

ERIE INDEMNITY CO
Form 10-Q
May 01, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

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 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

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

(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 46,252,506 at April 18, 2014.

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 April 18, 2014.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Consolidated Statements of Operations – Three months ended March 31, 2014 and 2013

Consolidated Statements of Comprehensive Income – Three months ended March 31, 2014 and 2013

Consolidated Statements of Financial Position – March 31, 2014 and December 31, 2013

Consolidated Statements of Cash Flows – Three months ended March 31, 2014 and 2013

Notes to Consolidated Financial Statements – March 31, 2014

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

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

Item 6. Exhibits

SIGNATURES

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

	Three months ended March 31,	
	2014	2013
Revenues		
Premiums earned	\$1,288	\$1,175
Net investment income	109	103
Net realized investment gains	56	249
Net impairment losses recognized in earnings	0	0
Equity in earnings of limited partnerships	50	36
Other income	8	8
Total revenues	1,511	1,571
Benefits and expenses		
Insurance losses and loss expenses	1,034	842
Policy acquisition and underwriting expenses	321	293
Total benefits and expenses	1,355	1,135
Income from operations before income taxes and noncontrolling interest	156	436
Provision for income taxes	47	146
Net income	\$109	\$290
Less: Net income attributable to noncontrolling interest in consolidated entity – Exchange	63	253
Net income attributable to Indemnity	\$46	\$37
Earnings Per Share		
Net income attributable to Indemnity per share		
Class A common stock – basic	\$0.99	\$0.78
Class A common stock – diluted	\$0.88	\$0.69
Class B common stock – basic and diluted	\$149	\$117
Weighted average shares outstanding attributable to Indemnity – Basic		
Class A common stock	46,402,270	46,774,968
Class B common stock	2,542	2,542
Weighted average shares outstanding attributable to Indemnity – Diluted		
Class A common stock	52,598,211	52,960,165
Class B common stock	2,542	2,542
Dividends declared per share		
Class A common stock	\$0.6350	\$0.5925
Class B common stock	\$95.2500	\$88.8750

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.

3

Table of Contents

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

	Three months ended March 31,	
	2014	2013
Net income	\$109	\$290
Other comprehensive income (loss)		
Change in unrealized holding gains (losses) on available-for-sale securities, net of tax (expense) benefit of \$(43) and \$6, respectively	80	(12)
Reclassification adjustment for gross gains included in net income, net of tax benefit of \$5 and \$5, respectively	(8)	(10)
Other comprehensive income (loss)	72	(22)
Comprehensive income	\$181	\$268
Less: Comprehensive income attributable to noncontrolling interest in consolidated entity – Exchange	132	232
Total comprehensive income – Indemnity	\$49	\$36

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

Table of Contents

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

	March 31, 2014 (Unaudited)	December 31, 2013
Assets		
Investments – Indemnity		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of \$490 and \$518, respectively)	\$502	\$526
Equity securities (cost of \$35 and \$50, respectively)	35	50
Limited partnerships (cost of \$119 and \$123, respectively)	145	146
Other invested assets	1	1
Investments – Exchange		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of \$7,923 and \$7,801, respectively)	8,379	8,162
Equity securities (cost of \$793 and \$778, respectively)	852	819
Trading securities, at fair value (cost of \$2,273 and \$2,198, respectively)	3,253	3,202
Limited partnerships (cost of \$780 and \$790, respectively)	953	940
Other invested assets	20	20
Total investments	14,140	13,866
Cash and cash equivalents (Exchange portion of \$335 and \$403, respectively)	379	452
Premiums receivable from policyholders – Exchange	1,194	1,167
Reinsurance recoverable – Exchange	175	172
Deferred income taxes – Indemnity	0	2
Deferred acquisition costs – Exchange	558	566
Other assets (Exchange portion of \$372 and \$337, respectively)	485	451
Total assets	\$16,931	\$16,676
Liabilities and shareholders' equity		
Liabilities		
Indemnity liabilities		
Deferred income taxes	\$0	\$0
Other liabilities	422	476
Exchange liabilities		
Losses and loss expense reserves	3,838	3,747
Life policy and deposit contract reserves	1,775	1,758
Unearned premiums	2,625	2,598
Deferred income taxes	492	450
Other liabilities	89	97
Total liabilities	9,241	9,126
Indemnity shareholders' equity		
Class A common stock, stated value \$0.0292 per share; 74,996,930 shares authorized; 68,299,200 shares issued; 46,303,226 and 46,461,125 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; 3,070 shares authorized; 2,542 shares issued and outstanding	0	0

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Additional paid-in-capital	16	16	
Accumulated other comprehensive loss	(56	) (59)
Retained earnings	1,918	1,902	
Total contributed capital and retained earnings	1,880	1,861	
Treasury stock, at cost, 21,995,974 and 21,838,075 shares, respectively	(1,138	) (1,127)
Total Indemnity shareholders' equity	742	734	
Noncontrolling interest in consolidated entity – Exchange	6,948	6,816	
Total equity	7,690	7,550	
Total liabilities, shareholders' equity, and noncontrolling interest	\$16,931	\$16,676	

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

Table of Contents

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

	Three months ended March 31,	
	2014	2013
Cash flows from operating activities		
Premiums collected	\$1,289	\$1,159
Net investment income received	121	106
Limited partnership distributions	25	46
Service agreement fee received	8	7
Commissions and bonuses paid to agents	(225)	(197)
Losses paid	(785)	(666)
Loss expenses paid	(130)	(119)
Other underwriting and acquisition costs paid	(235)	(206)
Income taxes paid	(14)	(3)
Net cash provided by operating activities	54	127
Cash flows from investing activities		
Purchase of investments:		
Fixed maturities	(501)	(551)
Preferred stock	(76)	(9)
Common stock	(260)	(464)
Limited partnerships	(27)	(23)
Sales/maturities of investments:		
Fixed maturity sales	159	122
Fixed maturity calls/maturities	244	265
Preferred stock	64	26
Common stock	267	453
Sale of and returns on limited partnerships	41	53
Net purchase of property and equipment	(6)	(6)
Net collections on agent loans	0	1
Net cash used in investing activities	(95)	(133)
Cash flows from financing activities		
Annuity deposits and interest	22	24
Annuity surrenders and withdrawals	(18)	(18)
Universal life deposits and interest	7	5
Universal life surrenders	(3)	(2)
Purchase of treasury stock	(10)	(15)
Dividends paid to shareholders	(30)	0
Net cash used in financing activities	(32)	(6)
Net decrease in cash and cash equivalents	(73)	(12)
Cash and cash equivalents at beginning of period	452	400
Cash and cash equivalents at end of period	\$379	\$388

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

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Nature of Operations

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

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

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

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

Erie Family Life Insurance Company (“EFL”), 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.

Indemnity plans to expand the property and casualty and life insurance operations of the Erie Insurance Group into the Commonwealth of Kentucky by the first quarter of 2015 or earlier if possible.

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 three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ended December 31, 2014. 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, 2013 as filed with the Securities and Exchange Commission on February 27, 2014.

Table of Contents

Principles of consolidation

We consolidate the Exchange as a variable interest entity for which Indemnity is the primary beneficiary. All intercompany accounts and transactions have been eliminated in consolidation. The required presentation of noncontrolling interests is reflected in the consolidated financial statements. Noncontrolling interests represent the ownership interests of the Exchange, all of which 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. 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.

Pending accounting pronouncements

In January 2014, the FASB issued ASU 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. This guidance permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Generally, investors in qualified affordable housing project investments expect to receive substantially all of their return through the receipt of tax credits and other tax benefits. ASU 2014-01 allows for the recording of the investment performance net of taxes as a component of income tax expense to more fairly represent the economics of the investments and provide users with a better understanding of the returns from such investments. The qualifications to make this accounting election were also made less restrictive. ASU 2014-01 is effective for annual and interim periods beginning after December 15, 2014, with early adoption permitted. While we are currently evaluating whether to make the accounting election and whether the election would be made for early adoption, such election is not expected to have a material impact on our consolidated financial statements.

Table of Contents

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 effect of any potential common shares. Potential common shares include outstanding vested and not yet vested awards related to our outside directors' stock compensation plan and any employee stock based awards.

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 March 31,					
	2014			2013		
	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	\$46	46,402,270	\$0.99	\$36	46,774,968	\$0.78
Dilutive effect of stock-based awards	0	95,141	—	0	84,397	—
Assumed conversion of Class B shares	0	6,100,800	—	1	6,100,800	—
Class A – Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	\$46	52,598,211	\$0.88	\$37	52,960,165	\$0.69
Class B – Basic and diluted EPS:						
Income available to Class B stockholders	\$0	2,542	\$149	\$0	2,542	\$117

Table of Contents

Note 4. Variable Interest Entity

Erie Insurance Exchange

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

Consolidation of the Exchange's financial results is required given the significance of the management fee to the Exchange and because Indemnity has the power to direct the activities of the Exchange that most significantly impact the Exchange's economic performance. The Exchange's anticipated economic performance is the product of its underwriting results combined with its investment results. The fees paid to Indemnity under the subscriber's agreement impact the anticipated economic performance attributable to the Exchange's results. Indemnity earns a management fee from the Exchange for the services it provides as attorney-in-fact. Indemnity's management fee revenues are based 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 March 31, 2014, 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.

Table of Contents

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, 2013 as filed with the Securities and Exchange Commission on February 27, 2014. 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 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 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 assumed voluntary 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 2014 and 2013, investment activities on life insurance related assets generated revenues of \$29 million and \$26 million, respectively, resulting in EFL reporting income before income taxes of \$13 million and \$11 million, respectively, 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. 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. Investment related income for the life operations is included in the investment segment results.

Table of Contents

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

(in millions)	Erie Insurance Group Three months ended March 31, 2014					Eliminations	Consolidated
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations			
Premiums earned/life policy revenue		\$1,268	\$20		\$0		\$1,288
Net investment income				\$112	(3)	)	109
Net realized investment gains				56			56
Net impairment losses recognized in earnings				0			0
Equity in earnings of limited partnerships				50			50
Management fee revenue	\$319				(319))	—
Service agreement and other revenue	7		1				8
Total revenues	326	1,268	21	218	(322)	)	1,511
Cost of management operations	268				(268))	—
Insurance losses and loss expenses		1,007	28		(1)	)	1,034
Policy acquisition and underwriting expenses		365	9		(53)	)	321
Total benefits and expenses	268	1,372	37	—	(322)	)	1,355
Income (loss) before income taxes	58	(104)	(16)	218	—		156
Provision for income taxes	20	(36)	(6)	69	—		47
Net income (loss)	\$38	\$(68)	\$(10)	\$149	—		\$109

(in millions)	Erie Insurance Group Three months ended March 31, 2013					Eliminations	Consolidated
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations			
Premiums earned/life policy revenue		\$1,156	\$19		\$0		\$1,175
Net investment income				\$106	(3)	)	103
Net realized investment gains				249			249
Net impairment losses recognized in earnings				0			0
Equity in earnings of limited partnerships				36			36
Management fee revenue	\$296				(296))	—
Service agreement and other revenue	7		1				8
Total revenues	303	1,156	20	391	(299)	)	1,571
Cost of management operations	254				(254))	—
Insurance losses and loss expenses		817	26		(1)	)	842

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Policy acquisition and underwriting expenses		328	9		(44	)	293
Total benefits and expenses	254	1,145	35	—	(299	)	1,135
Income (loss) before income taxes	49	11	(15	)	391	—	436
Provision for income taxes	17	4	(5	)	130	—	146
Net income (loss)	\$32	\$7	\$(10	)	\$261	\$—	\$ 290

Table of Contents

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.

Table of Contents

The following table represents our consolidated fair value measurements on a recurring basis by asset class and level of input at March 31, 2014:

(in millions)	Erie Insurance Group March 31, 2014 Fair value measurements using:			
	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	\$241	\$0	\$241	\$0
Corporate debt securities	261	0	260	1
Collateralized debt obligations	0	0	0	0
Total fixed maturities	502	0	501	1
Nonredeemable preferred stock	15	2	13	0
Common stock	20	20	0	0
Total available-for-sale securities	537	22	514	1
Other investments ⁽¹⁾	18	0	0	18
Total – Indemnity	\$555	\$22	\$514	\$19
Exchange				
Available-for-sale securities:				
U.S. treasury	\$66	\$0	\$66	\$0
Government sponsored enterprises	38	0	38	0
States & political subdivisions	1,485	0	1,485	0
Foreign government securities	15	0	15	0
Corporate debt securities	6,494	0	6,468	26
Residential mortgage-backed securities	151	0	151	0
Commercial mortgage-backed securities	44	0	44	0
Collateralized debt obligations	14	0	14	0
Other debt securities	72	0	72	0
Total fixed maturities	8,379	0	8,353	26
Nonredeemable preferred stock	656	273	382	1
Common stock	196	196	0	0
Total available-for-sale securities	9,231	469	8,735	27
Trading securities:				
Common stock	3,253	3,238	0	15
Total trading securities	3,253	3,238	0	15
Other investments ⁽¹⁾	98	0	0	98
Total – Exchange	\$12,582	\$3,707	\$8,735	\$140
Total – Erie Insurance Group	\$13,137	\$3,729	\$9,249	\$159

(1) Other investments measured at fair value represent four real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option. These investments can never be redeemed with the funds. Instead, distributions are received when liquidation of the underlying assets of the funds occur. It is estimated that the underlying assets will generally be liquidated between 5 and 10 years from the inception

of the funds. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner. Fair value is based on our proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to our balance sheet date. These values are then analyzed to determine if they represent the NAV at our balance sheet date, with adjustment being made where appropriate. We consider observable market data and perform a review validating the appropriateness of the NAV at each balance sheet date. It is likely that all of the investments will be redeemed at a future date for an amount different than the NAV of our ownership interest in partners' capital as of March 31, 2014. During the three months ended March 31, 2014, Indemnity made no contributions and received distributions totaling \$1.3 million, and the Exchange made no contributions and received distributions totaling \$4.8 million for these investments. As of March 31, 2014, the amount of unfunded commitments related to the investments was \$1.5 million for Indemnity and \$4.5 million for the Exchange.

