

ERIE INDEMNITY CO  
Form 10-Q  
November 03, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2011**

Commission file number 0-24000

**ERIE INDEMNITY COMPANY**

(Exact name of registrant as specified in its charter)

PENNSYLVANIA

(State or other jurisdiction of  
incorporation or organization)

25-0466020

(I.R.S. Employer  
Identification No.)

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

16530  
(Zip Code)

(814) 870-2000

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

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

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

(Do not check if a smaller

reporting company)

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

Yes  No

The number of shares outstanding of the registrant's Class A Common Stock as of the latest practicable date, with no par value and a stated value of \$0.0292 per share, was 48,046,314 at October 20, 2011.

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 2,546 at October 20, 2011.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Consolidated Statements of Operations Three and Nine months ended September 30, 2011 and 2010

Consolidated Statements of Financial Position September 30, 2011 and December 31, 2010

Consolidated Statements of Comprehensive Income Three and Nine months ended September 30, 2011 and 2010

Consolidated Statements of Cash Flows Nine months ended September 30, 2011 and 2010

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

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

|  | Three months ended<br>September 30, |                | Nine months ended<br>September 30, |                |
|--|-------------------------------------|----------------|------------------------------------|----------------|
|  | 2011                                | 2010           | 2011                               | 2010           |
| <b>Revenues</b>  |                                     |                |                                    |                |
| Premiums earned  | \$ 1,061                            | \$ 1,005       | \$ 3,138                           | \$ 2,972       |
| Net investment income  | 108                                 | 110            | 326                                | 322            |
| Net realized investment (losses) gains   | (422)                               | 205            | (234)                              | 117            |
| Net impairment losses recognized in earnings   | 0                                   | 0              | 0                                  | (6)            |
| Equity in earnings of limited partnerships   | 40                                  | 28             | 150                                | 58             |
| Other income   | 9                                   | 9              | 26                                 | 26             |
| Total revenues   | 796                                 | 1,357          | 3,406                              | 3,489          |
| <b>Benefits and expenses</b>   |                                     |                |                                    |                |
| Insurance losses and loss expenses   | 848                                 | 710            | 2,724                              | 2,208          |
| Policy acquisition and underwriting expenses   | 253                                 | 242            | 749                                | 699            |
| Total benefits and expenses  | 1,101                               | 952            | 3,473                              | 2,907          |
| <b>(Loss) income from operations before income taxes and noncontrolling interest</b>                     |                                     |                |                                    |                |
| Provision for income taxes   | (125)                               | 130            | (54)                               | 176            |
| <b>Net (loss) income</b>   | <b>(180)</b>                        | <b>275</b>     | <b>(13)</b>                        | <b>406</b>     |
| <b>Less: Net (loss) income attributable to noncontrolling interest in consolidated entity - Exchange</b> |                                     |                |                                    |                |
|  | (227)                               | 221            | (156)                              | 256            |
| <b>Net income attributable to Indemnity</b>  | <b>\$ 47</b>                        | <b>\$ 54</b>   | <b>\$ 143</b>                      | <b>\$ 150</b>  |
| <b>Earnings Per Share</b>  |                                     |                |                                    |                |
| <b>Net income attributable to Indemnity per share</b>  |                                     |                |                                    |                |
| Class A common stock basic   | \$ 0.97                             | \$ 1.05        | \$ 2.90                            | \$ 2.92        |
| <b>Class A common stock diluted</b>  | <b>\$ 0.87</b>                      | <b>\$ 0.94</b> | <b>\$ 2.59</b>                     | <b>\$ 2.62</b> |
| Class B common stock basic and diluted   | \$146.67                            | \$150.87       | \$439.39                           | \$421.91       |
| <b>Weighted average shares outstanding attributable to Indemnity Basic</b>                               |                                     |                |                                    |                |
| Class A common stock   | 48,503,383                          | 50,499,551     | 49,176,124                         | 50,897,035     |
| Class B common stock   | 2,546                               | 2,546          | 2,546                              | 2,546          |
| <b>Weighted average shares outstanding attributable to Indemnity Diluted</b>                             |                                     |                |                                    |                |
| Class A common stock   | 54,685,021                          | 56,678,321     | 55,357,762                         | 57,075,805     |
| Class B common stock   | 2,546                               | 2,546          | 2,546                              | 2,546          |

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**Dividends declared per share**

|                      |          |          |           |          |
|----------------------|----------|----------|-----------|----------|
| Class A common stock | \$ 0.515 | \$ 0.48  | \$ 1.545  | \$ 1.44  |
| Class B common stock | \$ 77.25 | \$ 72.00 | \$ 231.75 | \$216.00 |

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

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ERIE INDEMNITY COMPANY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(dollars in millions, except per share data)

|   | September 30,<br>2011<br>(Unaudited) | December 31,<br>2010 |
|---|--------------------------------------|----------------------|
| <b>Assets</b>   |                                      |                      |
| <b>Investments Indemnity</b>  |                                      |                      |
| Available-for-sale securities, at fair value:   |                                      |                      |
| Fixed maturities (amortized cost of \$507 and \$257, respectively)  | \$ 517                               | \$ 264               |
| Equity securities (cost of \$21 and \$20, respectively)   | 22                                   | 24                   |
| Trading securities, at fair value (cost of \$24 and \$21, respectively)   | 26                                   | 28                   |
| Limited partnerships (cost of \$198 and \$202, respectively)  | 223                                  | 216                  |
| Other invested assets   | 1                                    | 1                    |
| <b>Investments Exchange</b>   |                                      |                      |
| Available-for-sale securities, at fair value:   |                                      |                      |
| Fixed maturities (amortized cost of \$6,877 and \$6,863, respectively)  | 7,331                                | 7,279                |
| Equity securities (cost of \$559 and \$503, respectively)   | 591                                  | 570                  |
| Trading securities, at fair value (cost of \$1,938 and \$1,773, respectively)   | 2,085                                | 2,306                |
| Limited partnerships (cost of \$1,055 and \$1,083, respectively)  | 1,187                                | 1,108                |
| Other invested assets   | 19                                   | 19                   |
| <b>Total investments</b>  | <b>12,002</b>                        | <b>11,815</b>        |
| Cash and cash equivalents (Exchange portion of \$42 and \$120, respectively)  | 76                                   | 430                  |
| Premiums receivable from policyholders - Exchange   | 1,035                                | 942                  |
| Reinsurance recoverable - Exchange  | 197                                  | 201                  |
| Deferred acquisition costs - Exchange   | 495                                  | 467                  |
| Other assets (Exchange portion of \$349 and \$357, respectively)  | 458                                  | 489                  |
| <b>Total assets</b>   | <b>\$14,263</b>                      | <b>\$14,344</b>      |
| <b>Liabilities and shareholders equity</b>  |                                      |                      |
| <b>Liabilities</b>  |                                      |                      |
| <b>Indemnity liabilities</b>  |                                      |                      |
| Deferred income taxes   | \$ 6                                 | \$ 26                |
| Other liabilities   | 381                                  | 382                  |
| <b>Exchange liabilities</b>   |                                      |                      |
| Losses and loss expense reserves  | 3,686                                | 3,584                |
| Life policy and deposit contract reserves   | 1,659                                | 1,603                |
| Unearned premiums   | 2,249                                | 2,082                |
| Deferred income taxes   | 97                                   | 257                  |
| Other liabilities   | 87                                   | 76                   |
| <b>Total liabilities</b>  | <b>8,165</b>                         | <b>8,010</b>         |
| <b>Indemnity s shareholders equity</b>  |                                      |                      |
| Class A common stock, stated value \$0.0292 per share; authorized 74,996,930 shares; 68,289,600 shares issued; 48,167,547 and 50,054,506 shares outstanding, respectively             |                                      |                      |
|   | 2                                    | 2                    |
| Class B common stock, convertible at a rate of 2,400 Class A shares for one Class B share, stated value \$70 per share; 2,546 shares authorized, issued and outstanding, respectively |                                      |                      |
|   | 0                                    | 0                    |
| Additional paid-in-capital  | 16                                   | 8                    |
| Accumulated other comprehensive loss  | (64)                                 | (53)                 |
| Retained earnings   | 1,894                                | 1,827                |
| Total contributed capital and retained earnings   | 1,848                                | 1,784                |
| Treasury stock, at cost, 20,122,053 and 18,235,094 shares, respectively   | (1,003)                              | (872)                |
| <b>Total Indemnity shareholders equity</b>  | <b>845</b>                           | <b>912</b>           |
| <b>Noncontrolling interest in consolidated entity Exchange</b>  | <b>5,253</b>                         | <b>5,422</b>         |
| <b>Total equity</b>   | <b>6,098</b>                         | <b>6,334</b>         |
| <b>Total liabilities, shareholders equity and noncontrolling interest</b>   | <b>\$14,263</b>                      | <b>\$14,344</b>      |

