed issuance of stock-based awards under compensation plans using the treasury stock method.

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:

(dollars in millions, except per share data)	Indemnity Shareholder Interest					
	Three months ended June 30,					
	2015			2014		
	Allocated net income (numerator)	Weighted shares (denominator)	Per-share amount	Allocated net income (numerator)	Weighted shares (denominator)	Per-share amount
Class A – Basic EPS:						
Income available to Class A stockholders	$56	46,189,068	$1.21	$49	46,214,153	$1.05
Dilutive effect of stock-based awards	0	272,646	—	0	96,461	—
Assumed conversion of Class B shares	0	6,100,800	—	0	6,100,800	—
Class A – Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	$56	52,562,514	$1.07	$49	52,411,414	$0.94
Class B – Basic EPS:						
Income available to Class B stockholders	$0	2,542	$181	$0	2,542	$158
Class B – Diluted EPS:						
Income available to Class B stockholders	$0	2,542	$180	$0	2,542	$158

(dollars in millions, except per share data)	Indemnity Shareholder Interest					
	Six months ended June 30,					
	2015			2014		
	Allocated net income (numerator)	Weighted shares (denominator)	Per-share amount	Allocated net income (numerator)	Weighted shares (denominator)	Per-share amount
Class A – Basic EPS:						
Income available to Class A stockholders	$94	46,189,068	$2.04	$94	46,307,659	$2.04
	0	308,765	—	0	96,461	—

Dilutive effect of stock-based awards						
Assumed conversion of Class B shares	1	6,100,800	—	1	6,100,800	—
Class A – Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	$95	52,598,633	$1.81	$95	52,504,920	$1.82
Class B – Basic EPS:						
Income available to Class B stockholders	$1	2,542	$306	$1	2,542	$307
Class B – Diluted EPS:						
Income available to Class B stockholders	$1	2,542	$305	$1	2,542	$307

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Note 4. Variable Interest Entity

Erie Insurance Exchange
The Exchange is a reciprocal insurance exchange domiciled in Pennsylvania, for which Indemnity serves as attorney-in-fact. Indemnity holds a variable interest in the Exchange due to the absence of decision-making capabilities by the equity owners (subscribers/policyholders) of the Exchange and due to the significance of the management fee the Exchange pays to Indemnity as its decision maker. Therefore as defined in ASC 810, Indemnity is deemed to have a controlling financial interest in the Exchange and is considered to be its primary beneficiary.

Under ASC 810, 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 upon 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 assumed written premiums of the Exchange, as defined by the subscriber's agreement signed by each policyholder. Management fee revenues and management fee expenses are eliminated upon consolidation.

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

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 any of the reporting periods presented. At June 30, 2015, 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.

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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, 2014 as filed with the Securities and Exchange Commission on February 26, 2015. 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 certain sales, underwriting, and policy issuance services. Management fee revenue, which is eliminated upon 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 private passenger 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 involuntary and ceded reinsurance business and 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 second quarters of 2015 and 2014, investment activities on life insurance related assets generated revenues of $25 million and
$24 million, respectively, resulting in EFL reporting income before income taxes of $13 million and $10 million, respectively, before intercompany eliminations. For the six months ended June 30, 2015 and 2014, investment activities on life insurance related assets generated revenues of $50 million and $53 million, respectively, resulting in EFL reporting income before income taxes of $23 million for both periods, before intercompany eliminations.

Investment operations

The investment operations segment includes returns from our fixed maturity, equity security and limited partnership investment portfolios to support our underwriting business. The Indemnity and Exchange portfolios are managed with the objective of maximizing after-tax returns on a risk-adjusted basis, while the EFL portfolio is managed to be closely aligned to its liabilities and to maintain a sufficient yield to meet profitability targets. We actively evaluate the portfolios for impairments and record impairment writedowns on investments in instances where the fair value of the investment is substantially below cost, and it is concluded that the decline in fair value is other-than-temporary. Investment related income for the life operations is included in the investment segment results.