Table of Contents

Level 3 Assets – Quarterly Change:

(in millions)	Erie Insurance Group			Purchases	Sales	Transfers in and (out) of Level 3 ⁽²⁾	Ending balance at March 31, 2014
	Beginning balance at December 31, 2013	Included in earnings (¹)	Included in other comprehensive income				
Indemnity							
Available-for-sale securities:							
Corporate debt securities	\$1	\$0	\$ 0	\$ 0	\$0	\$0	\$1
Collateralized debt obligations	1	0	0	0	(1)	0	0
Total fixed maturities	2	0	0	0	(1)	0	1
Total available-for-sale securities	2	0	0	0	(1)	0	1
Other investments	18	1	0	0	(1)	0	18
Total Level 3 assets – Indemnity	\$20	\$1	\$ 0	\$ 0	\$(2)	\$0	\$19
Exchange							
Available-for-sale securities:							
Corporate debt securities	\$26	\$0	\$ 0	\$ 0	\$0	\$0	\$26
Collateralized debt obligations	5	1	(1)	0	(3)	(2)	0
Total fixed maturities	31	1	(1)	0	(3)	(2)	26
Nonredeemable preferred stock	0	0	0	1	0	0	1
Total available-for-sale securities	31	1	(1)	1	(3)	(2)	27
Trading securities:							
Common stock	15	0	0	0	0	0	15
Total trading securities	15	0	0	0	0	0	15
Other investments	98	5	0	0	(5)	0	98
Total Level 3 assets – Exchange	\$144	\$6	\$ (1)	\$ 1	\$(8)	\$(2)	\$140
Total Level 3 assets – Erie Insurance Group	\$164	\$7	\$ (1)	\$ 1	\$(10)	\$(2)	\$159

These amounts are reported in the Consolidated Statement of Operations. There is \$1 million included in net (1) realized investment gains (losses) and \$6 million included in equity in earnings of limited partnerships for the three months ended March 31, 2014 on Level 3 securities.

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

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

For Indemnity, there were no transfers between Level 1 and Level 2 or between Level 2 and Level 3 for the three months ended March 31, 2014.

For the Exchange, Level 1 to Level 2 transfers totaled \$3 million due to trading activity levels for one preferred stock holding, and there were no transfers from Level 2 to Level 1 for the three months ended March 31, 2014. There were no Level 2 to Level 3 transfers, and Level 3 to Level 2 transfers totaled \$2 million for one fixed maturity holding as a

result of using observable market data to determine the fair value at March 31, 2014.

Table of Contents

Quantitative and Qualitative Disclosures about Unobservable Inputs

(dollars in millions)	Erie Insurance Group March 31, 2014		Valuation techniques	Unobservable input	Range	Weighted average
	Fair value	No. of holdings				
Indemnity						
Corporate debt securities ⁽¹⁾	\$1	1	Market approach	Non-binding broker quote	113	
Collateralized debt obligations ⁽²⁾	0	1	Income approach	Projected maturity date	Dec 2014	
				Repayment at maturity	8%	
				Discount rate	15%	
Other investments ⁽⁴⁾	18	2				
Total Level 3 assets – Indemnity	\$19	4				
Exchange						
Corporate debt securities ⁽¹⁾⁽³⁾	\$26	7	Market approach	Non-binding broker quote	107-117	110
				Comparable transaction EBITDA multiples	8.0 - 11.9x	8.0x
				Comparable security yield	6%	
Collateralized debt obligations ⁽²⁾	0	2	Income approach	Projected maturity date	Dec 2014 - Oct 2035	
				Repayment at maturity	8 - 100%	38%
				Discount rate	15 - 18%	17%
Nonredeemable preferred stock ⁽⁵⁾	1	1	Market approach	Held at cost		
Common stock ⁽³⁾	15	4	Market approach	Comparable transaction EBITDA multiples	8.0 - 11.9x	8.0x
				Discount for lack of marketability	5 - 30%	8%
Other investments ⁽⁴⁾	98	4				
Total Level 3 assets – Exchange	\$140	18				
Total Level 3 assets – Erie Insurance Group	\$159	22				

Corporate debt securities – The unobservable input used in the fair value measurement of certain corporate 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. When a non-binding broker quote was the only input available, it was considered unobservable.

(2)

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, 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.

(3) 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.

(4) Other investments – Other investments represent certain limited partnerships that are recorded at fair value and are based upon net asset value (NAV) provided by the general partner where the unobservable inputs are not reasonably available to us.

(5) Nonredeemable preferred stock - Represents a private security where cost was determined to be the best estimate of fair value.

Securities valued using unobservable inputs shown above totaled \$159 million at March 31, 2014. In total, Level 3 assets represent less than 1.2% of the total assets measured at fair value on a recurring basis for the Erie Insurance Group.

Table of Contents

The following table represents our consolidated fair value measurements on a recurring basis by asset class and level of input at December 31, 2013:

(in millions)	Erie Insurance Group December 31, 2013 Fair value measurements using:			
	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	\$243	\$ 0	\$243	\$0
Corporate debt securities	282	0	281	1
Collateralized debt obligations	1	0	0	1
Total fixed maturities	526	0	524	2
Nonredeemable preferred stock	25	2	23	0
Common stock	25	25	0	0
Total available-for-sale securities	576	27	547	2
Other investments ⁽¹⁾	18	0	0	18
Total – Indemnity	\$594	\$ 27	\$547	\$ 20
Exchange				
Available-for-sale securities:				
U.S. government & agencies	\$172	\$ 0	\$172	\$0
States & political subdivisions	1,470	0	1,470	0
Foreign government securities	15	0	15	0
Corporate debt securities	6,211	0	6,185	26
Residential mortgage-backed securities	156	0	156	0
Commercial mortgage-backed securities	47	0	47	0
Collateralized debt obligations	16	0	11	5
Other debt securities	75	0	75	0
Total fixed maturities	8,162	0	8,131	31
Nonredeemable preferred stock	621	242	379	0
Common stock	198	198	0	0
Total available-for-sale securities	8,981	440	8,510	31
Trading securities:				
Common stock	3,202	3,187	0	15
Total trading securities	3,202	3,187	0	15
Other investments ⁽¹⁾	98	0	0	98
Total – Exchange	\$12,281	\$ 3,627	\$8,510	\$ 144
Total – Erie Insurance Group	\$12,875	\$ 3,654	\$9,057	\$ 164

(1) Other investments measured at fair value represent four real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option. These investments can never be redeemed with the funds. Instead, distributions are received when liquidation of the underlying assets of the funds occur. It is estimated that the underlying assets will generally be liquidated between 5 and 10 years from the inception of the funds. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner. Fair value is based on our proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to our balance sheet date. These

values are then analyzed to determine if they represent the NAV at our balance sheet date, with adjustment being made where appropriate. We consider observable market data and perform a review validating the appropriateness of the NAV at each balance sheet date. It is likely that all of the investments will be redeemed at a future date for an amount different than the NAV of our ownership interest in partners' capital as of December 31, 2013. During the year ended December 31, 2013, Indemnity made no contributions and received distributions totaling \$2.4 million, and the Exchange made no contributions and received distributions totaling \$21.7 million for these investments. As of December 31, 2013, the amount of unfunded commitments related to the investments was \$1.5 million for Indemnity and \$4.5 million for the Exchange.

Table of Contents

Level 3 Assets – Quarterly Change:

(in millions)	Erie Insurance Group						Ending balance at March 31, 2013
	Beginning balance at December 31, 2012	Included in earnings ⁽¹⁾	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 ⁽²⁾	
Indemnity							
Available-for-sale securities:							
Corporate debt securities	\$1	\$0	\$0	\$0	\$0	\$0	\$1
Collateralized debt obligations	3	0	0	0	(1)	0	2
Total fixed maturities	4	0	0	0	(1)	0	3
Total available-for-sale securities	4	0	0	0	(1)	0	3
Other investments	19	1	0	0	0	0	20
Total Level 3 assets – Indemnity	\$23	\$1	\$0	\$0	\$(1)	\$0	\$23
Exchange							
Available-for-sale securities:							
Corporate debt securities	43	0	1	0	(1)	15	58
Commercial mortgage-backed securities	0	0	0	0	0	5	5
Collateralized debt obligations	16	1	1	0	(5)	1	14
Total fixed maturities	59	1	2	0	(6)	21	77
Nonredeemable preferred stock	0	0	3	4	0	5	12
Total available-for-sale securities	59	1	5	4	(6)	26	89
Trading securities:							
Common stock	15	(3)	0	0	(5)	0	7
Total trading securities	15	(3)	0	0	(5)	0	7
Other investments	109	4	0	0	(1)	0	112
Total Level 3 assets – Exchange	\$183	\$2	\$5	\$4	\$(12)	\$26	\$208
Total Level 3 assets – Erie Insurance Group	\$206	\$3	\$5	\$4	\$(13)	\$26	\$231

These amounts are reported in the Consolidated Statement of Operations. There is \$2 million of losses included in (1) net realized investment (losses) and \$5 million included in equity in earnings of limited partnerships for the three months ended March 31, 2013 on Level 3 securities.

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

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

For Indemnity, there were no Level 1 to Level 2 transfers for the three months March 31, 2013. Level 2 to Level 1 transfers totaled \$1 million due to trading activity levels related to one preferred stock holding, and there were no transfers between Levels 2 and Level 3.

For the Exchange, Level 1 to Level 2 transfers totaled \$6 million and Level 2 to Level 1 transfers totaled \$51 million due to trading activity levels related to one preferred stock holding and five preferred stock holdings, respectively, for the three months ended March 31, 2013. Level 2 to Level 3 transfers totaled \$39 million related to seven fixed maturity holdings and one preferred stock holding. Level 3 to Level 2 transfers totaled \$13 million for one fixed maturity holding. These transfers in and out of Level 3 were primarily the result of using non-binding and binding broker quotes, respectively, to determine the fair value at March 31, 2013.

Table of Contents

The following table presents our consolidated fair value measurements on a recurring basis by pricing source at March 31, 2014:

(in millions)	Erie Insurance Group March 31, 2014			
	Total	Level 1	Level 2	Level 3
Indemnity				
Fixed maturities:				
Priced via pricing services	\$501	\$0	\$501	\$0
Priced via market comparables/broker quotes ⁽¹⁾	1	0	0	1
Priced via internal modeling	0	0	0	0
Total fixed maturities	502	0	501	1
Nonredeemable preferred stock:				
Priced via pricing services	13	2	11	0
Priced via market comparables/broker quotes ⁽¹⁾	2	0	2	0
Total nonredeemable preferred stock	15	2	13	0
Common stock:				
Priced via pricing services	20	20	0	0
Total common stock	20	20	0	0
Other investments:				
Priced via unobservable inputs ⁽²⁾	18	0	0	18
Total other investments	18	0	0	18
Total – Indemnity	\$555	\$22	\$514	\$19
Exchange				
Fixed maturities:				
Priced via pricing services	\$8,306	\$0	\$8,306	\$0
Priced via market comparables/broker quotes ⁽¹⁾	65	0	47	18
Priced via internal modeling	8	0	0	8
Total fixed maturities	8,379	0	8,353	26
Nonredeemable preferred stock:				
Priced via pricing services	641	273	368	0
Priced via market comparables/broker quotes ⁽¹⁾	14	0	14	0
Priced via internal modeling	1	0	0	1
Total nonredeemable preferred stock	656	273	382	1
Common stock:				
Priced via pricing services	3,434	3,434	0	0
Priced via internal modeling	15	0	0	15
Total common stock	3,449	3,434	0	15
Other investments:				
Priced via unobservable inputs ⁽²⁾	98	0	0	98
Total other investments	98	0	0	98
Total – Exchange	\$12,582	\$3,707	\$8,735	\$140
Total – Erie Insurance Group	\$13,137	\$3,729	\$9,249	\$159

(1) When a non-binding broker quote was the only price available, the security was classified as Level 3.

Other investments measured at fair value represent real estate funds included on the balance sheet as limited (2) partnership investments that are reported under the fair value option. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner.

There were no assets measured at fair value on a nonrecurring basis during the three months ended March 31, 2014.