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

## ERIE INDEMNITY COMPANY

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

*(in millions)*

|  | Three months ended<br>September 30, |              | Nine months ended<br>September 30, |              |
|--|-------------------------------------|--------------|------------------------------------|--------------|
|  | 2011                                | 2010         | 2011                               | 2010         |
| <b>Accumulated other comprehensive loss</b>                                  |                                     |              |                                    |              |
| Balance, beginning of period Indemnity                                       | \$ (63)                             | \$ (32)      | \$ (53)                            | \$ (43)      |
| Gross unrealized holding (losses) gains on investments arising during period | (2)                                 | 25           | 1                                  | 44           |
| Unrealized gains transferred to noncontrolling interest (Note 1)             |                                     |              | (13)                               |              |
| Reclassification adjustment for gross gains included in net income           | 0                                   | (2)          | (5)                                | (4)          |
| Unrealized holding (losses) gains on investments                             | (2)                                 | 23           | (17)                               | 40           |
| Income tax benefit (expense) related to unrealized (losses) gains            | 1                                   | (8)          | 6                                  | (14)         |
| Change in other comprehensive loss, net of tax Indemnity                     | (1)                                 | 15           | (11)                               | 26           |
| Balance, end of period Indemnity   | \$ (64)                             | \$ (17)      | \$ (64)                            | \$ (17)      |
| Change in other comprehensive loss, net of tax Indemnity                     | \$ (1)                              | \$ 15        | \$ (11)                            | \$ 26        |
| Change in other comprehensive income, net of tax Exchange                    | (36)                                | 118          | (13)                               | 189          |
| Change in other comprehensive income, net of tax Erie Insurance Group        | \$ (37)                             | \$133        | \$ (24)                            | \$215        |
| <b>Comprehensive income</b>  |                                     |              |                                    |              |
| Net (loss) income Erie Insurance Group                                       | \$(180)                             | \$275        | \$ (13)                            | \$406        |
| Change in other comprehensive income, net of tax Erie Insurance Group        | (37)                                | 133          | (24)                               | 215          |
| Unrealized gains transferred to noncontrolling interest, net of tax (Note 1) |                                     |              | 9                                  |              |
| Total comprehensive (loss) income Erie Insurance Group                       | (217)                               | 408          | (28)                               | 621          |
| Less: Noncontrolling interest in consolidated entity Exchange                | (263)                               | 339          | (169)                              | 445          |
| <b>Total comprehensive income - Indemnity</b>                                | <b>\$ 46</b>                        | <b>\$ 69</b> | <b>\$141</b>                       | <b>\$176</b> |

See accompanying notes to Consolidated Financial Statements.



## ERIE INDEMNITY COMPANY

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

*(in millions)*

|   | Nine months ended<br>September 30, |               |
|---|------------------------------------|---------------|
|   | 2011                               | 2010          |
| <b>Cash flows from operating activities</b>                   |                                    |               |
| Premiums collected  | \$ 3,213                           | \$ 3,068      |
| Net investment income received                                | 340                                | 325           |
| Limited partnership distributions                             | 93                                 | 88            |
| Service agreement fee received                                | 25                                 | 26            |
| Commissions and bonuses paid to agents                        | (450)                              | (414)         |
| Losses paid   | (2,221)                            | (1,808)       |
| Loss expenses paid  | (331)                              | (321)         |
| Other underwriting and acquisition costs paid                 | (406)                              | (394)         |
| Income taxes paid   | (38)                               | (105)         |
| <b>Net cash provided by operating activities</b>              | <b>225</b>                         | <b>465</b>    |
| <b>Cash flows from investing activities</b>                   |                                    |               |
| Purchase of investments:                                      |                                    |               |
| Fixed maturities  | (1,482)                            | (1,415)       |
| Preferred stock   | (100)                              | (146)         |
| Common stock  | (1,198)                            | (787)         |
| Limited partnerships  | (108)                              | (105)         |
| Sales/maturities of investments:                              |                                    |               |
| Fixed maturity sales  | 525                                | 486           |
| Fixed maturity calls/maturities                               | 722                                | 794           |
| Preferred stock   | 63                                 | 117           |
| Common stock  | 1,107                              | 740           |
| Sale of and returns on limited partnerships                   | 82                                 | 40            |
| Purchase of property and equipment                            | (5)                                | (27)          |
| Net (distributions) collections on agent loans                | (1)                                | 2             |
| <b>Net cash used in investing activities</b>                  | <b>(395)</b>                       | <b>(301)</b>  |
| <b>Cash flows from financing activities</b>                   |                                    |               |
| Annuity and supplementary contract deposits and interest      | 74                                 | 87            |
| Annuity and supplementary contract surrenders and withdrawals | (60)                               | (59)          |
| Universal life deposits and interest                          | 24                                 | 30            |
| Universal life surrenders                                     | (13)                               | (26)          |
| Purchase of treasury stock                                    | (132)                              | (44)          |
| Dividends paid to shareholders                                | (77)                               | (74)          |
| <b>Net cash used in financing activities</b>                  | <b>(184)</b>                       | <b>(86)</b>   |
| Net (decrease) increase in cash and cash equivalents          | (354)                              | 78            |
| Cash and cash equivalents at beginning of period              | 430                                | 234           |
| <b>Cash and cash equivalents at end of period</b>             | <b>\$ 76</b>                       | <b>\$ 312</b> |

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



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 1. Nature of Operations**

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

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

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

Through December 31, 2010, Indemnity also operated as a property and casualty insurer through its wholly owned subsidiaries, Erie Insurance Company ( EIC ), Erie Insurance Company of New York ( ENY ) and Erie Insurance Property and Casualty Company ( EPC ). EIC, ENY and EPC, together with the Exchange and its wholly owned subsidiary, Flagship City Insurance Company ( Flagship ), 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. On December 31, 2010, Indemnity sold all of the outstanding capital stock of its wholly owned property and casualty subsidiaries to the Exchange.

Erie Family Life Insurance Company ( EFL ) is an affiliated life insurance company that underwrites and sells individual and group life insurance policies and fixed annuities. On March 31, 2011, Indemnity sold its 21.6% ownership interest in EFL to the Exchange. There was no gain or loss resulting from this sale as Indemnity is the primary decision maker for the Exchange.

All property and casualty and life insurance operations are now owned by the Exchange, and Indemnity will continue to function solely as the management company.

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

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

**Note 2. Significant Accounting Policies**

Basis of presentation

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

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods have been included. Operating results for the nine month period ended

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September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. 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, 2010 as filed with the Securities and Exchange Commission on February 24, 2011.

### Principles of consolidation

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

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

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

### Adopted accounting pronouncements

In January 2010, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU) 2010-06, *Improving Disclosures about Fair Value Measurements*. This guidance updated the disclosures in ASC 820, *Fair Value Measurements and Disclosures*. The additional disclosures include the amounts and reasons for significant transfers between the levels in the fair value hierarchy, the expansion of fair market disclosures by each class of assets, disclosure of the policy for recognition of level transfers, and disclosure of the valuation techniques used for all Level 2 and Level 3 assets. These disclosures were effective for periods beginning after December 15, 2009 and have been included in Note 6, Fair Value. An additional disclosure requirement to present purchases, sales, issuances, and settlements of Level 3 activity on a gross basis became effective with periods beginning after December 15, 2010. The additional disclosures required by this guidance have also been included in Note 6.

### Pending accounting pronouncements

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In October 2010, the FASB issued ASU 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. This guidance modifies the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal insurance contracts. The amendments in this update specify that the costs are limited to incremental direct costs that result directly from successful contract transactions and would not have been incurred by the insurance entity had the contract transactions not occurred. These costs must be directly related to underwriting, policy issuance and processing, medical and inspection and sales force contract selling. The amendments also specify that advertising costs only should be included as deferred acquisition costs if the direct-response advertising criteria are met. ASU 2010-26 is effective for interim and annual reporting periods beginning after December 15, 2011 with either prospective or retrospective adoption permitted. We plan to prospectively adopt this guidance and, after the completion of our analysis, expect the impact of this update on the Company's financial position, cash flows and results of operations to be immaterial, as this guidance has no impact on the Indemnity shareholder interest.

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In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurements*. This guidance changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements and certain other changes to converge with the fair value guidance of the International Accounting Standards Board. The amendments in this update detail the requirements specific to measuring the fair value of an instrument classified in a reporting entity's shareholders' equity. The amendments also clarify that a reporting entity should disclose quantitative information about the observable inputs used in the fair value measurement categorized within Level 3 of the fair value hierarchy. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. We do not expect the adoption of this new guidance to have a material impact on our consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income*. This guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in shareholders' equity. The amendments in this update specify an entity has the option to present the total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The disclosures required remain the same. In both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 is effective for fiscal years beginning after December 15, 2011. We do not expect the adoption of this new guidance to have a material impact on our consolidated financial statements.

### Note 3. Earnings Per Share

Basic earnings per share are calculated under the two-class method, which allocates earnings to each class of stock based on its dividend rights. Class B shares are convertible into Class A shares at a conversion ratio of 2,400 to 1. Class A diluted earnings per share are calculated under the if-converted method, which reflects the conversion of Class B shares and the effect of potentially dilutive outstanding employee stock-based awards and awards vested and not yet vested related to the outside directors' stock compensation plan. Vested shares related to the outside directors' compensation plan were included in the table below for the first time at December 31, 2010. The September 30, 2010 amounts have been updated to include these shares. This had no impact on previously reported diluted earnings per share.