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

(in millions)	Erie Insurance Group Three months ended June 30, 2015					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		$1,412	$22		$0	$ 1,434
Net investment income				$130	(3)	127
Net realized investment losses				(7)		(7)
Net impairment losses recognized in earnings				(2)		(2)
Equity in earnings of limited partnerships				72		72
Management fee revenue	$395				(395)	—
Service agreement and other revenue	7		1			8
Total revenues	402	1,412	23	193	(398)	1,632
Cost of management operations	332				(332)	—
Insurance losses and loss expenses		952	25		(1)	976
Policy acquisition and underwriting expenses		416	10		(65)	361
Total benefits and expenses	332	1,368	35	—	(398)	1,337
Income (loss) before income taxes	70	44	(12)	193	—	295
Provision for income taxes	24	16	(4)	62	—	98
Net income (loss)	$46	$28	$(8)	$131	$—	$ 197

(in millions)	Erie Insurance Group Three months ended June 30, 2014					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		$1,298	$22		$(1)	$ 1,319
Net investment income				$116	(5)	111
Net realized investment gains				133		133
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				27		27
Management fee revenue	$366				(366)	—
Service agreement and other revenue	8		0			8
Total revenues	374	1,298	22	276	(372)	1,598
Cost of management operations	306				(306)	—
Insurance losses and loss expenses		1,101	27		(2)	1,126

Policy acquisition and underwriting expenses		380	9		(64)	325
Total benefits and expenses	306	1,481	36	—	(372)	1,451
Income (loss) before income taxes	68	(183)	(14)	276	—	147
Provision for income taxes	24	(64)	(5)	89	—	44
Net income (loss)	$44	$(119)	$(9)	$187	$—	$ 103

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(in millions)	Erie Insurance Group Six months ended June 30, 2015					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		$2,792	$44		$0	$ 2,836
Net investment income				$246	(6)	240
Net realized investment gains				49		49
Net impairment losses recognized in earnings				(4)		(4)
Equity in earnings of limited partnerships				100		100
Management fee revenue	$738				(738)	—
Service agreement and other revenue	15		1			16
Total revenues	753	2,792	45	391	(744)	3,237
Cost of management operations	630				(630)	—
Insurance losses and loss expenses		1,985	53		(2)	2,036
Policy acquisition and underwriting expenses		802	19		(112)	709
Total benefits and expenses	630	2,787	72	—	(744)	2,745
Income (loss) before income taxes	123	5	(27)	391	—	492
Provision for income taxes	43	2	(9)	123	—	159
Net income (loss)	$80	$3	$(18)	$268	$—	$ 333

(in millions)	Erie Insurance Group Six months ended June 30, 2014					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		$2,566	$42		$ (1)	$ 2,607
Net investment income				$228	(8)	220
Net realized investment gains				189		189
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				77		77
Management fee revenue	$685				(685)	—
Service agreement and other revenue	15		1			16
Total revenues	700	2,566	43	494	(694)	3,109
Cost of management operations	574				(574)	—
Insurance losses and loss expenses		2,108	55		(3)	2,160
Policy acquisition and underwriting expenses		745	18		(117)	646

Total benefits and expenses	574	2,853	73	—	(694)	2,806
Income (loss) before income taxes	126	(287)	(30)	494	—	303
Provision for income taxes	44	(100)	(11)	158	—	91
Net income (loss)	$82	$(187)	$(19)	$336	$—	$ 212

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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 under current market conditions. Financial instruments are categorized based upon the following characteristics or inputs to the valuation techniques:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.

- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

- Level 3 – Unobservable inputs for the asset or liability.

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

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

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

When a price from the pricing service is not available, values are determined by obtaining broker/dealer 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 securities in an illiquid market, there may be no prices available from a pricing service and no comparable market quotes available. In these situations, we value the security using an internally-developed, risk-adjusted discounted cash flow model.

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The following table represents our consolidated fair value measurements on a recurring basis by asset class and level of input at June 30, 2015:

	Erie Insurance Group June 30, 2015 Fair value measurements using:			
(in millions)	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	$225	$0	$225	$0
Corporate debt securities	235	0	235	0
Residential mortgage-backed securities	9	0	9	0
Commercial mortgage-backed securities	49	0	49	0
Collateralized debt obligations	38	0	37	1
Other debt securities	5	0	5	0
Total fixed maturities	561	0	560	1
Nonredeemable preferred stock	10	1	9	0
Common stock	12	12	0	0
Total available-for-sale securities	583	13	569	1
Other investments [1]	6			