Table of Contents

Note 7. Investments

Available-for-sale securities

The following table summarizes the cost and fair value of our available-for-sale securities at March 31, 2014:

(in millions)	Erie Insurance Group			
	March 31, 2014			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Indemnity				
Available-for-sale securities:				
States & political subdivisions	\$231	\$ 10	\$ 0	\$241
Corporate debt securities	259	2	0	261
Collateralized debt obligations	0	0	0	0
Total fixed maturities	490	12	0	502
Nonredeemable preferred stock	14	1	0	15
Common stock	21	0	1	20
Total available-for-sale securities – Indemnity	\$525	\$ 13	\$ 1	\$537
Exchange				
Available-for-sale securities:				
U.S. treasury	\$66	\$ 0	\$ 0	\$66
Government sponsored enterprises	37	1	0	38
States & political subdivisions	1,422	70	7	1,485
Foreign government securities	15	0	0	15
Corporate debt securities	6,113	400	19	6,494
Residential mortgage-backed securities	151	3	3	151
Commercial mortgage-backed securities	42	2	0	44
Collateralized debt obligations	7	7	0	14
Other debt securities	70	2	0	72
Total fixed maturities	7,923	485	29	8,379
Nonredeemable preferred stock	596	64	4	656
Common stock	197	1	2	196
Total available-for-sale securities – Exchange	\$8,716	\$ 550	\$ 35	\$9,231
Total available-for-sale securities – Erie Insurance Group	\$9,241	\$ 563	\$ 36	\$9,768

Table of Contents

The following table summarizes the cost and fair value of our available-for-sale securities at December 31, 2013:

(in millions)	Erie Insurance Group December 31, 2013			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Indemnity				
Available-for-sale securities:				
States & political subdivisions	\$237	\$ 7	\$ 1	\$243
Corporate debt securities	280	2	0	282
Collateralized debt obligations	1	0	0	1
Total fixed maturities	518	9	1	526
Nonredeemable preferred stock	24	2	1	25
Common stock	26	0	1	25
Total available-for-sale securities – Indemnity	\$568	\$ 11	\$ 3	\$576
Exchange				
Available-for-sale securities:				
U.S. government & agencies	\$171	\$ 1	\$ 0	\$172
States & political subdivisions	1,430	55	15	1,470
Foreign government securities	15	0	0	15
Corporate debt securities	5,902	354	45	6,211
Residential mortgage-backed securities	157	3	4	156
Commercial mortgage-backed securities	45	2	0	47
Collateralized debt obligations	8	8	0	16
Other debt securities	73	3	1	75
Total fixed maturities	7,801	426	65	8,162
Nonredeemable preferred stock	577	55	11	621
Common stock	201	0	3	198
Total available-for-sale securities – Exchange	\$8,579	\$ 481	\$ 79	\$8,981
Total available-for-sale securities – Erie Insurance Group	\$9,147	\$ 492	\$ 82	\$9,557

The amortized cost and estimated fair value of fixed maturities at March 31, 2014 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.

(in millions)	Erie Insurance Group March 31, 2014	
	Amortized cost	Estimated fair value
Indemnity		
Due in one year or less	\$76	\$77
Due after one year through five years	237	240
Due after five years through ten years	100	104
Due after ten years	77	81
Total fixed maturities – Indemnity	\$490	\$502
Exchange		

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Due in one year or less	386	393
Due after one year through five years	3,052	3,239
Due after five years through ten years	2,941	3,113
Due after ten years	1,544	1,634
Total fixed maturities – Exchange	\$7,923	\$8,379
Total fixed maturities – Erie Insurance Group	\$8,413	\$8,881

Table of Contents

Available-for-sale securities in a gross unrealized loss position at March 31, 2014 are as follows. Data is provided by length of time for securities in a gross unrealized loss position.

(dollars in millions)	Erie Insurance Group							
	March 31, 2014							
	Less than 12 months		12 months or longer		Total		No. of	holdings
Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses			
Indemnity								
Available-for-sale securities:								
States & political subdivisions	\$11	\$0	\$0	\$0	\$11	\$0		5
Corporate debt securities	40	0	0	0	40	0		9
Total fixed maturities	51	0	0	0	51	0		14
Nonredeemable preferred stock	3	0	1	0	4	0		3
Common stock	0	0	20	1	20	1		2
Total available-for-sale securities – Indemnity	\$54	\$0	\$21	\$1	\$75	\$1		19
Quality breakdown of fixed maturities:								
Investment grade	\$51	\$0	\$0	\$0	\$51	\$0		14
Non-investment grade	0	0	0	0	0	0		0
Total fixed maturities – Indemnity	\$51	\$0	\$0	\$0	\$51	\$0		14
Exchange								
Available-for-sale securities:								
U.S. treasury	\$3	\$0	\$0	\$0	\$3	\$0		3
States & political subdivisions	216	5	31	2	247	7		62
Foreign government securities	0	0	5	0	5	0		1
Corporate debt securities	828	17	36	2	864	19		161
Residential mortgage-backed securities	67	2	14	1	81	3		14
Commercial mortgage-backed securities	2	0	0	0	2	0		1
Other debt securities	20	0	0	0	20	0		4
Total fixed maturities	1,136	24	86	5	1,222	29		246
Nonredeemable preferred stock	85	3	15	1	100	4		17
Common stock	31	1	100	1	131	2		2
Total available-for-sale securities – Exchange	\$1,252	\$28	\$201	\$7	\$1,453	\$35		265
Quality breakdown of fixed maturities:								
Investment grade	\$1,104	\$23	\$81	\$4	\$1,185	\$27		238
Non-investment grade	32	1	5	1	37	2		8
Total fixed maturities – Exchange	\$1,136	\$24	\$86	\$5	\$1,222	\$29		246

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 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.

Table of Contents

Available-for-sale securities in a gross unrealized loss position at December 31, 2013 are as follows. Data is provided by length of time for securities in a gross unrealized loss position.

(dollars in millions)	Erie Insurance Group December 31, 2013						
	Less than 12 months		12 months or longer		Total		No. of holdings
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	
Indemnity							
Available-for-sale securities:							
States & political subdivisions	\$58	\$1	\$0	\$0	\$58	\$1	21
Corporate debt securities	\$54	\$0	\$10	\$0	\$64	\$0	11
Total fixed maturities	112	1	10	0	122	1	32
Nonredeemable preferred stock	5	1	3	0	8	1	4
Common stock	12	1	13	0	25	1	2
Total available-for-sale securities – Indemnity	\$129	\$3	\$26	\$0	\$155	\$3	38
Quality breakdown of fixed maturities:							
Investment grade	\$112	\$1	\$10	\$0	\$122	\$1	32
Non-investment grade	0	0	0	0	0	0	0
Total fixed maturities – Indemnity	\$112	\$1	\$10	\$0	\$122	\$1	32
Exchange							
Available-for-sale securities:							
U.S. government & agencies	\$1	\$0	\$0	\$0	\$1	\$0	2
States & political subdivisions	408	13	18	2	426	15	100
Foreign government securities	5	0	0	0	5	0	1
Corporate debt securities	1,251	43	36	2	1,287	45	237
Residential mortgage-backed securities	71	4	8	0	79	4	12
Commercial mortgage-backed securities	5	0	0	0	5	0	1
Other debt securities	30	1	0	0	30	1	5
Total fixed maturities	1,771	61	62	4	1,833	65	358
Nonredeemable preferred stock	182	10	13	1	195	11	27
Common stock	97	3	101	0	198	3	3
Total available-for-sale securities – Exchange	\$2,050	\$74	\$176	\$5	\$2,226	\$79	388
Quality breakdown of fixed maturities:							
Investment grade	\$1,707	\$57	\$62	\$4	\$1,769	\$61	344
Non-investment grade	64	4	0	0	64	4	14
Total fixed maturities – Exchange	\$1,771	\$61	\$62	\$4	\$1,833	\$65	358

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 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.

Table of Contents

Net investment income

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:

(in millions)	Erie Insurance Group	
	Three months ended March 31, 2014	2013
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	\$86	\$83
Equity securities	29	24
Cash equivalents and other	0	0
Total investment income	115	107
Less: investment expenses	10	8
Investment income, net of expenses – Exchange	\$105	\$99
Investment income, net of expenses – Erie Insurance Group	\$109	\$103

Table of Contents

Realized investment gains (losses)

Realized gains and losses on sales of securities are recognized in income based upon the specific identification method. Realized gains (losses) on investments were as follows:

(in millions)	Erie Insurance Group	
	Three months ended March 31, 2014	2013
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	1	0
Gross realized losses	0	0
Net realized gains	1	0
Net realized investment gains – Indemnity	\$1	\$0
Exchange		
Available-for-sale securities:		
Fixed maturities:		
Gross realized gains	\$6	\$15
Gross realized losses	(1	) (2
Net realized gains	5	13
Equity securities:		
Gross realized gains	8	2
Gross realized losses	(1	) 0
Net realized gains	7	2
Trading securities:		
Common stock:		
Gross realized gains	70	102
Gross realized losses	(3	) (12
(Decreases) increases in fair value ⁽¹⁾	(24	) 144
Net realized gains	43	234
Net realized investment gains – Exchange	\$55	\$249
Net realized investment gains – Erie Insurance Group	\$56	\$249

(1) The fair value on our common stock portfolio is based upon exchange traded prices provided by a nationally recognized pricing service.

Table of Contents

Net impairment losses

Indemnity recorded impairment losses of less than \$0.1 million in the first quarter of 2014, compared to no impairment losses in the first quarter of 2013. The Exchange record impairment losses of \$0.2 million in the first quarter of 2014, compared to \$0.4 million in the first quarter of 2013.

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

Limited partnership investments, excluding certain real estate limited partnerships recorded at fair value, are generally reported on a one-quarter lag, therefore our year-to-date limited partnership results through March 31, 2014 are comprised of partnership financial results for the fourth quarter of 2013. Given the lag in reporting, our limited partnership results do not reflect the market conditions of the first quarter of 2014. Cash contributions made to and distributions received from the partnerships are recorded in the period in which the transaction occurs.

Amounts included in equity in earnings of limited partnerships by method of accounting are included below:

(in millions)	Erie Insurance Group Three months ended March 31,	
	2014	2013
Indemnity		
Equity in earnings of limited partnerships accounted for under the equity method	\$5	\$2
Change in fair value of limited partnerships accounted for under the fair value option	1	1
Equity in earnings of limited partnerships – Indemnity	\$6	\$3
Exchange		
Equity in earnings of limited partnerships accounted for under the equity method	\$39	\$29
Change in fair value of limited partnerships accounted for under the fair value option	5	4
Equity in earnings of limited partnerships – Exchange	\$44	\$33
Equity in earnings of limited partnerships – Erie Insurance Group	\$50	\$36

Table of Contents

We have provided summarized financial information in the following tables for the three months ended March 31, 2014 and for the year ended December 31, 2013. Amounts provided in the tables are presented using the latest available financial statements received from the partnerships for the respective periods. 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.

As these investments are generally reported on a one-quarter lag, our limited partnership results through March 31, 2014 include partnership financial results for the fourth quarter of 2013.

(dollars in millions)	Erie Insurance Group			
	As of and for the three months ended March 31, 2014			
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%	25	\$43	\$(3)	\$3
Greater than or equal to 10% but less than 50%	3	19	4	0
Greater than 50%	0	0	0	0
Total private equity	28	62	1	3
Mezzanine debt:				
Less than 10%	11	13	0	0
Greater than or equal to 10% but less than 50%	3	6	0	0
Greater than 50%	1	0	0	0
Total mezzanine debt	15	19	0	0
Real estate:				
Less than 10%	11	43	1	0
Greater than or equal to 10% but less than 50%	3	15	1	0
Greater than 50%	2	6	0	0
Total real estate	16	64	2	0
Total limited partnerships – Indemnity	59	\$145	\$3	\$3
Exchange				
Private equity:				
Less than 10%	43	\$389	\$(6)	\$19
Greater than or equal to 10% but less than 50%	3	79	14	0
Greater than 50%	0	0	0	0
Total private equity	46	468	8	19
Mezzanine debt:				
Less than 10%	19	115	1	3
Greater than or equal to 10% but less than 50%	4	24	(2)	2
Greater than 50%	3	31	1	1
Total mezzanine debt	26	170	0	6
Real estate:				
Less than 10%	20	211	5	4

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Greater than or equal to 10% but less than 50%	7	79	0	1
Greater than 50%	2	25	(12	) 13
Total real estate	29	315	(7	) 18
Total limited partnerships – Exchange	101	\$953	\$1	\$43
Total limited partnerships – Erie Insurance Group		\$1,098	\$4	\$46

Per the limited partnership financial statements, total partnership assets were \$49 billion and total partnership liabilities were \$5 billion at March 31, 2014 (as recorded in the December 31, 2013 limited partnership financial statements). For the three month period comparable to that presented in the preceding table (fourth quarter of 2013), total partnership valuation adjustment gains were \$0.1 billion and total partnership net income was \$2 billion.

Table of Contents

As these investments are generally reported on a one-quarter lag, our limited partnership results through December 31, 2013 include partnership financial results for the fourth quarter of 2012 and the first three quarters of 2013.

(dollars in millions)	Erie Insurance Group			
	As of and for the year ended December 31, 2013			
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	\$46	\$(6)	\$9
Greater than or equal to 10% but less than 50%	3	16	3	0
Greater than 50%	0	0	0	0
Total private equity	29	62	(3)	9
Mezzanine debt:				
Less than 10%	11	14	0	1
Greater than or equal to 10% but less than 50%	3	6	0	2
Greater than 50%	1	0	0	0
Total mezzanine debt	15	20	0	3
Real estate:				
Less than 10%	12	44	0	5
Greater than or equal to 10% but less than 50%	3	14	(1)	4
Greater than 50%	2	6	1	4
Total real estate	17	64	0	13
Total limited partnerships – Indemnity	61	\$146	\$(3)	\$25
Exchange				
Private equity:				
Less than 10%	44	\$396	\$(24)	\$79
Greater than or equal to 10% but less than 50%	3	67	13	2
Greater than 50%	0	0	0	0
Total private equity	47	463	(11)	81
Mezzanine debt:				
Less than 10%	19	117	1	13
Greater than or equal to 10% but less than 50%	4	23	(3)	7
Greater than 50%	3	32	1	3
Total mezzanine debt	26	172	(1)	23
Real estate:				
Less than 10%	22	211	(10)	34
Greater than or equal to 10% but less than 50%	6	71	(2)	10
Greater than 50%	2	23	(1)	16
Total real estate	30	305	(13)	60
Total limited partnerships – Exchange	103	\$940	\$(25)	\$164
Total limited partnerships – Erie Insurance Group		\$1,086	\$(28)	\$189

Per the limited partnership financial statements, total partnership assets were \$50 billion and total partnership liabilities were \$5 billion at December 31, 2013 (as recorded in the September 30, 2013 limited partnership financial statements). For the twelve month period comparable to that presented in the preceding table (fourth quarter of 2012 and first three quarters of 2013), total partnership valuation adjustment gains were \$2 billion and total partnership net income was \$7 billion.