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

| <i>(dollars in millions,<br/>except per share data)</i>               | Indemnity Earnings Per Share Calculation<br>Three months ended September 30, |   |                         |  |   |                         |
|---|--|---|-------------------------|--|---|-------------------------|
|   | Allocated<br>net income<br>(numerator)                                       | 2011<br>Weighted<br>shares<br>(denominator) | Per-<br>share<br>amount | Allocated<br>net income<br>(numerator) | 2010<br>Weighted<br>shares<br>(denominator) | Per-<br>share<br>amount |
| <b>Class A Basic EPS:</b>   |  |   |                         |  |   |                         |
| Income available to Class A stockholders                              | \$47   | 48,503,383                                  | \$ 0.97                 | \$54                                   | 50,499,551                                  | \$ 1.05                 |
| Dilutive effect of stock awards                                       | 0  | 71,238                                      |                         | 0                                      | 68,370                                      |                         |
| Assumed conversion of Class B shares                                  | 0  | 6,110,400                                   |                         | 0                                      | 6,110,400                                   |                         |
| <b>Class A Diluted EPS:</b>   |  |   |                         |  |   |                         |
| Income available to Class A stockholders on Class A equivalent shares | \$47   | 54,685,021                                  | \$ 0.87                 | \$54                                   | 56,678,321                                  | \$ 0.94                 |

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**Class B Basic and diluted**

**EPS:**

|  |      |       |          |      |       |          |
|--|------|-------|----------|------|-------|----------|
| Income available to Class B stockholders | \$ 0 | 2,546 | \$146.67 | \$ 0 | 2,546 | \$150.87 |
|--|------|-------|----------|------|-------|----------|



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(dollars in millions, except per share data)

|   | Indemnity Earnings Per Share Calculation<br>Nine months ended September 30, |                                    |                  |                                  |                                    |                  |
|---|---|------------------------------------|------------------|----------------------------------|------------------------------------|------------------|
|   | Allocated net income (numerator)  | 2011 Weighted shares (denominator) | Per-share amount | Allocated net income (numerator) | 2010 Weighted shares (denominator) | Per-share amount |
| <b>Class A Basic EPS:</b>   |   |                                    |                  |                                  |                                    |                  |
| Income available to Class A stockholders                              | \$142   | 49,176,124                         | \$ 2.90          | \$149                            | 50,897,035                         | \$ 2.92          |
| Dilutive effect of stock awards                                       | 0   | 71,238                             |                  | 0                                | 68,370                             |                  |
| Assumed conversion of Class B shares                                  | 1   | 6,110,400                          |                  | 1                                | 6,110,400                          |                  |
| <b>Class A Diluted EPS:</b>   |   |                                    |                  |                                  |                                    |                  |
| Income available to Class A stockholders on Class A equivalent shares | \$143   | 55,357,762                         | \$ 2.59          | \$150                            | 57,075,805                         | \$ 2.62          |
| <b>Class B Basic and diluted EPS:</b>                                 |   |                                    |                  |                                  |                                    |                  |
| Income available to Class B stockholders                              | \$ 1  | 2,546                              | \$439.39         | \$ 1                             | 2,546                              | \$421.91         |

Included in the diluted earnings per share calculations for the third quarters and first nine months of 2011 and 2010 were 5,486 and 7,959 shares, respectively, of stock-based awards not yet vested and 65,752 and 54,011 shares, respectively, of awards vested related to our outside directors stock compensation plan. Also included in both the third quarter and first nine months of 2010 were 6,400 shares of other stock-based awards not yet vested.

**Note 4. Variable Interest Entity**

Erie Insurance Exchange

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

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

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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.

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On December 31, 2010, Indemnity sold all of the outstanding capital stock of its wholly owned subsidiaries to the Exchange. On March 31, 2011, Indemnity sold its 21.6% ownership interest in EFL to the Exchange. Under this new structure, all property and casualty and life insurance operations are owned by the Exchange, and Indemnity will continue to function solely as the management company. There was no impact on the existing reinsurance pooling agreement between the Exchange and EIC or ENY as a result of the sales, nor was there any impact to the subscribers (policyholders) of the Exchange, to the Exchange's independent insurance agents, or to Indemnity's employees.

Indemnity has not provided financial or other support to the Exchange for the reporting periods presented. At September 30, 2011, there are no explicit or implicit arrangements that would require Indemnity to provide future financial support to the Exchange. Indemnity is not liable if the Exchange was to be in violation of its debt covenants or was unable to meet its obligation for unfunded commitments to limited partnerships.

### **Note 5. Segment Information**

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

Financial Statements and Supplementary Data, Note 2, Significant Accounting Policies, in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on February 24, 2011. 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.

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

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

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

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segment principally based on 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 third quarters of 2011 and 2010, investment activities on life insurance related assets generated revenues of \$29 million and \$27 million, respectively, resulting in EFL reporting income

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before income taxes of \$13 million and \$16 million, respectively, before intercompany eliminations. For the nine months ended September 30, 2011 and 2010, investment activities on life insurance related assets generated revenues of \$83 million and \$79 million, respectively, resulting in EFL reporting income before taxes of \$38 million and \$37 million, respectively, before intercompany eliminations.

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

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

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

*(in millions)*

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

Erie Insurance Group  
For the three months ended September 30, 2010

*(in millions)*

|  | Management operations | Property and casualty insurance operations | Life insurance operations | Investment operations | Eliminations | Consolidated |
|--|-----------------------|--|---------------------------|-----------------------|--------------|--------------|
| Premiums earned/life policy revenue          |                       | \$990                                      | \$ 16                     |                       | \$ (1)       | \$1,005      |
| Net investment income                        |                       |  |                           | \$113                 | (3)          | 110          |
| Net realized investment gains                |                       |  |                           | 205                   |              | 205          |
| Net impairment losses recognized in earnings |                       |  |                           | 0                     |              | 0            |
| Equity in earnings of limited partnerships   |                       |  |                           | 28                    |              | 28           |

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|   |       |      |        |       |       |        |
|---|-------|------|--------|-------|-------|--------|
| Management fee revenue                      | \$266 |      |        |       | (266) |        |
| Service agreement and other revenue         | 9     |      | 0      |       |       | 9      |
| Total revenues                              | 275   | 990  | 16     | 346   | (270) | 1,357  |
| Cost of management operations               | 217   |      |        |       | (217) |        |
| Insurance losses and loss expenses          |       | 690  | 21     |       | (1)   | 710    |
| Policy acquisition and underwriting expense |       | 288  | 6      |       | (52)  | 242    |
| Total benefits and expenses                 | 217   | 978  | 27     |       | (270) | 952    |
| Income (loss) before income taxes           | 58    | 12   | (11)   | 346   |       | 405    |
| Provision for income taxes                  | 22    | 4    | (4)    | 108   |       | 130    |
| Net income (loss)                           | \$ 36 | \$ 8 | \$ (7) | \$238 | \$    | \$ 275 |

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

(in millions)

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

Erie Insurance Group  
For the nine months ended September 30, 2010

(in millions)

|  | Management<br>operations | Property<br>and casualty<br>insurance<br>operations | Life<br>insurance<br>operations | Investment<br>operations | Eliminations | Consolidated |
|--|--------------------------|---|---------------------------------|--------------------------|--------------|--------------|
| Premiums earned/life policy revenue          |                          | \$2,926   | \$ 48                           |                          | \$ (2)       | \$2,972      |
| Net investment income                        |                          |   |                                 | \$330                    | (8)          | 322          |
| Net realized investment gains                |                          |   |                                 | 117                      |              | 117          |
| Net impairment losses recognized in earnings |                          |   |                                 | (6)                      |              | (6)          |
| Equity in earnings of limited partnerships   |                          |   |                                 | 58                       |              | 58           |
| Management fee revenue                       | \$773                    |   |                                 |                          | (773)        |              |
| Service agreement and other revenue          | 26                       |   | 0                               |                          |              | 26           |
| Total revenues                               | 799                      | 2,926   | 48                              | 499                      | (783)        | 3,489        |
| Cost of management operations                | 626                      |   |                                 |                          | (626)        |              |
| Insurance losses and loss expenses           |                          | 2,145   | 67                              |                          | (4)          | 2,208        |
| Policy acquisition and underwriting expense  |                          | 829   | 23                              |                          | (153)        | 699          |
| Total benefits and expenses                  | 626                      | 2,974   | 90                              |                          | (783)        | 2,907        |
| Income (loss) before income taxes            | 173                      | (48)  | (42)                            | 499                      |              | 582          |
| Provision for income taxes                   | 61                       | (17)  | (15)                            | 147                      |              | 176          |
| Net income (loss)                            | \$112                    | \$ (31)   | \$(27)                          | \$352                    | \$           | \$ 406       |

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





**Note 6. Fair Value**

The 2010 fair value information within this note has been conformed to this current presentation.

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

Level 1: Quoted prices for identical instruments in active markets not subject to adjustments or discounts.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3: Instruments whose significant value drivers are unobservable and reflect management's estimate of fair value based upon assumptions used by market participants in an orderly transaction as of the valuation date.

The following table represents the fair value measurements on a recurring basis for our consolidated available-for-sale and trading securities by asset class and level of input at September 30, 2011:

| Erie Insurance Group<br>September 30, 2011<br>Fair value measurements using: |        |  |  |  |
|--|--------|--|--|--|
| <i>(in millions)</i>   | Total  | Quoted prices in<br>active markets<br>for<br>identical assets<br>Level 1 | Significant<br>observable<br>inputs<br>Level 2 | Significant<br>unobservable<br>inputs<br>Level 3 |
| <b>Indemnity</b>   |        |  |  |  |
| Available-for-sale securities:   |        |  |  |  |
| States & political subdivisions  | \$ 224 | \$ 0   | \$ 224   | \$ 0   |
| Corporate debt securities  | 260    | 0  | 260  | 0  |
| Other debt securities  | 9      | 0  | 9  | 0  |
| Commercial mortgage-backed securities (CMBS)                                 | 20     | 0  | 20   | 0  |
| Collateralized debt obligations (CDO)  | 4      | 0  | 0  | 4  |
| Total fixed maturities   | 517    | 0  | 513  | 4  |
| Nonredeemable preferred stock  | 22     | 7  | 15   | 0  |
| Total available-for-sale securities  | 539    | 7  | 528  | 4  |
| Trading securities:  |        |  |  |  |

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|   |          |         |         |      |
|---|----------|---------|---------|------|
| Common stock                                  | 26       | 26      | 0       | 0    |
| Total trading securities                      | 26       | 26      | 0       | 0    |
| Total Indemnity                               | \$ 565   | \$ 33   | \$ 528  | \$ 4 |
| <b>Exchange</b>                               |          |         |         |      |
| Available-for-sale securities:                |          |         |         |      |
| U.S. government & agencies                    | \$ 37    | \$ 6    | \$ 31   | \$ 0 |
| States & political subdivisions               | 1,417    | 0       | 1,413   | 4    |
| Foreign government securities                 | 21       | 0       | 21      | 0    |
| Corporate debt securities                     | 5,446    | 15      | 5,419   | 12   |
| Other debt securities                         | 68       | 0       | 63      | 5    |
| Residential mortgage-backed securities (RMBS) | 203      | 0       | 203     | 0    |
| Commercial mortgage-backed securities (CMBS)  | 70       | 0       | 70      | 0    |
| Collateralized debt obligations (CDO)         | 69       | 0       | 40      | 29   |
| Total fixed maturities                        | 7,331    | 21      | 7,260   | 50   |
| Nonredeemable preferred stock                 | 591      | 181     | 404     | 6    |
| Total available-for-sale securities           | 7,922    | 202     | 7,664   | 56   |
| Trading securities:                           |          |         |         |      |
| Common stock                                  | 2,085    | 2,072   | 0       | 13   |
| Total trading securities                      | 2,085    | 2,072   | 0       | 13   |
| Total Exchange                                | \$10,007 | \$2,274 | \$7,664 | \$69 |
| Total Erie Insurance Group                    | \$10,572 | \$2,307 | \$8,192 | \$73 |

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Level 3 Assets Quarterly Change:

Erie Insurance Group

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

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

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

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Level 3 Assets Year-to-Date Change:

Erie Insurance Group

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

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

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

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

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The following table represents the fair value measurements on a recurring basis for our consolidated available-for-sale and trading securities by asset class and level of input at December 31, 2010:

| Erie Insurance Group<br>December 31, 2010<br>Fair value measurements using: |          |   |  |  |
|---|----------|---|--|--|
| <i>(in millions)</i>  | Total    | Quoted prices in<br>active markets for<br>identical assets<br>Level 1 | Significant<br>observable<br>inputs<br>Level 2 | Significant<br>unobservable<br>inputs<br>Level 3 |
| <b>Indemnity</b>  |          |   |  |  |
| Available-for-sale securities:  |          |   |  |  |
| U.S. government & agencies  | \$ 25    | \$ 25   | \$ 0   | \$ 0   |
| States & political subdivisions   | 197      | 0   | 197  | 0  |
| Corporate debt securities   | 38       | 0   | 38   | 0  |
| Collateralized debt obligations (CDO)                                       | 4        | 0   | 0  | 4  |
| Total fixed maturities  | 264      | 25  | 235  | 4  |
| Nonredeemable preferred stock   | 24       | 11  | 13   | 0  |
| Total available-for-sale securities   | 288      | 36  | 248  | 4  |
| Trading securities:   |          |   |  |  |
| Common stock  | 28       | 28  | 0  | 0  |
| Total trading securities  | 28       | 28  | 0  | 0  |
| Total Indemnity   | \$ 316   | \$ 64   | \$ 248   | \$ 4   |
| <b>Exchange</b>   |          |   |  |  |
| Available-for-sale securities:  |          |   |  |  |
| U.S. government & agencies  | \$ 87    | \$ 12   | \$ 75  | \$ 0   |
| States & political subdivisions   | 1,471    | 0   | 1,467  | 4  |
| Foreign government securities   | 21       | 0   | 21   | 0  |
| Corporate debt securities   | 5,263    | 12  | 5,240  | 11   |
| Other debt securities   | 57       | 0   | 47   | 10   |
| Residential mortgage-backed securities (RMBS)                               | 224      | 0   | 224  | 0  |
| Commercial mortgage-backed securities (CMBS)                                | 86       | 0   | 86   | 0  |
| Collateralized debt obligations (CDO)                                       | 70       | 0   | 40   | 30   |
| Total fixed maturities  | 7,279    | 24  | 7,200  | 55   |
| Nonredeemable preferred stock   | 570      | 166   | 397  | 7  |
| Total available-for-sale securities   | 7,849    | 190   | 7,597  | 62   |
| Trading securities:   |          |   |  |  |
| Common stock  | 2,306    | 2,294   | 0  | 12   |
| Total trading securities  | 2,306    | 2,294   | 0  | 12   |
| Total Exchange  | \$10,155 | \$2,484   | \$7,597  | \$74   |
| Total Erie Insurance Group  | \$10,471 | \$2,548   | \$7,845  | \$78   |

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Level 3 Assets Quarterly Change:

| (in millions)                             | Erie Insurance Group               |                          |  |                                  |                                       | Ending balance at September 30, 2010 |
|---|------------------------------------|--------------------------|--|----------------------------------|---------------------------------------|--------------------------------------|
|   | Beginning balance at June 30, 2010 | Included in earnings (1) | Included in other comprehensive income | Purchases, sales and adjustments | Transfers in and (out) of Level 3 (2) |                                      |
| <b>Indemnity</b>                          |                                    |                          |  |                                  |                                       |                                      |
| Available-for-sale securities:            |                                    |                          |  |                                  |                                       |                                      |
| Corporate debt securities                 | \$ 2                               | \$0                      | \$0                                    | \$ 0                             | \$ 0                                  | \$ 2                                 |
| Collateralized debt obligations (CDO)     | 8                                  | 0                        | 0                                      | 0                                | (1)                                   | 7                                    |
| Total fixed maturities                    | 10                                 | 0                        | 0                                      | 0                                | (1)                                   | 9                                    |
| Nonredeemable preferred stock             | 1                                  | 0                        | 0                                      | 1                                | 0                                     | 2                                    |
| Total available-for-sale securities       | 11                                 | 0                        | 0                                      | 1                                | (1)                                   | 11                                   |
| Trading securities:                       |                                    |                          |  |                                  |                                       |                                      |
| Common stock                              | 0                                  | 0                        | 0                                      | 0                                | 0                                     | 0                                    |
| Total trading securities                  | 0                                  | 0                        | 0                                      | 0                                | 0                                     | 0                                    |
| Total Level 3 assets Indemnity            | \$11                               | \$0                      | \$0                                    | \$ 1                             | \$ (1)                                | \$11                                 |
| <b>Exchange</b>                           |                                    |                          |  |                                  |                                       |                                      |
| Available-for-sale securities:            |                                    |                          |  |                                  |                                       |                                      |
| Corporate debt securities                 | \$ 9                               | \$0                      | \$0                                    | \$ 0                             | \$ 0                                  | \$ 9                                 |
| Other debt securities                     | 5                                  | 0                        | 0                                      | 0                                | 0                                     | 5                                    |
| Collateralized debt obligations (CDO)     | 53                                 | 0                        | 0                                      | (1)                              | (10)                                  | 42                                   |
| Total fixed maturities                    | 67                                 | 0                        | 0                                      | (1)                              | (10)                                  | 56                                   |
| Nonredeemable preferred stock             | 4                                  | 0                        | 0                                      | 1                                | 0                                     | 5                                    |
| Total available-for-sale securities       | 71                                 | 0                        | 0                                      | 0                                | (10)                                  | 61                                   |
| Trading securities:                       |                                    |                          |  |                                  |                                       |                                      |
| Common stock                              | 10                                 | 1                        | 0                                      | 0                                | 0                                     | 11                                   |
| Total trading securities                  | 10                                 | 1                        | 0                                      | 0                                | 0                                     | 11                                   |
| Total Level 3 assets Exchange             | \$81                               | \$1                      | \$0                                    | \$ 0                             | \$(10)                                | \$72                                 |
| Total Level 3 assets Erie Insurance Group | \$92                               | \$1                      | \$0                                    | \$ 1                             | \$(11)                                | \$83                                 |

(1) Includes losses as a result of other-than-temporary impairments and accrual of discount and amortization of premium. These amounts are reported in the Consolidated Statements of Operations. There was \$1 million in unrealized gains included in earnings for the nine months ended September 30, 2010 on Level 3 securities.