See also Note 14. "Commitments and Contingencies," for investment commitments related to limited partnerships.

Table of Contents

Note 8. Bank Line of Credit

As of March 31, 2014, Indemnity has access to a \$100 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on November 3, 2018. As of March 31, 2014, a total of \$98.2 million remains available under the facility due to \$1.8 million outstanding letters of credit, which reduce the availability for letters of credit to \$23.2 million. Indemnity had no borrowings outstanding on its line of credit as of March 31, 2014. Bonds with a fair value of \$113 million were pledged as collateral on the line at March 31, 2014.

As of March 31, 2014, the Exchange has access to a \$300 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on October 25, 2018. As of March 31, 2014, a total of \$298.9 million remains available under the facility due to \$1.1 million outstanding letters of credit, which reduce the availability for letters of credit to \$23.9 million. The Exchange had no borrowings outstanding on its line of credit as of March 31, 2014. Bonds with a fair value of \$335 million were pledged as collateral on the line at March 31, 2014.

Both lines have securities pledged as collateral that have no trading restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position as of March 31, 2014. The banks require compliance with certain covenants, which include 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, 2014.

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, 2014, we recorded a net deferred tax liability of \$492 million on our Consolidated Statements of Financial Position. Of this amount, \$0.2 million is a net deferred tax liability attributable to Indemnity and \$492 million is a net deferred tax liability attributable to the Exchange. There was no deferred tax valuation allowance recorded at March 31, 2014. Our effective tax rate is calculated after consideration of permanent differences related to our investment revenues. Given that these amounts represent over 98% of the total permanent differences, the effective tax rate is approximately 35% for both Indemnity and the Exchange when the investment related permanent differences are excluded.

Table of Contents

Note 10. Postretirement Benefits

Pension plans

Our pension plans consist of a noncontributory defined benefit pension plan covering substantially all employees and an unfunded supplemental employee retirement plan for certain members of executive and senior management 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. Although Indemnity is the sponsor of these postretirement plans and records the funded status of these plans, the Exchange and EFL reimburse Indemnity for approximately 55% of the annual benefit expense of these plans, which represents pension benefits for Indemnity employees performing claims and EFL functions.

Prior to 2003, the employee pension plan purchased annuities from EFL for certain plan participants that were receiving benefit payments under the pension plan. These are nonparticipating annuity contracts under which EFL has unconditionally contracted to provide specified benefits to beneficiaries; however, the pension plan remains the primary obligor to the beneficiaries and a contingent liability, \$26 million at March 31, 2014, exists in the event EFL does not honor the annuity contracts.

The cost of our pension plans are as follows:

(in millions)	Erie Insurance Group	
	Three months ended March 31,	
	2014	2013
Service cost for benefits earned	\$6	\$7
Interest cost on benefits obligation	7	6
Expected return on plan assets	(8	) (8
Prior service cost amortization	0	0
Net actuarial loss amortization	2	4
Pension plan cost ⁽¹⁾	\$7	\$9

⁽¹⁾ Pension plan costs represent the total cost for the Erie Insurance Group before reimbursements to Indemnity from the Exchange and EFL.

Note 11. Indemnity Capital Stock

Class A and B common stock

Holder 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. There were no conversions of Class B shares to Class A shares during the three months ended March 31, 2014 and the year ended December 31, 2013. 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 \$26 million of repurchase authority remaining under this program at March 31, 2014.

Table of Contents

Note 12. Indemnity Accumulated Other Comprehensive Loss

Changes in Indemnity's accumulated other comprehensive loss by component attributable to the Indemnity shareholder interest is presented as follows for the three months ended March 31, 2014:

(in millions)	Indemnity Shareholder Interest		Total
	Unrealized holding gains (losses) on available-for-sale securities	Postretirement plans ⁽²⁾	
Balance at December 31, 2013	\$6	\$(65)	\$(59)
Other comprehensive income before reclassifications, net of tax	4	0	4
Amounts reclassified from accumulated other comprehensive income (loss), net of tax ⁽¹⁾	(1)	0	(1)
Net current period other comprehensive income, net of tax	3	0	3
Balance at March 31, 2014	\$9	\$(65)	\$(56)

(1) See the following table for details about these reclassifications.

(2) There are no amounts reclassified out of accumulated other comprehensive loss related to postretirement plan items during interim periods.

Amounts reclassified out of accumulated other comprehensive income (loss) and the related affected line item in the Consolidated Statements of Operations where net income is presented are as follows for the three months ended March 31, 2014:

(in millions)	Erie Insurance Group Three months ended March 31, 2014 Amounts reclassified from accumulated other comprehensive income (loss) ⁽¹⁾
Unrealized holding gains (losses) on available-for-sale securities:	
Net realized investment gains	\$13
Net impairment losses recognized in earnings	0
Income from operations before income taxes and noncontrolling interest	13
Provision for income taxes	5
Net income	8
Less: Net income attributable to noncontrolling interest in consolidated entity – Exchange	7
Net income attributable to Indemnity	\$1
Amortization of postretirement plan items ⁽²⁾ :	
Net income attributable to Indemnity	\$0
Net income attributable to Indemnity	\$1

(1) Positive amounts indicate net income, while negative amounts indicate net loss.

(2) There are no amounts reclassified out of accumulated other comprehensive loss related to postretirement plan items during interim periods.

31

Table of Contents

Note 13. Indemnity Shareholders' Equity and Noncontrolling Interest

A reconciliation of the beginning and ending balances of Indemnity's shareholders' equity and the noncontrolling interest is presented as follows for the year ended December 31, 2013 and for the three months ended March 31, 2014:

(in millions, except per share data)	Erie Insurance Group		
	Indemnity shareholder interest	Exchange noncontrolling interest	Erie Insurance Group
Balance at December 31, 2012	\$642	\$6,149	\$6,791
Net income	163	885	1,048
Change in other comprehensive income (loss), net of tax	74	(218	) (144
Net purchase of treasury stock	(32	) —	(32
Dividends declared:			
Class A \$2.4125 per share	(112	) —	(112
Class B \$361.875 per share	(1	) —	(1
Balance at December 31, 2013	\$734	\$6,816	\$7,550
Net income	46	63	109
Change in other comprehensive income, net of tax	3	69	72
Net purchase of treasury stock	(11	) —	(11
Dividends declared:			
Class A \$0.635 per share	(30	) —	(30
Class B \$95.25 per share	0	—	0
Balance at March 31, 2014	\$742	\$6,948	\$7,690

Note 14. Commitments and Contingencies

Indemnity has contractual commitments to invest up to \$28 million related to its limited partnership investments at March 31, 2014. These commitments are split among private equity securities of \$12 million, mezzanine debt securities of \$10 million, and real estate activities of \$6 million. These commitments will be funded as required by the partnership agreements.

The Exchange, including EFL, has contractual commitments to invest up to \$430 million related to its limited partnership investments at March 31, 2014. These commitments are split among private equity securities of \$136 million, mezzanine debt securities of \$189 million, and real estate activities of \$105 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, results of operations, or cash flows. Legal fees are expensed as incurred. We believe that our accruals for legal proceedings are appropriate and, individually and in the aggregate, are not expected to be material to our consolidated financial condition, operations, or cash flows.

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

Table of Contents

We are subject to escheatment laws and regulations requiring the identification, reporting and payment to the state of unclaimed or abandoned funds of our policyholders, annuitants, claimants and shareholders. We are also subject to audit and examination for compliance with these requirements.

In August 2012, we were notified that we would be subject to an audit of our compliance with the unclaimed property laws of a number of jurisdictions both within and outside our operating territory. The audit commenced in April 2013 and is ongoing. Additionally, EFL has been named in a lawsuit filed by the State Treasurer of West Virginia. The Complaint alleges that EFL has failed to comply with the West Virginia Uniform Unclaimed Property Act. EFL filed a motion to dismiss and a favorable decision was rendered in December 2013 with the Court dismissing the Complaint with prejudice. The State Treasurer appealed the dismissal of the lawsuit in January 2014.

It is probable that ongoing inquiries, audits, and other regulatory activity will result in the payment of additional death claims and escheatment of funds, as well as possible fines. EFL will incur expenses to identify death claims, confirm that benefits are due and notify the beneficiaries. At this time, we are not able to reasonably estimate the possible loss or range of loss related to this issue due to the early stage of development.

Note 15. Indemnity Supplemental Information

Consolidating Statement of Financial Position

(in millions)	Erie Insurance Group			
	At March 31, 2014			
	Indemnity shareholder interest	Exchange noncontrolling interest	Reclassifications and eliminations	Erie Insurance Group
Assets				
Investments				
Available-for-sale securities, at fair value:				
Fixed maturities	\$502	\$8,379	\$—	\$8,881
Equity securities	35	852	—	887
Trading securities, at fair value	—	3,253	—	3,253
Limited partnerships	145	953	—	1,098
Other invested assets	1	20	—	21
Total investments	683	13,457	—	14,140
Cash and cash equivalents	44	335	—	379
Premiums receivable from policyholders	—	1,194	—	1,194
Reinsurance recoverable	—	175	—	175
Deferred acquisition costs	—	558	—	558
Other assets	113	372	—	485
Receivables from the Exchange and other affiliates	301	—	(301) —
Note receivable from EFL	25	—	(25) —
Total assets	\$1,166	\$16,091	\$(326	) \$16,931
Liabilities				
Losses and loss expense reserves	\$—	\$3,838	\$—	\$3,838
Life policy and deposit contract reserves	—	1,775	—	1,775
Unearned premiums	—	2,625	—	2,625
Deferred income tax liability	0	492	—	492
Other liabilities	424	413	(326	) 511
Total liabilities	424	9,143	(326	) 9,241

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Shareholders' equity and noncontrolling interest				
Total Indemnity shareholders' equity	742	—	—	742
Noncontrolling interest in consolidated entity – Exchange	—	6,948	—	6,948
Total equity	742	6,948	—	7,690
Total liabilities, shareholders' equity, and noncontrolling interest	\$1,166	\$16,091	\$(326)	) \$16,931

33

Table of Contents

Consolidating Statement of Financial Position

(in millions)	Erie Insurance Group At December 31, 2013			
	Indemnity shareholder interest	Exchange noncontrolling interest	Reclassifications and eliminations	Erie Insurance Group
Assets				
Investments				
Available-for-sale securities, at fair value:				
Fixed maturities	\$526	\$8,162	\$—	\$8,688
Equity securities	50	819	—	869
Trading securities, at fair value	—	3,202	—	3,202
Limited partnerships	146	940	—	1,086
Other invested assets	1	20	—	21
Total investments	723	13,143	—	13,866
Cash and cash equivalents	49	403	—	452
Premiums receivable from policyholders	—	1,167	—	1,167
Reinsurance recoverable	—	172	—	172
Deferred income tax asset	2	0	—	2
Deferred acquisition costs	—	566	—	566
Other assets	114	337	—	451
Receivables from the Exchange and other affiliates	300	—	(300) —
Note receivable from EFL	25	—	(25) —
Total assets	\$1,213	\$15,788	\$(325	) \$16,676
Liabilities				
Losses and loss expense reserves	\$—	\$3,747	\$—	\$3,747
Life policy and deposit contract reserves	—	1,758	—	1,758
Unearned premiums	—	2,598	—	2,598
Deferred income tax liability	0	450	—	450
Other liabilities	479	419	(325	) 573
Total liabilities	479	8,972	(325	) 9,126
Shareholders' equity and noncontrolling interest				
Total Indemnity shareholders' equity	734	—	—	734
Noncontrolling interest in consolidated entity – Exchange	—	6,816	—	6,816
Total equity	734	6,816	—	7,550
Total liabilities, shareholders' equity, and noncontrolling interest	\$1,213	\$15,788	\$(325	) \$16,676

Receivables from the Exchange and EFL and concentrations of credit risk – Financial instruments could potentially expose Indemnity to concentrations of credit risk, including unsecured receivables from the Exchange. A majority of Indemnity's revenue and receivables are from the Exchange and affiliates. See also Note 4, "Variable Interest Entity."

Management fees and expense allocation amounts due from the Exchange were \$296 million at March 31, 2014 and December 31, 2013. The receivable from EFL for expense allocations and interest on the surplus note totaled \$5 million and \$4 million at March 31, 2014 and December 31, 2013 respectively.

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Note receivable from EFL – Indemnity is due \$25 million from EFL in the form of a surplus note that was issued in 2003. The note may be repaid only out of unassigned surplus of EFL. Both principal and interest payments are subject to prior approval by the Pennsylvania Insurance Commissioner. The note bears an annual interest rate of 6.7% and will be payable on demand on or after December 31, 2018, with interest scheduled to be paid semi-annually, subject to prior approval by the Pennsylvania Insurance Commissioner. For each of the three months ended March 31, 2014 and 2013, Indemnity recognized interest income on the note of \$0.4 million.

Table of Contents

Income attributable to Indemnity shareholder interest

(in millions)	Indemnity Shareholder Interest	
	Three months ended March 31,	
	2014	2013
Management operations:		
Management fee revenue, net	\$319	\$296
Service agreement revenue	7	7
Total revenue from management operations	326	303
Cost of management operations	268	254
Income from management operations before taxes	58	49
Investment operations:		
Net investment income	4	4
Net realized gains on investments	1	0
Net impairment losses recognized in earnings	0	0
Equity in earnings of limited partnerships	6	3
Income from investment operations before taxes	11	7
Income from operations before income taxes	69	56
Provision for income taxes	23	19
Net income attributable to Indemnity	\$46	\$37

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,	
	2014	2013
Management fee received	\$317	\$288
Service agreement fee received	8	7
Net investment income received	6	5
Limited partnership distributions	3	7
Increase in reimbursements collected from affiliates	1	2
Commissions and bonuses paid to agents	(225)	(197)
Salaries and wages paid	(47)	(44)
Pension contribution and employee benefits paid	(23)	(22)
General operating expenses paid	(50)	(45)
Income taxes recovered (paid)	1	(2)
Net cash used in operating activities	(9)	(1)
Net cash provided by investing activities	44	45
Net cash used in financing activities	(40)	(15)
Net (decrease) increase in cash and cash equivalents	(5)	29
Cash and cash equivalents at beginning of period	49	12
Cash and cash equivalents at end of period	\$44	\$41

Note 16. Subsequent Events

No items were identified in the period subsequent to the financial statement date that required adjustment or disclosure.

35

Table of Contents

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

The following discussion of financial condition and results of operations highlights significant factors influencing the Erie Insurance Group ("we," "us," "our"). This discussion should be read in conjunction with the historical financial statements 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, 2013, as contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2014.

INDEX

	Page Number
<u>Cautionary Statement Regarding Forward-Looking Information</u>	<u>36</u>
<u>Recent Accounting Pronouncements</u>	<u>37</u>
<u>Operating Overview</u>	<u>38</u>
<u>Results of Operations</u>	<u>43</u>
<u>Management Operations</u>	<u>43</u>
<u>Property and Casualty Insurance Operations</u>	<u>45</u>
<u>Life Insurance Operations</u>	<u>49</u>
<u>Investment Operations</u>	<u>50</u>
<u>Financial Condition</u>	<u>52</u>
<u>Investments</u>	<u>52</u>
<u>Liabilities</u>	<u>56</u>
<u>Impact of Inflation</u>	<u>57</u>
<u>Liquidity and Capital Resources</u>	<u>57</u>
<u>Critical Accounting Estimates</u>	<u>60</u>

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:

- 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;
- factors affecting the quality and liquidity of Indemnity's investment portfolio;
- credit risk from the Exchange;
- Indemnity's ability to meet liquidity needs and access capital; and
- outcome of pending and potential litigation against Indemnity.

Table of Contents

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

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

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

Table of Contents

OPERATING OVERVIEW

Overview

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

The Exchange is a reciprocal insurance exchange organized under Article X of Pennsylvania's Insurance Company Law of 1921 under which individuals, partnerships, and corporations are authorized to exchange reciprocal or inter-insurance contracts with each other, or with individuals, partnerships, and corporations of other states and countries, providing indemnity among themselves from any loss which may be insured against under any provision of the insurance laws except life insurance. 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 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;

- net investment income and results on investments that belong to Indemnity; and

- other income and expenses, including income taxes, that are the responsibility of Indemnity.

The Exchange’s or the noncontrolling interest in income comprises:

- 100% interest in the net underwriting results of the property and casualty insurance operations;

- 100% interest in the net earnings of EFL's life insurance operations;

net investment income and results on investments that belong to the Exchange and its subsidiaries; and
other income and expenses, including income taxes, that are the responsibility of the Exchange and its subsidiaries.

38

Table of Contents

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	
	Three months ended March 31,		Three months ended March 31,		Three months ended March 31,		Three months ended March 31,	
	2014	2013	2014	2013	2014	2013	2014	2013
Management operations:								
Management fee revenue, net	\$ 319	\$ 296	\$—	\$—	\$(319)	\$(296)	\$—	\$—
Service agreement revenue	7	7	—	—	—	—	7	7
Total revenue from management operations	326	303	—	—	(319)	(296)	7	7
Cost of management operations	268	254	—	—	(268)	(254)	—	—
Income from management operations before taxes	58	49	—	—	(51)	(42)	7	7
Property and casualty insurance operations:								
Net premiums earned	—	—	1,268	1,156	—	—	1,268	1,156
Losses and loss expenses	—	—	1,007	817	(1)	(1)	1,006	816
Policy acquisition and underwriting expenses	—	—	365	328	(53)	(44)	312	284
(Loss) income from property and casualty insurance operations before taxes	—	—	(104)	11	54	45	(50)	56
Life insurance operations: ⁽¹⁾								
Total revenue	—	—	50	46	0	0	50	46
Total benefits and expenses	—	—	37	35	0	0	37	35
Income from life insurance operations before taxes	—	—	13	11	0	0	13	11
Investment operations: ⁽¹⁾								
Net investment income	4	4	84	79	(3)	(3)	85	80
Net realized gains on investments	1	0	50	246	—	—	51	246
Net impairment losses recognized in earnings	0	0	0	0	—	—	0	0
Equity in earnings of limited partnerships	6	3	44	33	—	—	50	36
Income from investment operations before taxes	11	7	178	358	(3)	(3)	186	362
Income from operations before income taxes and noncontrolling interest	69	56	87	380	—	—	156	436
Provision for income taxes	23	19	24	127	—	—	47	146
Net income	\$46	\$37	\$63	\$253	\$—	\$—	\$109	\$290

(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.

Net income in the first quarter of 2014 was primarily impacted by lower earnings from our investment operations and increased losses from our property and casualty insurance operations compared to the first quarter of 2013.

Our investment operations generated lower levels of net realized gains on investments, due to lower realized gains from the sales of securities and decreases in fair value of common stocks compared to increases in fair value of common stock recorded in the first quarter of 2013, offset somewhat by slight increases in equity in earnings of limited partnerships and net investment income.

The Exchange's property and casualty insurance operations experienced a 9.6% increase in earned premium in the first quarter of 2014, driven by increases in policies in force and the average premium per policy. Losses from the Exchange's property and casualty insurance operations increased in the first quarter of 2014 due to a higher volume of non-catastrophe weather related claims, resulting from more severe winter weather, and increased catastrophe losses, offset somewhat by favorable development on prior accident year loss reserves, compared to adverse development in the first quarter of 2013.

Table of Contents

Reconciliation of Operating Income to Net Income (Unaudited)

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

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

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

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

(in millions, except per share data)	Indemnity Shareholder Interest	
	Three months ended March 31,	
	2014	2013
	(Unaudited)	
Operating income attributable to Indemnity	\$45	\$37
Net realized gains and impairments on investments	1	0
Income tax expense	0	0
Realized gains and impairments, net of income taxes	1	0
Net income attributable to Indemnity	\$46	\$37
Per Indemnity Class A common share-diluted:		
Operating income attributable to Indemnity	\$0.87	\$0.69
Net realized gains and impairments on investments	0.02	0.00
Income tax expense	(0.01	) 0.00
Realized gains and impairments, net of income taxes	0.01	0.00
Net income attributable to Indemnity	\$0.88	\$0.69

Summary of Results – Indemnity Shareholder Interest

Three months ended March 31, 2014

Net income attributable to Indemnity Class A per share-diluted was \$0.88 per share in the first quarter of 2014, compared to \$0.69 per share in the first quarter of 2013.

Operating income attributable to Indemnity Class A per share-diluted (excluding net realized gains or losses, impairments on investments, and related taxes) was \$0.87 per share in the first quarter of 2014, compared to \$0.69 per share in the first quarter of 2013.

Table of Contents

Operating Segments

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

Management operations

Management operations generate internal management fee revenue, which accrues to the Indemnity shareholder interest, as Indemnity provides services relating to the sales, underwriting, and issuance of policies on behalf of the Exchange. Management fee revenue is based upon all premiums written or assumed by the Exchange and the management fee rate, which is not to exceed 25%. Our Board of Directors establishes the management fee rate at least annually, generally in December for the following year, and considers factors such as the relative financial strength of Indemnity and the Exchange and projected revenue streams. The management fee rate was set at 25% for both 2014 and 2013. 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 2,150 independent agencies, with over 10,650 licensed property and casualty representatives, will contribute to future growth as new agents build their books of business with the Property and Casualty Group.

Geographic expansion is also a component of the Property and Casualty Group's premium growth strategy. The Property and Casualty Group plans to expand operations into the Commonwealth of Kentucky by the first quarter of 2015 or earlier if possible.

The property and casualty insurance operations insure preferred and standard risks while maintaining a disciplined underwriting approach. Based upon direct written premium in 2013, 44% of our premiums were derived from personal auto, 26% from homeowners and 29% from commercial lines. Pennsylvania, Maryland, Virginia, North Carolina and Ohio made up 75% of the property and casualty lines insurance business 2013 direct written premium.

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

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

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

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

Life insurance operations

EFL generates revenues through the sale of its individual and group life insurance policies and fixed annuities. These products provide our property and casualty agency force an opportunity to cross-sell both personal and commercial accounts. EFL's profitability depends principally on the ability to develop, price, and distribute insurance products, attract and retain deposit funds, generate investment returns, and manage expenses. Other drivers include mortality and morbidity experience, persistency experience to enable the recovery of acquisition costs, maintenance of interest spreads over the amounts credited to deposit funds, and the maintenance of strong ratings from rating agencies. EFL plans to expand operations into the Commonwealth of Kentucky by the first quarter of 2015 or earlier if possible.

Table of Contents

Earnings on life insurance related invested assets are integral to the evaluation of the life insurance operations because of the long duration of life products. On that basis, for presentation purposes, the life insurance operations segment discussion includes the life insurance related investment results. However, also for presentation purposes, the segment footnote and the investment operations segment discussion also include the life insurance investment results as part of the Exchange's investment results.

Investment operations

We generate revenues 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. 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, which includes consideration for intent to sell.

General Conditions and Trends Affecting Our Business

Economic conditions

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

Financial market volatility

Our portfolio of fixed income, preferred and common stocks, and limited partnerships are subject to market volatility especially in periods of instability in the worldwide financial markets. Over time, net investment income could also be impacted by volatility and by the general level of interest rates, which impact reinvested cash flow from the portfolio and business operations. Depending upon market conditions, which are unpredictable and remain uncertain, considerable fluctuation could exist in our reported total investment income, which could have an adverse impact on our financial condition, results of operations, and cash flows.

Table of Contents

RESULTS OF OPERATIONS

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

Management Operations

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

(dollars in millions)	Indemnity Shareholder Interest Three months ended March 31, 2014 2013 % Change (Unaudited)		
	Management fee revenue, net	\$319	\$296	7.7 %
Service agreement revenue	7	7	3.0
Total revenue from management operations	326	303	7.5
Cost of management operations	268	254	5.2
Income from management operations – Indemnity ⁽¹⁾	\$58	\$49	20.0 %
Gross margin	17.9	% 16.1	% 1.8 pts.

(1) The Indemnity shareholder interest retains 100% of the income from the 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:

(dollars in millions)	Indemnity Shareholder Interest Three months ended March 31, 2014 2013 % Change (Unaudited)		
	Property and Casualty Group direct written premium	\$1,279	\$1,187	7.8 %
Management fee rate	25	% 25	%
Management fee revenue, gross	320	297	7.8
Change in allowance for management fee returned on cancelled policies ⁽¹⁾	(1)	(1)	NM
Management fee revenue, net of allowance	\$319	\$296	7.7 %

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.

Management fee revenue increased \$23 million, or 7.7 percent, in the first quarter of 2014, compared to the first quarter of 2013. Direct written premium of the Property and Casualty Group increased 7.8% in the first quarter of 2014, compared to the first quarter of 2013, due to a 4.7% increase in policies in force and a 4.2% increase in the

year-over-year average premium per policy for all lines of business. The year-over-year policy retention ratio was 90.6% at March 31, 2014 and December 31, 2013, and 91.0% at March 31, 2013. 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 2014 and 2013. Changes in the management fee rate can affect the Indemnity shareholder interest's revenue and net income from this segment significantly.

Table of Contents

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 in both the first quarters of 2014 and 2013. The consistency in the service fee revenue compared to the growth in policies in force reflects the continued shift in policies to the monthly direct debit payment plan, which does not incur service charges, and the no-fee single payment plan, which offers a premium discount. The shift to these plans is driven by the consumers' desire to avoid paying service charges and to take advantage of the discount in pricing offered for paid-in-full policies.

Cost of management operations

(in millions)	Indemnity Shareholder Interest			
	Three months ended March 31,		% Change	
	2014	2013	(Unaudited)	
Commissions:				
Total commissions	\$174	\$164	6.0	%
Non-commission expense:				
Sales and advertising	\$14	\$14	3.0	%
Underwriting and policy processing	32	30	8.6	
Information technology	28	26	8.4	
Customer service	7	5	21.9	
Administrative and other	13	15	(19.6)
Total non-commission expense	\$94	\$90	3.6	%
Total cost of management operations	\$268	\$254	5.2	%

Commissions – Commissions increased \$10 million in the first quarter of 2014, compared to the same respective period in 2013, primarily a result of the 7.8% increase in direct written premiums of the Property and Casualty Group. Offsetting this increase was a slight decrease in other agent compensation primarily due to a decrease in the projected profitability bonus component as a result of factoring in the underwriting results of the Property and Casualty Group for the current quarter.

Non-commission expense – Non-commission expense increased \$4 million in the first quarter of 2014, compared to the first quarter of 2013. Sales and advertising costs remained flat compared to the first quarter of 2013. Underwriting and policy processing costs increased \$2 million due to increased personnel costs and increased cost of underwriting reports. Information technology costs increased \$2 million, which included \$1 million of personnel costs and \$1 million of professional fees. Customer service costs increased \$2 million due to an increase of \$1 million each in credit card processing fees and personnel costs. Administrative and other expenses decreased \$2 million driven by decreases of \$1 million each in personnel and professional fees.