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

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Level 3 Assets Year-to-Date Change:

| (in millions)                             | Erie Insurance Group                   |                          |  |                                  |                                       | Ending balance at September 30, 2010 |
|---|--|--------------------------|--|----------------------------------|---------------------------------------|--------------------------------------|
|   | Beginning balance at December 31, 2009 | Included in earnings (1) | Included in other comprehensive income | Purchases, sales and adjustments | Transfers in and (out) of Level 3 (2) |                                      |
| <b>Indemnity</b>                          |  |                          |  |                                  |                                       |                                      |
| Available-for-sale securities:            |  |                          |  |                                  |                                       |                                      |
| Corporate debt securities                 | \$ 2                                   | \$0                      | \$0                                    | \$0                              | \$ 0                                  | \$ 2                                 |
| Collateralized debt obligations (CDO)     | 8                                      | 0                        | 0                                      | 0                                | (1)                                   | 7                                    |
| Total fixed maturities                    | 10                                     | 0                        | 0                                      | 0                                | (1)                                   | 9                                    |
| Nonredeemable preferred stock             | 1                                      | 0                        | 0                                      | 1                                | 0                                     | 2                                    |
| Total available-for-sale securities       | 11                                     | 0                        | 0                                      | 1                                | (1)                                   | 11                                   |
| Trading securities:                       |  |                          |  |                                  |                                       |                                      |
| Common stock                              | 0                                      | 0                        | 0                                      | 0                                | 0                                     | 0                                    |
| Total trading securities                  | 0                                      | 0                        | 0                                      | 0                                | 0                                     | 0                                    |
| Total Level 3 assets Indemnity            | \$11                                   | \$0                      | \$0                                    | \$1                              | \$(1)                                 | \$11                                 |
| <b>Exchange</b>                           |  |                          |  |                                  |                                       |                                      |
| Available-for-sale securities:            |  |                          |  |                                  |                                       |                                      |
| Corporate debt securities                 | \$17                                   | \$0                      | \$0                                    | \$0                              | \$(8)                                 | \$ 9                                 |
| Other debt securities                     | 5                                      | 0                        | 0                                      | 0                                | 0                                     | 5                                    |
| Collateralized debt obligations (CDO)     | 49                                     | 2                        | 4                                      | 0                                | (13)                                  | 42                                   |
| Total fixed maturities                    | 71                                     | 2                        | 4                                      | 0                                | (21)                                  | 56                                   |
| Nonredeemable preferred stock             | 4                                      | 0                        | 1                                      | 0                                | 0                                     | 5                                    |
| Total available-for-sale securities       | 75                                     | 2                        | 5                                      | 0                                | (21)                                  | 61                                   |
| Trading securities:                       |  |                          |  |                                  |                                       |                                      |
| Common stock                              | 9                                      | 2                        | 0                                      | 0                                | 0                                     | 11                                   |
| Total trading securities                  | 9                                      | 2                        | 0                                      | 0                                | 0                                     | 11                                   |
| Total Level 3 assets Exchange             | \$84                                   | \$4                      | \$5                                    | \$0                              | \$(21)                                | \$72                                 |
| Total Level 3 assets Erie Insurance Group | \$95                                   | \$4                      | \$5                                    | \$1                              | \$(22)                                | \$83                                 |

(1) Includes losses as a result of other-than-temporary impairments and accrual of discount and amortization of premium. These amounts are reported in the Consolidated Statements of Operations. There was \$2 million in unrealized gains included in earnings for the nine months ended September 30, 2010 on Level 3 securities.

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

There were no significant transfers between Levels 1 and 2 for the nine months ended September 30, 2010.

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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 on 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 on corroborating information and our knowledge and monitoring of market conditions. At September 30, 2011, we adjusted some prices received by the pricing service to reflect an alternate fair market value based on observable market data such as a disparity in price of comparable securities and/or non-binding broker quotes.

The following table displays the number and values of these adjustments at September 30, 2011:

| <i>(dollars in millions)</i> | Number of<br>holdings | Erie Insurance Group<br>Value of<br>securities<br>using pricing<br>service | Value of<br>securities used in<br>the financial<br>statements |
|------------------------------|-----------------------|--|---|
| Exchange                     | 7                     | \$26.8   | \$26.1  |
| Total Erie Insurance Group   | 7                     | \$26.8   | \$26.1  |

We perform continuous reviews of the prices obtained from the pricing service. This includes evaluating the methodology and inputs used by the pricing service to ensure we determine the proper level classification 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 and believe that their prices adequately consider market activity in determining fair value.

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

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



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The following table sets forth the fair value of the consolidated fixed maturity, preferred stock, and common stock securities by pricing source:

| <i>(in millions)</i>   | Erie Insurance Group<br>September 30, 2011 |         |         |         |
|--|--|---------|---------|---------|
|  | Total                                      | Level 1 | Level 2 | Level 3 |
| <b>Indemnity</b>   |  |         |         |         |
| Fixed maturity securities:   |  |         |         |         |
| Priced via pricing services  | \$ 512                                     | \$ 0    | \$ 512  | \$ 0    |
| Priced via market comparables/non-binding broker quote (1)           | 1  | 0       | 1       | 0       |
| Priced via internal modeling (2)                                     | 4  | 0       | 0       | 4       |
| Total fixed maturity securities                                      | 517  | 0       | 513     | 4       |
| Preferred stock securities:  |  |         |         |         |
| Priced via pricing services  | 20   | 7       | 13      | 0       |
| Priced via market comparables/non-binding broker quote (1)           | 2  | 0       | 2       | 0       |
| Priced via internal modeling (2)                                     | 0  | 0       | 0       | 0       |
| Total preferred stock securities                                     | 22   | 7       | 15      | 0       |
| Common stock securities:   |  |         |         |         |
| Priced via pricing services  | 26   | 26      | 0       | 0       |
| Priced via market comparables/non-binding broker quote (1)           | 0  | 0       | 0       | 0       |
| Priced via internal modeling (2)                                     | 0  | 0       | 0       | 0       |
| Total common stock securities  | 26   | 26      | 0       | 0       |
| Total available-for-sale and trading securities Indemnity            | \$ 565                                     | \$ 33   | \$ 528  | \$ 4    |
| <b>Exchange</b>  |  |         |         |         |
| Fixed maturity securities:   |  |         |         |         |
| Priced via pricing services  | \$ 7,192                                   | \$ 21   | \$7,171 | \$ 0    |
| Priced via market comparables/non-binding broker quote (1)           | 89   | 0       | 89      | 0       |
| Priced via internal modeling (2)                                     | 50   | 0       | 0       | 50      |
| Total fixed maturity securities                                      | 7,331                                      | 21      | 7,260   | 50      |
| Preferred stock securities:  |  |         |         |         |
| Priced via pricing services  | 560  | 181     | 373     | 6       |
| Priced via market comparables/non-binding broker quote (1)           | 31   | 0       | 31      | 0       |
| Priced via internal modeling (2)                                     | 0  | 0       | 0       | 0       |
| Total preferred stock securities                                     | 591  | 181     | 404     | 6       |
| Common stock securities:   |  |         |         |         |
| Priced via pricing services  | 2,072                                      | 2,072   | 0       | 0       |
| Priced via market comparables/non-binding broker quote (1)           | 0  | 0       | 0       | 0       |
| Priced via internal modeling (2)                                     | 13   | 0       | 0       | 13      |
| Total common stock securities  | 2,085                                      | 2,072   | 0       | 13      |
| Total available-for-sale and trading securities Exchange             | \$10,007                                   | \$2,274 | \$7,664 | \$69    |
| Total available-for-sale and trading securities Erie Insurance Group | \$10,572                                   | \$2,307 | \$8,192 | \$73    |

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

(2) Internal modeling using a discounted cash flow model was performed on 11 fixed maturities and 3 common equity securities representing 0.6% of the total portfolio of the Erie Insurance Group.

We have no assets that were measured at fair value on a nonrecurring basis during the nine months ended September 30, 2011.



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**Note 7. Investments**

The 2010 investment information within this note has been conformed to this current presentation.

The following tables summarize the cost and fair value of our available-for-sale securities at September 30, 2011 and December 31, 2010:

| <i>(in millions)</i>                                     | Erie Insurance Group<br>September 30, 2011 |                              |                               |                         |
|--|--|------------------------------|-------------------------------|-------------------------|
|  | Amortized<br>cost                          | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Estimated<br>fair value |
| <b>Indemnity</b>   |  |                              |                               |                         |
| Available-for-sale securities:                           |  |                              |                               |                         |
| States & political subdivisions                          | \$ 213                                     | \$ 11                        | \$ 0                          | \$ 224                  |
| Corporate debt securities                                | 261  | 1                            | 2                             | 260                     |
| Other debt securities                                    | 9  | 0                            | 0                             | 9                       |
| Commercial mortgage-backed securities (CMBS)             | 20   | 0                            | 0                             | 20                      |
| Collateralized debt obligations (CDO)                    | 4  | 0                            | 0                             | 4                       |
| Total fixed maturities                                   | 507  | 12                           | 2                             | 517                     |
| Nonredeemable preferred stock                            | 21   | 1                            | 0                             | 22                      |
| Total available-for-sale securities Indemnity            | \$ 528                                     | \$ 13                        | \$ 2                          | \$ 539                  |
| <b>Exchange</b>  |  |                              |                               |                         |
| Available-for-sale securities:                           |  |                              |                               |                         |
| U.S. government & agencies                               | \$ 35                                      | \$ 2                         | \$ 0                          | \$ 37                   |
| States & political subdivisions                          | 1,336                                      | 82                           | 1                             | 1,417                   |
| Foreign government securities                            | 20   | 1                            | 0                             | 21                      |
| Corporate debt securities                                | 5,094                                      | 385                          | 33                            | 5,446                   |
| Other debt securities                                    | 66   | 2                            | 0                             | 68                      |
| Residential mortgage-backed securities (RMBS)            | 191  | 12                           | 0                             | 203                     |
| Commercial mortgage-backed securities (CMBS)             | 66   | 4                            | 0                             | 70                      |
| Collateralized debt obligations (CDO)                    | 69   | 5                            | 5                             | 69                      |
| Total fixed maturities                                   | 6,877                                      | 493                          | 39                            | 7,331                   |
| Nonredeemable preferred stock                            | 559  | 46                           | 14                            | 591                     |
| Total available-for-sale securities Exchange             | \$7,436                                    | \$539                        | \$53                          | \$7,922                 |
| Total available-for-sale securities Erie Insurance Group | \$7,964                                    | \$552                        | \$55                          | \$8,461                 |

| <i>(in millions)</i>                          | Erie Insurance Group<br>December 31, 2010 |                              |                               |                         |
|---|---|------------------------------|-------------------------------|-------------------------|
|   | Amortized<br>cost                         | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Estimated<br>fair value |
| <b>Indemnity</b>                              |   |                              |                               |                         |
| Available-for-sale securities:                |   |                              |                               |                         |
| U.S. government & agencies                    | \$ 25                                     | \$ 0                         | \$ 0                          | \$ 25                   |
| States & political subdivisions               | 193                                       | 6                            | 2                             | 197                     |
| Corporate debt securities                     | 36  | 2                            | 0                             | 38                      |
| Collateralized debt obligations (CDO)         | 3   | 1                            | 0                             | 4                       |
| Total fixed maturities                        | 257                                       | 9                            | 2                             | 264                     |
| Nonredeemable preferred stock                 | 20  | 4                            | 0                             | 24                      |
| Total available-for-sale securities Indemnity | \$ 277                                    | \$ 13                        | \$ 2                          | \$ 288                  |
| <b>Exchange</b>                               |   |                              |                               |                         |
| Available-for-sale securities:                |   |                              |                               |                         |
| U.S. government & agencies                    | \$ 85                                     | \$ 2                         | \$ 0                          | \$ 87                   |
| States & political subdivisions               | 1,437                                     | 43                           | 9                             | 1,471                   |
| Foreign government securities                 | 20  | 1                            | 0                             | 21                      |

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|   |                      |         |       |      |         |
|---|----------------------|---------|-------|------|---------|
| Corporate debt securities                     |                      | 4,900   | 377   | 14   | 5,263   |
| Other debt securities                         |                      | 54      | 3     | 0    | 57      |
| Residential mortgage-backed securities (RMBS) |                      | 216     | 9     | 1    | 224     |
| Commercial mortgage-backed securities (CMBS)  |                      | 82      | 5     | 1    | 86      |
| Collateralized debt obligations (CDO)         |                      | 69      | 6     | 5    | 70      |
| Total fixed maturities                        |                      | 6,863   | 446   | 30   | 7,279   |
| Nonredeemable preferred stock                 |                      | 503     | 74    | 7    | 570     |
| Total available-for-sale securities           | Exchange             | \$7,366 | \$520 | \$37 | \$7,849 |
| Total available-for-sale securities           | Erie Insurance Group | \$7,643 | \$533 | \$39 | \$8,137 |

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The amortized cost and estimated fair value of fixed maturities at September 30, 2011 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 |                      |
|---|----------------------|----------------------|
|   | Amortized cost       | Estimated fair value |
| <b>Indemnity</b>                            |                      |                      |
| Due in one year or less                     | \$ 152               | \$ 152               |
| Due after one year through five years       | 219                  | 222                  |
| Due after five years through ten years      | 48                   | 51                   |
| Due after ten years                         | 88                   | 92                   |
| Total fixed maturities Indemnity            | \$ 507               | \$ 517               |
| <b>Exchange</b>                             |                      |                      |
| Due in one year or less                     | 449                  | 457                  |
| Due after one year through five years       | 2,451                | 2,576                |
| Due after five years through ten years      | 2,722                | 2,949                |
| Due after ten years                         | 1,255                | 1,349                |
| Total fixed maturities Exchange             | \$6,877              | \$7,331              |
| Total fixed maturities Erie Insurance Group | \$7,384              | \$7,848              |

Fixed maturities and equity securities in a gross unrealized loss position at September 30, 2011 are as follows. Data is provided by length of time securities were in a gross unrealized loss position.

|   |       |      |      |      |        |      |     |
|---|-------|------|------|------|--------|------|-----|
| <b>Available-for-sale securities:</b>         |       |      |      |      |        |      |     |
| States & political subdivisions               | \$ 0  | \$ 0 | \$ 2 | \$ 0 | \$ 2   | \$ 0 | 1   |
| Corporate debt securities                     | 195   | 2    | 0    | 0    | 195    | 2    | 34  |
| Other debt securities                         | 9     | 0    | 0    | 0    | 9      | 0    | 2   |
| Commercial mortgage-backed securities (CMBS)  | 20    | 0    | 0    | 0    | 20     | 0    | 4   |
| Total fixed maturities Indemnity              | 224   | 2    | 2    | 0    | 226    | 2    | 41  |
| Nonredeemable preferred stock                 | 6     | 0    | 3    | 0    | 9      | 0    | 4   |
| Total available-for-sale securities Indemnity | \$230 | \$ 2 | \$ 5 | \$ 0 | \$ 235 | \$ 2 | 45  |
| <b>Quality breakdown of fixed maturities:</b> |       |      |      |      |        |      |     |
| Investment grade                              | \$224 | \$ 2 | \$ 2 | \$ 0 | \$ 226 | \$ 2 | 41  |
| Non-investment grade                          | 0     | 0    | 0    | 0    | 0      | 0    | 0   |
| Total fixed maturities Indemnity              | \$224 | \$ 2 | \$ 2 | \$ 0 | \$ 226 | \$ 2 | 41  |
| <b>Exchange</b>                               |       |      |      |      |        |      |     |
| <b>Available-for-sale securities:</b>         |       |      |      |      |        |      |     |
| U.S. government & agencies                    | \$ 5  | \$ 0 | \$ 0 | \$ 0 | \$ 5   | \$ 0 | 1   |
| States & political subdivisions               | 9     | 0    | 11   | 1    | 20     | 1    | 5   |
| Corporate debt securities                     | 752   | 30   | 54   | 3    | 806    | 33   | 130 |
| Other debt securities                         | 5     | 0    | 0    | 0    | 5      | 0    | 1   |
|   | 9     | 0    | 0    | 0    | 9      | 0    | 4   |

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|  |       |      |       |      |         |      |     |
|--|-------|------|-------|------|---------|------|-----|
| <b>Residential mortgage-backed securities (RMBS)</b> |       |      |       |      |         |      |     |
| Commercial mortgage-backed securities (CMBS)         | 5     | 0    | 0     | 0    | 5       | 0    | 2   |
| Collateralized debt obligations (CDO)                | 0     | 0    | 32    | 5    | 32      | 5    | 6   |
| Total fixed maturities Exchange                      | 785   | 30   | 97    | 9    | 882     | 39   | 149 |
| Nonredeemable preferred stock                        | 156   | 12   | 34    | 2    | 190     | 14   | 26  |
| Total available-for-sale securities Exchange         | \$941 | \$42 | \$131 | \$11 | \$1,072 | \$53 | 175 |