Gross margin

The gross margin in the first quarter of 2014 was 17.9%, compared to 16.1% in the first quarter of 2013, as a result of revenue growth outpacing expense increases.

Table of Contents

Property and Casualty Insurance Operations

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

(dollars in millions)	Property and Casualty Group Three months ended March 31, 2014 2013 % Change (Unaudited)			
Premiums:				
Direct written premium	\$1,279	\$1,187	7.8	%
Reinsurance premium – assumed and ceded	(7)	(13)	44.8	
Net written premium	1,272	1,174	8.3	
Change in unearned premium	(4)	(18)	(75.3)	
Net premiums earned	1,268	1,156	9.6	
Losses and loss expenses:				
Current accident year, excluding catastrophe losses	927	783	18.5	
Current accident year catastrophe losses	93	27	NM	
Prior accident years, including prior year catastrophe losses	(13)	7	NM	
Losses and loss expenses	1,007	817	23.3	
Policy acquisition and other underwriting expenses	365	328	11.2	
Total losses and expenses	1,372	1,145	19.8	
Underwriting (loss) income – Exchange ⁽¹⁾	\$(104)	\$11	NM	%
Loss and loss expense ratios:				
Current accident year loss ratio, excluding catastrophe losses	73.2	% 67.7	% 5.5	pts.
Current accident year catastrophe loss ratio	7.3	2.3	5.0	
Prior accident year loss ratio, including prior year catastrophe losses	(1.0)	0.6	(1.6)	
Total loss and loss expense ratio	79.5	70.6	8.9	
Policy acquisition and other underwriting expense ratio	28.8	28.4	0.4	
Combined ratio	108.3	% 99.0	% 9.3	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

Direct written premium – Direct written premium of the Property and Casualty Group increased 7.8% to \$1.3 billion in the first quarter of 2014, from \$1.2 billion in the first quarter of 2013, 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 4.7%

in the first quarter of 2014 as the result of continuing strong policyholder retention and a slight increase in new policies written, compared to an increase of 4.3% in the first quarter of 2013. The year-over-year average premium per policy for all lines of business increased 4.2% at March 31, 2014, compared to 4.7% at March 31, 2013. The combined impact of these increases was seen primarily in our renewal business premiums.

Premiums generated from new business remained relatively flat at \$151 million, increasing only 0.2% in the first quarter of 2014, compared to an increase of 17.3% in the first quarter of 2013. Underlying the trend in new business premiums was a 1.0% increase in new business policies written in the first quarter of 2014, compared to 14.6% in the first quarter of 2013, while the year-over-year average premium per policy on new business increased 1.0% at March 31, 2014, compared to 6.8% at March 31, 2013.

Table of Contents

Premiums generated from renewal business increased 8.9% to \$1.1 billion in the first quarter of 2014, compared to an increase of 9.1% to \$1.0 billion in the first quarter of 2013. Underlying the trend in renewal business premiums were increases in average premium per policy and steady policy retention trends. The renewal business year-over-year average premium per policy increased 4.7% at March 31, 2014, compared to 4.5% at March 31, 2013. The Property and Casualty Group's year-over-year policy retention ratio was 90.6% at March 31, 2014 and December 31, 2013, and 91.0% at March 31, 2013.

Personal lines – Total personal lines premiums written increased 7.8% to \$872 million in the first quarter of 2014, from \$810 million in the first quarter of 2013, driven by an increase of 4.6% in the total personal lines policies in force and an increase of 3.8% in the total personal lines year-over-year average premium per policy.

New business premiums written on personal lines increased 5.3% in the first quarter of 2014, compared to 20.4% in the first quarter of 2013, driven by increases in new business policies written and average premium per policy. Personal lines new business policies written increased 1.7% in the first quarter of 2014, compared to 16.9% in the first quarter of 2013, while the year-over-year average premium per policy on personal lines new business increased 4.8% at both March 31, 2014 and March 31, 2013.

Private passenger auto new business premiums written increased 7.6% in the first quarter of 2014, compared to 18.5% in the first quarter of 2013. New business policies written for private passenger auto increased 4.0% in the first quarter of 2014, compared to 15.6% in the first quarter of 2013, while the new business year-over-year average premium per policy for private passenger auto increased 3.5% at March 31, 2014, compared to 3.6% at March 31, 2013.

Homeowners new business premiums written increased 0.7% in the first quarter of 2014, compared to 23.7% in the first quarter of 2013. New business policies written for homeowners decreased 2.9% in the first quarter of 2014, compared to an increase of 17.4% in the first quarter of 2013. The new business year-over-year average premium per policy for homeowners increased 5.5% at March 31, 2014, compared to 9.7% at March 31, 2013.

Renewal premiums written on personal lines increased 8.1% in the first quarter of 2014, compared to 7.1% in the first quarter of 2013, driven by increases in average premium per policy and steady policy retention trends. The year-over-year average premium per policy on personal lines renewal business increased 3.7% at both March 31, 2014 and March 31, 2013. The personal lines year-over-year policy retention ratio was 91.1% at March 31, 2014, 91.2% at December 31, 2013, and 91.6% at March 31, 2013.

Private passenger auto renewal premiums written increased 5.6% in the first quarter of 2014, compared to 4.3% in the first quarter of 2013. The year-over-year average premium per policy on private passenger auto renewal business increased 1.6% at March 31, 2014, compared to 1.2% at March 31, 2013. The private passenger auto year-over-year policy retention ratio was 92.0% at March 31, 2014, 92.1% at December 31, 2013, and 92.2% at March 31, 2013.

Homeowners renewal premiums written increased 13.1% in both the first quarters of 2014 and 2013. The year-over-year average premium per policy on homeowners renewal business increased 8.1% at March 31, 2014, compared to 8.9% at March 31, 2013. The homeowners year-over-year policyholder retention ratio was 90.0% at March 31, 2014, 90.1% at December 31, 2013, and 90.8% at March 31, 2013.

Commercial lines – Total commercial lines premiums written increased 7.8% to \$407 million in the first quarter of 2014, from \$377 million in the first quarter of 2013, driven by a 4.9% increase in the total commercial lines policies in force and a 5.2% increase in the total commercial lines year-over-year average premium per policy.

New business premiums written on commercial lines decreased 8.6% in the first quarter of 2014, compared to an increase of 12.0% in the first quarter of 2013, driven by decreases in new business policies written and average premium per policy. The combined impact of these decreases was seen primarily in the commercial multi-peril and commercial auto lines of business. Commercial lines new business policies written decreased 2.5% in the first quarter of 2014, compared to an increase of 5.2% in the first quarter of 2013, while the year-over-year average premium per policy on commercial lines new business decreased 1.3% at March 31, 2014, compared to an increase of 15.6% at March 31, 2013.

Renewal premiums for commercial lines increased 10.6% in the first quarter of 2014, compared to an increase of 13.9% in the first quarter of 2013, 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 line of business, and to a lesser extent in the commercial auto and workers compensation lines of business. The year-over-year average premium per policy on commercial lines renewal business increased 6.3% at March 31, 2014, compared to 5.5% at March 31, 2013. The year-over-year policy retention ratio for commercial lines was 87.1% at March 31, 2014, and 86.7% at December 31, 2013 and March 31, 2013.

Table of Contents

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, 2014, we had over 2,150 agencies with over 10,650 licensed property and casualty representatives. The Property and Casualty Group plans to expand operations into the Commonwealth of Kentucky by the first quarter of 2015 or earlier if possible.

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, steady policy retention ratios, and increased average premium per policy.

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 73.2% in the first quarter of 2014, compared to 67.7% in the first quarter of 2013. The higher ratio in the first three months of 2014 was driven primarily by a higher volume of non-catastrophe weather related claims resulting from more severe winter weather compared to the first three months of 2013.

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 \$93 million in the first quarter of 2014, compared to \$27 million in the first quarter of 2013, and contributed 7.3 points and 2.3 points, respectively, to the loss ratios. In the first quarter of 2014, catastrophe losses primarily included freezing, ice, snow, and wind storms that occurred in January and February in the state of Pennsylvania, and to lesser degrees in Maryland, North Carolina, and Ohio.

Prior accident years, including prior accident year catastrophe losses – The following table provides a breakout of our property and casualty insurance operation’s 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,	
	2014	2013
	(Unaudited)	
Direct business, including reserves for catastrophe losses and salvage and subrogation	\$(17	) \$9
Assumed reinsurance business	8	(1)
Ceded reinsurance business	(4	) (1)

Total prior year loss development \$(13) \$7

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 2014, the Property and Casualty Group experienced favorable development on direct prior accident year loss reserves of \$17 million that improved the combined ratio by 1.3 points, compared to adverse development of \$9 million in the first quarter of 2013 that contributed 0.8 points to the combined ratio.

The favorable development in the first quarter of 2014 was primarily due to the workers compensation line of business, offset somewhat by adverse development in the commercial auto line of business. In the first quarter of 2013, the adverse development was primarily due to increased reserves related to two massive injury lifetime medical claims in the workers compensation line of business, offset by favorable development in the commercial multi-peril and homeowners lines of business resulting from better than expected severity trends on property claims.

Table of Contents

Assumed reinsurance – The Property and Casualty Group experienced adverse development on prior accident year loss reserves for its assumed involuntary reinsurance business totaling \$8 million in the first quarter of 2014, compared to favorable development of \$1 million in the first quarter of 2013.

Ceded reinsurance – The Property and Casualty Group’s ceded reinsurance reserve recoveries increased by \$4 million and \$1 million in the first quarters of 2014 and 2013, respectively. An increase in ceded recoveries is reflected as favorable loss development as it represents an increase in recoveries resulting from adverse development on our direct loss reserves, while a decrease in ceded recoveries is reflected as adverse loss development as it represents a decrease in recoveries resulting from favorable development on our direct loss reserves. In the first three months of 2014, the increase in ceded recoveries was primarily due to adverse development related to the business catastrophe liability, whereas the increase in the first three months of 2013 was primarily due to adverse development in the commercial multi-peril and workers compensation lines of business.

Policy acquisition and other underwriting expenses – Our policy acquisition and other underwriting expense ratio increased 0.4 points to 28.8% in the first quarter of 2014, from 28.4% in the first quarter of 2013. The management fee rate was 25% for the periods ended March 31, 2014 and 2013.

Table of Contents

Life Insurance Operations

EFL is a Pennsylvania-domiciled life insurance company which underwrites and sells individual and group life insurance policies and fixed annuities and operates in 10 states and the District of Columbia. EFL plans to expand operations into the Commonwealth of Kentucky by the first quarter of 2015 or earlier if possible. A summary of the results of our life insurance operations is as follows:

(in millions)	Erie Family Life Insurance Company			
	2014	2013	% Change	
	Three months ended March 31, (Unaudited)			
Individual and group life premiums, gross	\$30	\$29	4.1	%
Reinsurance premiums – ceded	(10)	(10)	0.9	
Individual and group life premiums, net	20	19	6.4	
Other revenue	1	1	3.7	
Total net policy revenue	21	20	6.4	
Net investment income	24	23	1.5	
Net realized gains on investments	5	3	72.0	
Impairment losses recognized in earnings	0	0	NM	
Equity in earnings of limited partnerships	0	0	NM	
Total revenues	50	46	8.4	
Benefits and other changes in policy reserves	28	26	6.4	
Amortization of deferred policy acquisition costs	3	3	17.3	
Other operating expenses	6	6	8.4	
Total benefits and expenses	37	35	7.5	
Income before taxes – Exchange ⁽¹⁾	\$13	\$11	11.0	%

NM = not meaningful

(1) The Exchange retains 100% of the income from the life insurance operations.

Policy revenue

Gross policy revenues increased 4.1% to \$30 million in the first quarter 2014, from \$29 million in the first quarter of 2013. EFL uses, and has used, a variety of reinsurance programs to reduce claims volatility and for other financial benefits. While the amount of risk that EFL retains can vary based upon the type of policy issued and the year it was issued, EFL generally does not retain more than \$1 million of risk on any individual life. Ceded reinsurance premiums totaled \$10 million in both the first quarters of 2014 and 2013.

Annuity and universal life premiums that are recorded as deposits totaled \$16 million in both the first quarters of 2014 and 2013, respectively, and therefore are not reflected in individual and group life premiums in the table above.

Investment revenue

EFL's investment revenue increased in the first quarter of 2014, compared to the first quarter of 2013, due to an increase in net realized gains on investments, primarily as a result of the sales of two previously impaired preferred stock securities, and an increase in net investment income, primarily as a result of increased preferred stock dividends. See the "Investment Operations" segment discussion that follows for further information.

Benefits and expenses

In the first quarter of 2014, total benefits and expenses were primarily impacted by an increase in benefits and other changes in policy reserves as a result of an increase in death benefits compared to the first quarter of 2013.

Table of Contents

Investment Operations

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

(in millions)	Erie Insurance Group			
	2014	2013	% Change	
	Three months ended March 31,			
	(Unaudited)			
Indemnity				
Net investment income	\$4	\$4	18.0	%
Net realized gains on investments	1	0	NM	
Net impairment losses recognized in earnings	0	0	NM	
Equity in earnings of limited partnerships	6	3	113.4	
Net revenue from investment operations – Indemnity	\$11	\$7	73.0	%
Exchange				
Net investment income	\$108	\$102	5.5	%
Net realized gains on investments	55	249	(77.7)
Net impairment losses recognized in earnings	0	0	(59.1)
Equity in earnings of limited partnerships	44	33	32.6	
Net revenue from investment operations – Exchange ⁽¹⁾	\$207	\$384	(46.2)%

NM = not meaningful

- (1) The Exchange's investment results for the first quarter of 2014 and 2013 include net investment revenues from EFL's operations of \$29 million and \$26 million, respectively.