**Quality breakdown of fixed maturities:**

|                                 |       |      |       |      |        |      |     |
|---------------------------------|-------|------|-------|------|--------|------|-----|
| Investment grade                | \$702 | \$26 | \$ 90 | \$ 8 | \$ 792 | \$34 | 127 |
| Non-investment grade            | 83    | 4    | 7     | 1    | 90     | 5    | 22  |
| Total fixed maturities Exchange | \$785 | \$30 | \$ 97 | \$ 9 | \$ 882 | \$39 | 149 |

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Fixed maturities and equity securities in a gross unrealized loss position at December 31, 2010 are as follows. Data is provided by length of time securities were in a gross unrealized loss position.

|   |       |      |       |      |         |      |     |
|---|-------|------|-------|------|---------|------|-----|
| <b>Available-for-sale securities:</b>         |       |      |       |      |         |      |     |
| U.S. government & agencies                    | \$ 25 | \$ 0 | \$ 0  | \$ 0 | \$ 25   | \$ 0 | 1   |
| States & political subdivisions               | 39    | 2    | 1     | 0    | 40      | 2    | 20  |
| Corporate debt securities                     | 31    | 0    | 0     | 0    | 31      | 0    | 3   |
| Total fixed maturities Indemnity              | 95    | 2    | 1     | 0    | 96      | 2    | 24  |
| Nonredeemable preferred stock                 | 3     | 0    | 0     | 0    | 3       | 0    | 1   |
| Total available-for-sale securities           |       |      |       |      |         |      |     |
| Indemnity                                     | \$ 98 | \$ 2 | \$ 1  | \$ 0 | \$ 99   | \$ 2 | 25  |
| <b>Quality breakdown of fixed maturities:</b> |       |      |       |      |         |      |     |
| Investment grade                              | \$ 95 | \$ 2 | \$ 1  | \$ 0 | \$ 96   | \$ 2 | 24  |
| Non-investment grade                          | 0     | 0    | 0     | 0    | 0       | 0    | 0   |
| Total fixed maturities Indemnity              | \$ 95 | \$ 2 | \$ 1  | \$ 0 | \$ 96   | \$ 2 | 24  |
| <b>Exchange</b>                               |       |      |       |      |         |      |     |
| <b>Available-for-sale securities:</b>         |       |      |       |      |         |      |     |
| U.S. government & agencies                    | \$ 22 | \$ 0 | \$ 0  | \$ 0 | \$ 22   | \$ 0 | 3   |
| States & political subdivisions               | 299   | 8    | 5     | 1    | 304     | 9    | 59  |
| Foreign government securities                 | 10    | 0    | 0     | 0    | 10      | 0    | 1   |
| Corporate debt securities                     | 398   | 8    | 144   | 6    | 542     | 14   | 101 |
| Residential mortgage-backed securities (RMBS) | 6     | 0    | 7     | 1    | 13      | 1    | 4   |
| Commercial mortgage-backed securities (CMBS)  | 0     | 0    | 12    | 1    | 12      | 1    | 2   |
| Collateralized debt obligations (CDO)         | 1     | 0    | 33    | 5    | 34      | 5    | 6   |
| Total fixed maturities Exchange               | 736   | 16   | 201   | 14   | 937     | 30   | 176 |
| Nonredeemable preferred stock                 | 45    | 2    | 59    | 5    | 104     | 7    | 15  |
| Total available-for-sale securities           |       |      |       |      |         |      |     |
| Exchange                                      | \$781 | \$18 | \$260 | \$19 | \$1,041 | \$37 | 191 |
| <b>Quality breakdown of fixed maturities:</b> |       |      |       |      |         |      |     |
| Investment grade                              | \$703 | \$16 | \$155 | \$11 | \$ 858  | \$27 | 154 |
| Non-investment grade                          | 33    | 0    | 46    | 3    | 79      | 3    | 22  |
| Total fixed maturities Exchange               | \$736 | \$16 | \$201 | \$14 | \$ 937  | \$30 | 176 |

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 are a general review of market conditions and financial performance of the issuer along with the extent and duration of which fair value is less than cost. Any debt securities that we intend to sell or will more likely than not be required to sell before recovery are included in other-than-temporary impairments with the impairment charges recognized in earnings.

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Investment income, net of expenses, was generated from the following portfolios:

| <i>(in millions)</i>               | Erie Insurance Group                |       |                                    |        |
|------------------------------------|-------------------------------------|-------|------------------------------------|--------|
|                                    | Three months ended<br>September 30, |       | Nine months ended<br>September 30, |        |
|                                    | 2011                                | 2010  | 2011                               | 2010   |
| <b>Indemnity</b>                   |                                     |       |                                    |        |
| Fixed maturities                   | \$ 3                                | \$ 8  | \$ 10                              | \$ 25  |
| Equity securities                  | 1                                   | 1     | 2                                  | 3      |
| Cash equivalents and other         | 0                                   | 1     | 1                                  | 1      |
| Total investment income            | 4                                   | 10    | 13                                 | 29     |
| Less: investment expenses          | 0                                   | 0     | 1                                  | 1      |
| Investment income, net of expenses | \$ 4                                | \$ 10 | \$ 12                              | \$ 28  |
| <b>Exchange</b>                    |                                     |       |                                    |        |
| Fixed maturities                   | \$ 91                               | \$ 88 | \$ 275                             | \$ 261 |
| Equity securities                  | 21                                  | 18    | 63                                 | 52     |
| Cash equivalents and other         | 0                                   | 1     | 0                                  | 1      |
| Total investment income            | 112                                 | 107   | 338                                | 314    |
| Less: investment expenses          | 8                                   | 7     | 24                                 | 20     |
| Investment income, net of expenses | \$104                               | \$100 | \$314                              | \$294  |
| Investment income, net of expenses | \$108                               | \$110 | \$326                              | \$322  |

Dividend income is recognized as earned and recorded to net investment income.



Realized gains (losses) on investments were as follows:

|  |                      |         |       |         |       |
|--|----------------------|---------|-------|---------|-------|
| <b>Available-for-sale securities:</b>  |                      |         |       |         |       |
| <b>Fixed maturities:</b>               |                      |         |       |         |       |
| Gross realized gains                   | \$ 0                 | \$ 2    | \$ 2  | \$ 5    |       |
| Gross realized losses                  | 0                    | (1)     | 0     | (1)     |       |
| Net realized gains                     | 0                    | 1       | 2     | 4       |       |
| <b>Equity securities:</b>              |                      |         |       |         |       |
| Gross realized gains                   | 0                    | 0       | 3     | 1       |       |
| Gross realized losses                  | 0                    | 1       | 0     | 0       |       |
| Net realized gains                     | 0                    | 1       | 3     | 1       |       |
| <b>Trading securities:</b>             |                      |         |       |         |       |
| <b>Common stock:</b>                   |                      |         |       |         |       |
| Gross realized gains                   | 0                    | 4       | 2     | 5       |       |
| Gross realized losses                  | 0                    | (1)     | 0     | (1)     |       |
| Valuation adjustments                  | (6)                  | 0       | (6)   | (2)     |       |
| Net realized gains (losses)            | (6)                  | 3       | (4)   | 2       |       |
| Net realized investment gains (losses) | Indemnity            | \$ (6)  | \$ 5  | \$ 1    | \$ 7  |
| <b>Exchange</b>                        |                      |         |       |         |       |
| <b>Available-for-sale securities:</b>  |                      |         |       |         |       |
| <b>Fixed maturities:</b>               |                      |         |       |         |       |
| Gross realized gains                   | \$ 15                | \$ 10   | \$ 66 | \$ 38   |       |
| Gross realized losses                  | (5)                  | (4)     | (22)  | (16)    |       |
| Net realized gains                     | 10                   | 6       | 44    | 22      |       |
| <b>Equity securities:</b>              |                      |         |       |         |       |
| Gross realized gains                   | 3                    | 4       | 19    | 11      |       |
| Gross realized losses                  | 0                    | (1)     | (1)   | (2)     |       |
| Net realized gains                     | 3                    | 3       | 18    | 9       |       |
| <b>Trading securities:</b>             |                      |         |       |         |       |
| <b>Common stock:</b>                   |                      |         |       |         |       |
| Gross realized gains                   | 56                   | 24      | 183   | 113     |       |
| Gross realized losses                  | (35)                 | (20)    | (59)  | (50)    |       |
| Valuation adjustments                  | (450)                | 187     | (421) | 16      |       |
| Net realized gains (losses)            | (429)                | 191     | (297) | 79      |       |
| Net realized investment gains (losses) | Exchange             | \$(416) | \$200 | \$(235) | \$110 |
| Net realized investment gains (losses) | Erie Insurance Group | \$(422) | \$205 | \$(234) | \$117 |