Net investment income

Net investment income primarily includes interest and dividends on our fixed maturity and equity security portfolios net of investment expenses. Indemnity's net investment income was unchanged in the first quarter of 2014, compared to the first quarter of 2013, while the Exchange's net investment income increased \$6 million. The increase in net investment income during the first quarter of 2014 for the Exchange was primarily due to higher dividend income from equity securities compared to the first quarter of 2013.

Net realized gains on investments

Net realized gains and losses on investments include the changes in fair value of common stocks designated as trading securities, and gains and losses resulting from the actual sales of all security categories. Indemnity generated net realized gains of \$1 million in the first quarter of 2014, compared to net gains of less than \$0.1 million in the first quarter of 2013, while the Exchange generated net realized gains of \$55 million, compared to net gains of \$249 million.

Net realized gains for Indemnity in the first quarter of 2014 primarily represented gains from the sale of equity securities. Net realized gains for the Exchange decreased in the first quarter of 2014 primarily due to lower realized gains from the sales of securities and decreases in fair value of common stocks recorded in the first quarter of 2014 compared to increases in the fair value of common stock recorded in the first quarter of 2013.

Net impairment losses recognized in earnings

Net impairment losses recorded in earnings for Indemnity were less than \$0.1 million in the first quarter of 2014, compared to no net impairment losses in the first quarter of 2013. Net impairment losses recorded in earnings for the Exchange were \$0.2 million for the first quarter of 2014, compared to net impairment losses of \$0.4 million for the

first quarter of 2013.

Equity in earnings of limited partnerships

Indemnity's equity in earnings of limited partnerships increased \$3 million in the first quarter of 2014, compared to the first quarter of 2013, while the Exchange's equity in earnings of limited partnerships increased \$11 million. The increase in earnings for both Indemnity and the Exchange during the first quarter of 2014 was due to higher earnings from private equity investments partially offset by lower earnings from mezzanine debt and real estate investments.

50

Table of Contents

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

(in millions)	Erie Insurance Group	
	2014	2013
	Three months ended March 31, (Unaudited)	
Indemnity		
Securities sold:		
Fixed maturities	\$0	\$0
Equity securities	1	0
Total net realized gains – Indemnity ⁽¹⁾	\$1	\$0
Exchange		
Securities sold:		
Fixed maturities	\$5	\$13
Equity securities	7	2
Common stock equity securities	67	90
Common stock (decreases) increases in fair value ⁽²⁾	(24	) 144
Total net realized gains – Exchange ⁽¹⁾ ⁽³⁾	\$55	\$249

(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 fair value on our common stock portfolio is based upon exchange traded prices provided by a nationally recognized pricing service.

(3) The Exchange’s results for the first quarters of 2014 and 2013 include net realized gains from EFL’s operations of \$5 million and \$3 million, respectively.

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

(in millions)	Erie Insurance Group	
	2014	2013
	Three months ended March 31, (Unaudited)	
Indemnity		
Private equity	\$4	\$(1
Mezzanine debt	0	1
Real estate	2	3
Total equity in earnings of limited partnerships – Indemnity	\$6	\$3
Exchange		
Private equity	\$27	\$10
Mezzanine debt	6	7
Real estate	11	16
Total equity in earnings of limited partnerships – Exchange ⁽¹⁾	\$44	\$33

(1) The Exchange’s results for the first quarter of 2014 and 2013 include equity in earnings of limited partnerships from EFL’s operations of \$0.3 million and \$0.4 million, respectively.

Limited partnership earnings pertain to investments in U.S. and foreign private equity, mezzanine debt, and real estate partnerships. Valuation adjustments are recorded to reflect the changes in fair value of the underlying investments held by the limited partnerships. These adjustments are recorded as a component of equity in earnings of limited partnerships in the Consolidated Statements of Operations.

Limited partnership earnings tend to be cyclical based upon market conditions, the age of the partnership, and the nature of the investments. Generally, limited partnership earnings are recorded on a quarter lag from financial statements we receive from our general partners. As a consequence, earnings from limited partnerships reported at March 31, 2014 reflect investment valuation changes resulting from the financial markets and the economy in the fourth quarter of 2013.

Table of Contents

FINANCIAL CONDITION

Investments

We generate revenues 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. 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, which includes consideration for intent to sell.

Distribution of investments

(in millions)	Erie Insurance Group Carrying value at		Carrying value at		
	March 31, 2014	% to total	December 31, 2013	% to total	
Indemnity	(Unaudited)				
Fixed maturities	\$502	74	% \$526	73	%
Equity securities:					
Preferred stock	15	2	25	3	
Common stock	20	3	25	3	
Limited partnerships:					
Private equity	62	9	62	9	
Mezzanine debt	19	3	20	3	
Real estate	64	9	64	9	
Real estate mortgage loans	1	0	1	0	
Total investments – Indemnity	\$683	100	% \$723	100	%
Exchange					
Fixed maturities	\$8,379	62	% \$8,162	62	%
Equity securities:					
Preferred stock	656	5	621	5	
Common stock	3,449	26	3,400	26	
Limited partnerships:					
Private equity	468	4	463	4	
Mezzanine debt	170	1	172	1	
Real estate	315	2	305	2	
Life policy loans	17	0	17	0	
Real estate mortgage loans	3	0	3	0	
Total investments – Exchange	\$13,457	100	% \$13,143	100	%
Total investments – Erie Insurance Group	\$14,140		\$13,866		

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 impairments are recorded in other comprehensive income. For available-for-sale equity securities, a charge is recorded in the Consolidated Statements of Operations for positions that have experienced other-than-temporary impairments. (See the "Investment Operations" section contained within this report for further information.) Management believes its investment valuation philosophy and accounting practices result in appropriate and timely measurement of value and recognition of impairment.

Table of Contents

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 \$240 million, or 48%, of the total fixed maturity portfolio for Indemnity and \$1.5 billion, or 18%, of the fixed maturity portfolio for the Exchange at March 31, 2014. The overall credit rating of the municipal portfolio without consideration of the underlying insurance is AA.

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 \$7 million at March 31, 2014, compared to \$5 million at December 31, 2013. At March 31, 2014, the Exchange had net unrealized gains on fixed maturities of \$296 million, compared to \$234 million at December 31, 2013.

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

(in millions)	Erie Insurance Group ⁽¹⁾ At March 31, 2014 (Unaudited)					Fair value
	AAA	AA	A	BBB	Non- investment grade	
Industry Sector						
Indemnity						
Basic materials	\$0	\$0	\$5	\$14	\$0	\$19
Communications	0	0	15	20	0	35
Consumer	0	0	10	22	0	32
Energy	0	5	7	14	0	26
Financial	0	8	60	56	0	124
Government-municipal	104	101	30	5	0	240
Industrial	0	0	1	5	0	6
Structured securities ⁽²⁾	0	0	0	0	0	0
Technology	0	0	0	9	0	9
Utilities	0	0	4	7	0	11
Total – Indemnity	\$104	\$114	\$132	\$152	\$0	\$502
Exchange						
Basic materials	\$0	\$0	\$38	\$200	\$21	\$259
Communications	0	0	229	316	21	566
Consumer	0	35	321	696	14	1,066
Diversified	0	0	15	0	0	15
Energy	7	56	144	469	9	685
Financial	1	153	1,027	1,553	115	2,849
Foreign government	0	10	5	0	0	15
Government-municipal	414	869	162	40	0	1,485
Government sponsored entity	0	38	0	0	0	38
Industrial	0	11	64	276	14	365
Structured securities ⁽²⁾	47	164	42	25	3	281
Technology	0	33	58	90	0	181
U.S. Treasury	0	66	0	0	0	66
Utilities	0	3	122	352	31	508

Edgar Filing: ERIE INDEMNITY CO - Form 10-Q

Total – Exchange	\$469	\$1,438	\$2,227	\$4,017	\$228	\$8,379
------------------	-------	---------	---------	---------	-------	---------

(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.

53

Table of Contents

Equity securities

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

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

(in millions)	Erie Insurance Group			
	Fair value at:		December 31, 2013	
	March 31, 2014			
	(Unaudited)			
Industry sector	Preferred stock	Common stock	Preferred stock	Common stock
Indemnity				
Communications	\$1	\$0	\$1	\$0
Diversified	0	0	3	0
Financial	10	0	16	0
Funds ⁽¹⁾	0	20	0	25
Utilities	4	0	5	0
Total – Indemnity	\$15	\$20	\$25	\$25
Exchange				
Basic materials	\$0	\$84	\$0	\$86
Communications	6	317	6	352
Consumer	16	983	6	968
Diversified	0	16	2	14
Energy	0	212	0	205
Financial	534	557	518	538
Funds ⁽¹⁾	0	483	0	479
Government	0	0	2	0
Industrial	0	460	0	457
Technology	1	267	0	240
Utilities	99	70	87	61
Total – Exchange	\$656	\$3,449	\$621	\$3,400

Includes certain exchange traded funds with underlying holdings of fixed maturity securities totaling \$20 million for Indemnity and \$196 million for the Exchange at March 31, 2014, and \$25 million for Indemnity and \$198 (1) million for the Exchange at December 31, 2013. These securities meet the criteria of a common stock under U.S. GAAP, and are included on the balance sheet as available-for-sale equity securities. Remaining common stock investments are classified as trading securities.

Equity securities classified as available-for-sale include preferred and certain common stock securities, 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. The unrealized gain on equity securities classified as available-for-sale, net of deferred taxes, for Indemnity was \$0.3 million at March 31, 2014, compared to an unrealized loss of less than \$0.1 million at December 31, 2013. The net unrealized gain on equity securities classified as available-for-sale for the Exchange was \$39 million at March 31, 2014, compared to an unrealized gain of \$26 million at December 31, 2013.

Our common stocks classified as trading securities are measured at fair value with all changes in unrealized gains and losses reflected in the Consolidated Statements of Operations.

Table of Contents

Limited partnerships

In the first quarter of 2014, investments in limited partnerships did not change meaningfully for Indemnity and the Exchange from the investment levels at December 31, 2013. Changes in partnership values are a function of contributions and distributions, adjusted for market value changes in the underlying investments. During the first quarter, net distributions received from the partnerships were generally offset by partnership earnings. Indemnity has made no new limited partnership commitments since 2006, and the balance of its limited partnership investments is expected to decline over time as additional distributions are received. 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 2014 reflect the partnership activity experienced in the fourth quarter of 2013.

The components of limited partnership investments are as follows:

(in millions)	Erie Insurance Group	
	At March 31, 2014	At December 31, 2013
Indemnity	(Unaudited)	
Private equity	\$62	\$62
Mezzanine debt	19	20
Real estate	64	64
Total limited partnerships – Indemnity	\$145	\$146
Exchange		
Private equity	\$468	\$463
Mezzanine debt	170	172
Real estate	315	305
Total limited partnerships – Exchange	\$953	\$940

Table of Contents

Liabilities

Property and casualty losses and loss expense reserves

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

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

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

(in millions)	Property and Casualty Group At March 31, At December 2014 31, 2013 (Unaudited)	
Gross reserve liability ⁽¹⁾ :		
Personal auto	\$1,206	\$1,217
Automobile massive injury	342	345
Homeowners	338	271
Workers compensation	594	604
Workers compensation massive injury	88	94
Commercial auto	384	371
Commercial multi-peril	629	587
All other lines of business	168	170
Assumed reinsurance	89	88
Gross reserves	3,838	3,747
Less: reinsurance recoverable	156	156
Net reserve liability — Exchange	\$3,682	\$3,591

Loss reserves are set at estimated ultimate costs, except for workers compensation loss reserves which have been (1) discounted using an interest rate of 2.5%. This discounting reduced unpaid losses and loss expenses by \$90 million at March 31, 2014 and \$85 million at December 31, 2013.

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 251 claimants requiring lifetime medical care, of which 95 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 \$282 million at March 31, 2014, which is net of \$148 million of anticipated reinsurance recoverables, compared to \$291 million at December 31, 2013, which is net of \$148 million of anticipated reinsurance recoverables.

Life insurance reserves

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

Table of Contents

IMPACT OF INFLATION

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

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

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

Volatility in the financial markets presents challenges to us as we do occasionally access our investment portfolio as a source of cash. Some of our fixed income investments, despite being publicly traded, are illiquid. Volatility in these markets could impair our ability to sell certain of our fixed income securities or cause such securities to sell at deep discounts. Additionally, our limited partnership investments are significantly less liquid. We believe we have sufficient liquidity to meet our needs from other sources even if market volatility persists throughout 2014.

Cash flow activities — Erie Insurance Group

The following table provides condensed consolidated cash flow information for the three months ended March 31:

(in millions)	Erie Insurance Group	
	2014	2013
Net cash provided by operating activities	\$54	\$127
Net cash used in investing activities	(95	) (133
Net cash used in financing activities	(32	) (6
Net decrease in cash and cash equivalents	\$(73	) \$(12

Net cash provided by operating activities totaled \$54 million and \$127 million for the first three months of 2014 and 2013, respectively. Decreased cash from operating activities for the first three months of 2014 was driven primarily by increases in losses and loss expenses, other underwriting and acquisition costs, commissions and bonuses paid to agents, and income taxes paid, combined with a decrease in limited partnership distributions received. Offsetting this decrease in cash provided somewhat were increases in premiums collected by the Exchange, driven by the increase in premiums written, and net investment income received compared to the first three months of 2013.

At March 31, 2014, we recorded a net deferred tax liability of \$0.2 million attributable to Indemnity and a net deferred tax liability of \$492 million attributable to the Exchange. There was no deferred tax valuation allowance recorded at March 31,

Table of Contents

2014. In the first quarter of 2014, Indemnity received a tax refund of \$1 million related to the 2006-2009 Internal Revenue Audit. Our capital gain and loss strategies take into consideration our ability to offset gains and losses in future periods, carry-back of capital loss opportunities to the three preceding years, and capital loss carry-forward opportunities to apply against future capital gains over the next five years.

Net cash used in investing activities totaled \$95 million and \$133 million for the first three months of 2014 and 2013, respectively. Investing activities in the first three months of 2014 primarily included decreased cash used to purchase certain common stocks, combined with decreased cash generated from the sale of other common stocks, compared to the first three months of 2013. At March 31, 2014, we had contractual commitments to invest up to \$458 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 \$148 million, mezzanine debt securities was \$199 million, and real estate activities was \$111 million.

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

Cash flow activities — Indemnity

The following table is a summary of cash flows for Indemnity for the three months ended March 31:

(in millions)	Indemnity Shareholder Interest	
	2014	2013
Net cash used in operating activities	\$(9	) \$(1
Net cash provided by investing activities	44	45
Net cash used in financing activities	(40	) (15
Net (decrease) increase in cash and cash equivalents	\$(5	) \$29

See Item 1. "Financial Statements - Note 15. Indemnity Supplemental Information," contained within this report for more detail on Indemnity's cash flows.

Net cash used in Indemnity's operating activities totaled \$9 million for the first three months of 2014, compared to \$1 million for the first three months of 2013. The slight increase in cash used in operating activities for the first three months of 2014 was primarily due to increased cash used for commissions paid to agents, general operating expenses, and salaries and wages, combined with a decrease in cash provided by limited partnership distributions. Offsetting this increase in cash used was an increase in management fee revenue received compared to the first three months of 2013. 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 \$225 million in the first three months of 2014, compared to \$197 million for the first three months of 2013, as a result of an increase in cash paid for scheduled commissions and bonus awards. Indemnity made a \$15 million contribution to its pension plan in the first quarter of 2014, compared to \$17 million in the first quarter of 2013. 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 55% of the net periodic benefit cost of the pension plan from its affiliates, which represents pension benefits for Indemnity employees performing claims and EFL functions.

At March 31, 2014, Indemnity recorded a net deferred tax liability of \$0.2 million. There was no deferred tax valuation allowance recorded at March 31, 2014. In the first quarter of 2014, Indemnity received a tax refund of \$1 million related to the 2006-2009 Internal Revenue Audit.

Net cash provided by Indemnity's investing activities totaled \$44 million for the first three months of 2014, compared to \$45 million for the first three months of 2013. Indemnity's first three months of 2014 investing activities primarily included increased cash generated from the sales of fixed maturity securities, offset somewhat by increased cash used to purchase other fixed maturity securities, compared to the first three months of 2013. Also impacting Indemnity's future investing activities are limited partnership commitments, which totaled \$28 million at March 31, 2014, 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 \$12 million, mezzanine debt securities was \$10 million, and real estate activities was \$6 million.

Net cash used in Indemnity's financing activities totaled \$40 million for the first three months of 2014, compared to \$15 million for the first three months of 2013. The increase in cash used in financing activities for the first three months of 2014

Table of Contents

was driven by a increase in the cash outlay for dividends paid to shareholders offset somewhat by a decrease in share repurchases. Dividends paid to shareholders totaled \$30 million for the first three months of 2014, compared to no dividends paid for the first three months of 2013. Normally, the regular quarterly dividend declared by the Board at its December meeting of the previous year is paid in January, as it was in 2014. In 2013 however, the payment of the regular dividend normally made in January was accelerated and paid in December 2012, due to the potential significant increases in tax rates on 2013 dividend income pending at the time of declaration. Additionally, Indemnity increased both its Class A and Class B shareholder quarterly dividends by 7.2% for 2014, compared to 2013. There are no regulatory restrictions on the payment of dividends to Indemnity's shareholders.

Indemnity repurchased 144,917 shares of its Class A nonvoting common stock in conjunction with its stock repurchase program at a total cost of \$10.2 million, based upon settlement date, in the first quarter of 2014. In the first three months of 2013, shares repurchased under this program totaled 203,364 at a total cost of \$14.6 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 includes, and is not in addition to, any unspent amounts remaining under the prior authorization. Indemnity had approximately \$26 million of repurchase authority remaining under this program at March 31, 2014, based upon trade date.

Additionally, in January 2014, we repurchased 2,800 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$201,411, or \$71.93 per share, for the vesting of stock-based awards for executive management. These shares were delivered to executive management in January 2014. In January 2013, we repurchased 444 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$30,927, or \$69.65 per share, to settle a payment due to a retired executive under our long-term incentive plan. These shares were delivered to the plan participant in January 2013.

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 \$44 million at March 31, 2014, 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 \$424 million at March 31, 2014. 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.

As of March 31, 2014, Indemnity has access to a \$100 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on November 3, 2018. As of March 31, 2014, a total of \$98.2 million remains available under the facility due to \$1.8 million outstanding letters of credit, which reduce the availability for letters of credit to \$23.2 million. Indemnity had no borrowings outstanding on its line of credit as of March 31, 2014. Bonds with a fair value of \$113 million were pledged as collateral on the line at March 31, 2014. These securities have no trading restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position. The bank requires compliance with certain covenants, which include leverage ratios for Indemnity. Indemnity was in compliance with its bank covenants at March 31, 2014.

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 \$335 million at March 31, 2014, 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 \$11.9 billion at March 31, 2014. 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.

As of March 31, 2014, the Exchange has access to a \$300 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on October 25, 2018. As of March 31, 2014, a total of \$298.9 million remains available under the facility due to \$1.1 million outstanding letters of credit, which reduce the availability for letters of credit to \$23.9 million. The Exchange had no borrowings outstanding on its line of credit as of March 31, 2014. Bonds with a fair value of \$335 million

Table of Contents

were pledged as collateral on the line at March 31, 2014. These securities have no trading restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position. The bank requires compliance with certain covenants, which include statutory surplus and risk based capital ratios for the Exchange. The Exchange was in compliance with its bank covenants at March 31, 2014.

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 2014.

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 limited partnership investment commitments.

Surplus Notes

Indemnity holds a surplus note for \$25 million from EFL that is payable on demand on or after December 31, 2018; however, no principal or interest payments may be made without prior approval of the Pennsylvania Insurance Commissioner. Interest payments are scheduled to be paid semi-annually. For the three months ended March 31, 2014 and 2013, Indemnity recognized interest income on the note of \$0.4 million.

The Exchange holds a surplus note for \$20 million from EFL that is payable on demand on or after December 31, 2025; however, no principal or interest payments may be made without prior approval of the Pennsylvania Insurance Commissioner. Interest payments are scheduled to be paid semi-annually. For the three months ended March 31, 2014 and 2013, the Exchange recognized interest income on the note of \$0.3 million.

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 losses and loss expense reserves, life insurance and annuity policy reserves, investment valuation, deferred acquisition costs related to life insurance and investment-type contracts, deferred taxes, and retirement benefit plans for employees. 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, 2013 of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 27, 2014. See Item 1. "Financial Statements - Note 6. Fair Value," contained within this report for additional information on our valuation of investments.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is primarily related to fluctuations in prices and interest rates. Quantitative and qualitative disclosures about market risk resulting from changes in prices, interest rates, and other risk exposures for the year ended December 31, 2013 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, 2014.

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, 2014. 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," contained 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, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

State Court Lawsuit Against Erie Indemnity Company

Erie Indemnity Company (“Indemnity”) was named as a defendant in a complaint filed on August 1, 2012 by alleged subscribers of the Erie Insurance Exchange (the “Exchange”) in the Court of Common Pleas Civil Division of Fayette County, Pennsylvania captioned Erie Insurance Exchange, an unincorporated association, by Joseph S. Sullivan and Anita Sullivan, Patricia R. Beltz, and Jenna L. DeBord, trustees ad litem v. Erie Indemnity Co. (the “Sullivan” lawsuit).

As subsequently amended, the complaint alleges that, beginning on September 1, 1997, Indemnity retained “Service Charges” (installment fees) and “Added Service Charges” (late fees and policy reinstatement charges) on policies written by the Exchange and its insurance subsidiaries, which allegedly should have been paid to the Exchange, in the amount of approximately \$308 million. In addition to their claim for monetary relief on behalf of the Exchange, the plaintiffs seek an accounting of all so-called intercompany transactions between Indemnity and the Exchange from 1996 to date. Plaintiffs allege that Indemnity breached its contractual, fiduciary, and equitable duties by retaining Service Charges and Added Service Charges that should have been retained by the Exchange. Plaintiffs bring these same claims under three separate derivative-type theories. First, plaintiffs purport to bring suit as members of the Exchange on behalf of the Exchange. Second, plaintiffs purport to bring suit as trustees ad litem on behalf of the Exchange. Third, plaintiffs purport to bring suit on behalf of the Exchange pursuant to Rule 1506 of the Pennsylvania Rules of Civil Procedure, which allows shareholders to bring suit derivatively on behalf of a corporation or similar entity.

Indemnity filed a motion in the state court in November 2012 seeking dismissal of the lawsuit. On December 19, 2013, the court granted Indemnity’s motion in part, holding that the Pennsylvania Insurance Holding Company Act “provides the [Pennsylvania Insurance] Department with special competence to address the subject matter of plaintiff’s claims” and referring “all issues” in the Sullivan lawsuit to the Pennsylvania Insurance Department (the “Department”) for “its views and any determination.” The court stayed all further proceedings and reserved decision on all other grounds for dismissal raised by Indemnity. Plaintiffs sought reconsideration of the court’s order, and on January 13, 2014, the court entered a revised order affirming its prior order and clarifying that the Department “shall decide any and all issues within its jurisdiction.” On January 30, 2014, Plaintiffs asked the court to certify its order to permit an immediate appeal to the Superior Court and to stay any proceedings in the Department pending completion of any appeal. On February 18, 2014, the court issued an order denying Plaintiffs’ motion. On March 20, 2014, Plaintiffs filed a petition for review with the Superior Court of Pennsylvania. Indemnity filed an answer to the petition on April 3, 2014. The Superior Court has not yet rendered a decision on Plaintiffs’ petition. The case is proceeding in the Department.

The Sullivan lawsuit is in its early stages. Indemnity believes that it has meritorious legal and factual defenses and intends to vigorously defend against all allegations and requests for relief in the lawsuit.

Federal Court Lawsuit Against Directors

On February 6, 2013, a lawsuit was filed in the United States District Court for the Western District of Pennsylvania, captioned Erie Insurance Exchange, an unincorporated association, by members Patricia R. Beltz, Joseph S. Sullivan and Anita Sullivan, and Patricia R. Beltz, on behalf of herself and others similarly situate v. Richard L. Stover; J. Ralph Borneman, Jr; Terrence W. Cavanaugh; Jonathan Hirt Hagen; Susan Hirt Hagen; Thomas B. Hagen; C. Scott Hartz; Claude C. Lilly, III; Lucian L. Morrison; Thomas W. Palmer; Martin P. Sheffield; Elizabeth H. Vorsheck; and Robert C. Wilburn (the “Beltz” lawsuit), by alleged policyholders of the Exchange who are also the plaintiffs in the Sullivan lawsuit. The individuals named as defendants in the Beltz lawsuit were the then-current Directors of Indemnity.

As subsequently amended, the Beltz lawsuit asserts many of the same allegations and claims for monetary relief as in the Sullivan lawsuit. Plaintiffs purport to sue on behalf of all policyholders of the Exchange, or, alternatively, on behalf of the Exchange itself. Indemnity filed a motion to intervene as a Party Defendant in the Beltz lawsuit in July 2013, and the Directors filed a motion to dismiss the lawsuit in August 2013. On February 10, 2014, the court entered an order granting Indemnity's motion to intervene and permitting Indemnity to join the Directors' motion to dismiss; granting in part the Directors' motion to dismiss; referring the matter to the Department to decide any and all issues within its jurisdiction; denying all other relief sought in the Directors' motion as moot; and dismissing the case without prejudice. To avoid duplicative proceedings and expedite the Department's review, the Parties have stipulated that only the Sullivan action will proceed before the Department and any final and non-appealable determinations made by the Department in the Sullivan action will be applied to the Beltz action. On March 7, 2014, Plaintiffs filed a notice of appeal to the United States Court of Appeals for the Third Circuit. Indemnity filed a motion to dismiss the appeal on April 3, 2014. The Court of Appeals for the Third Circuit has not yet rendered a decision on either Plaintiffs' appeal or Indemnity's motion to dismiss the appeal.

Table of Contents

Indemnity believes that it has meritorious legal and factual defenses and intends to vigorously defend against all allegations and requests for relief in the Beltz lawsuit. The Directors have also advised Indemnity that they intend to vigorously defend against the claims in the Beltz lawsuit and have sought indemnification and advancement of expenses from the Company in connection with the Beltz lawsuit.

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, 2013 as filed with the Securities and Exchange Commission on February 27, 2014.

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, 2014:

(dollars in millions, except per share data)	Period	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, 2014	37,075	\$71.47	34,275	\$35
	February 1 – 28, 2014	34,160	69.64	34,160	32
	March 1 – 31, 2013	89,464	69.48	89,464	26
	Total	160,699		157,899	

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.

Additionally, in January 2014, we repurchased 2,800 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$201,411, or \$71.93 per share, for the vesting of stock-based awards for executive management. These shares were delivered to executive management in January 2014.

Table of Contents

ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibit
10.1	First Amendment to Erie Indemnity Company Equity Compensation Plan effective January 1, 2014, dated March 10, 2014.
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.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

64

Table of Contents

SIGNATURES

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

Erie Indemnity Company
(Registrant)

Date: May 1, 2014

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

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