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The components of other-than-temporary impairments on investments are included below:

| <i>(in millions)</i>                             | Erie Insurance Group                |      |                                    |       |
|--|-------------------------------------|------|------------------------------------|-------|
|  | Three months ended<br>September 30, |      | Nine months ended<br>September 30, |       |
|  | 2011                                | 2010 | 2011                               | 2010  |
| <b>Indemnity</b>                                 |                                     |      |                                    |       |
| Fixed maturities                                 | \$0                                 | \$0  | \$0                                | \$(1) |
| Equity securities                                | 0                                   | 0    | 0                                  | 0     |
| Total  | 0                                   | 0    | 0                                  | (1)   |
| Portion recognized in other comprehensive income | 0                                   | 0    | 0                                  | 0     |
| Net impairment losses recognized in earnings     | \$0                                 | \$0  | \$0                                | \$(1) |
|  | Indemnity                           |      |                                    |       |
| <b>Exchange</b>                                  |                                     |      |                                    |       |
| Fixed maturities                                 | \$0                                 | \$0  | \$0                                | \$(4) |
| Equity securities                                | 0                                   | 0    | 0                                  | (1)   |
| Total  | 0                                   | 0    | 0                                  | (5)   |
| Portion recognized in other comprehensive income | 0                                   | 0    | 0                                  | 0     |
| Net impairment losses recognized in earnings     | \$0                                 | \$0  | \$0                                | \$(5) |
|  | Exchange                            |      |                                    |       |
| Net impairment losses recognized in earnings     | \$0                                 | \$0  | \$0                                | \$(6) |
|  | Erie Insurance Group                |      |                                    |       |

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

Limited partnerships

Our limited partnership investments are recorded using the equity method of accounting. As these investments are generally reported on a one-quarter lag, our limited partnership results for the nine months ended September 30, 2011 are comprised of partnership financial results for the fourth quarter of 2010 and the first six months of 2011. Given the lag in reporting, our limited partnership results do not reflect the market conditions of the third quarter of 2011. Cash contributions made to and distributions received from the partnerships are recorded in the period in which the transaction occurs.

We have provided summarized financial information in the following table for the nine months ended September 30, 2011 and for the year ended December 31, 2010. Amounts provided in the table are presented using the latest available financial statements received from the partnerships. Limited partnership financial information has been presented based on the investment percentage in the partnerships for the Erie Insurance Group consistent with how management evaluates the investments.

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Erie Insurance Group  
As of and for the nine months ended September 30, 2011

(dollars in millions)

| Investment percentage in limited partnerships   | Number of partnerships | Asset recorded | Income (loss) recognized due to valuation adjustments by the partnerships | Income (loss) recorded |
|---|------------------------|----------------|---|------------------------|
| <b>Indemnity</b>                                |                        |                |   |                        |
| Private equity:                                 |                        |                |   |                        |
| Less than 10%                                   | 26                     | \$ 80          | \$ 7  | \$ 4                   |
| Greater than or equal to 10% but less than 50%  | 3                      | 9              | (1)   | 3                      |
| Greater than 50%                                | 0                      | 0              | 0   | 0                      |
| Total private equity                            | 29                     | 89             | 6   | 7                      |
| Mezzanine debt:                                 |                        |                |   |                        |
| Less than 10%                                   | 11                     | 26             | (1)   | 5                      |
| Greater than or equal to 10% but less than 50%  | 3                      | 15             | 1   | 1                      |
| Greater than 50%                                | 1                      | 1              | (1)   | 0                      |
| Total mezzanine debt                            | 15                     | 42             | (1)   | 6                      |
| Real estate:                                    |                        |                |   |                        |
| Less than 10%                                   | 12                     | 62             | 5   | 0                      |
| Greater than or equal to 10% but less than 50%  | 3                      | 19             | 1   | 0                      |
| Greater than 50%                                | 4                      | 11             | 2   | (1)                    |
| Total real estate                               | 19                     | 92             | 8   | (1)                    |
| Total limited partnerships Indemnity            | 63                     | \$ 223         | \$13  | \$12                   |
| <b>Exchange</b>                                 |                        |                |   |                        |
| Private equity:                                 |                        |                |   |                        |
| Less than 10%                                   | 42                     | \$ 544         | \$35  | \$28                   |
| Greater than or equal to 10% but less than 50%  | 3                      | 40             | (5)   | 11                     |
| Greater than 50%                                | 0                      | 0              | 0   | 0                      |
| Total private equity                            | 45                     | 584            | 30  | 39                     |
| Mezzanine debt:                                 |                        |                |   |                        |
| Less than 10%                                   | 16                     | 141            | (6)   | 18                     |
| Greater than or equal to 10% but less than 50%  | 3                      | 30             | 1   | 0                      |
| Greater than 50%                                | 3                      | 44             | 0   | 8                      |
| Total mezzanine debt                            | 22                     | 215            | (5)   | 26                     |
| Real estate:                                    |                        |                |   |                        |
| Less than 10%                                   | 25                     | 285            | 27  | 1                      |
| Greater than or equal to 10% but less than 50%  | 5                      | 61             | 2   | 0                      |
| Greater than 50%                                | 4                      | 42             | 1   | 4                      |
| Total real estate                               | 34                     | 388            | 30  | 5                      |
| Total limited partnerships Exchange             | 101                    | \$1,187        | \$55  | \$70                   |
| Total limited partnerships Erie Insurance Group |                        | \$1,410        | \$68  | \$82                   |

Per the limited partnership financial statements, total partnership assets were \$55 billion and total partnership liabilities were \$5 billion at September 30, 2011 (as recorded in the June 30, 2011 limited partnership financial statements). For the nine month period comparable to that presented in the preceding table (fourth quarter 2010 and first two quarters of 2011), total partnership valuation adjustment gains were \$4 billion and total partnership net income was \$3 billion.

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As these investments are generally reported on a one-quarter lag, our limited partnership results through December 31, 2010 include the partnership results for the fourth quarter of 2009 and the first three quarters of 2010.

Erie Insurance Group  
As of and for the year ended December 31, 2010

(dollars in millions)

| Investment percentage in limited partnerships   | Number of partnerships | Asset recorded | Income (loss) recognized due to valuation adjustments by the partnerships | Income (loss) recorded |
|---|------------------------|----------------|---|------------------------|
| <b>Indemnity</b>                                |                        |                |   |                        |
| Private equity:                                 |                        |                |   |                        |
| Less than 10%                                   | 26                     | \$ 78          | \$ 4  | \$ 7                   |
| Greater than or equal to 10% but less than 50%  | 3                      | 8              | 3   | 0                      |
| Greater than 50%                                | 0                      | 0              | 0   | 0                      |
| Total private equity                            | 29                     | 86             | 7   | 7                      |
| Mezzanine debt:                                 |                        |                |   |                        |
| Less than 10%                                   | 11                     | 30             | 4   | 3                      |
| Greater than or equal to 10% but less than 50%  | 3                      | 15             | 2   | (2)                    |
| Greater than 50%                                | 1                      | 2              | 0   | 0                      |
| Total mezzanine debt                            | 15                     | 47             | 6   | 1                      |
| Real estate:                                    |                        |                |   |                        |
| Less than 10%                                   | 12                     | 59             | 30  | (31)                   |
| Greater than or equal to 10% but less than 50%  | 4                      | 14             | 10  | (10)                   |
| Greater than 50%                                | 4                      | 10             | 4   | (3)                    |
| Total real estate                               | 20                     | 83             | 44  | (44)                   |
| Total limited partnerships Indemnity            | 64                     | \$ 216         | \$ 57   | \$(36)                 |
| <b>Exchange</b>                                 |                        |                |   |                        |
| Private equity:                                 |                        |                |   |                        |
| Less than 10%                                   | 41                     | \$ 517         | \$ 28   | \$ 40                  |
| Greater than or equal to 10% but less than 50%  | 3                      | 38             | 10  | 0                      |
| Greater than 50%                                | 0                      | 0              | 0   | (1)                    |
| Total private equity                            | 44                     | 555            | 38  | 39                     |
| Mezzanine debt:                                 |                        |                |   |                        |
| Less than 10%                                   | 14                     | 142            | 12  | 13                     |
| Greater than or equal to 10% but less than 50%  | 3                      | 41             | 2   | (2)                    |
| Greater than 50%                                | 3                      | 31             | 0   | 2                      |
| Total mezzanine debt                            | 20                     | 214            | 14  | 13                     |
| Real estate:                                    |                        |                |   |                        |
| Less than 10%                                   | 25                     | 250            | (11)  | 10                     |
| Greater than or equal to 10% but less than 50%  | 6                      | 52             | 7   | (7)                    |
| Greater than 50%                                | 4                      | 37             | 15  | (11)                   |
| Total real estate                               | 35                     | 339            | 11  | (8)                    |
| Total limited partnerships Exchange             | 99                     | \$1,108        | \$ 63   | \$ 44                  |
| Total limited partnerships Erie Insurance Group |                        | \$1,324        | \$120   | \$ 8                   |

Per the limited partnership financial statements, total partnership assets were \$58 billion and total partnership liabilities were \$10 billion at December 31, 2010 (as recorded in the September 30, 2010 limited partnership financial statements). For the twelve month period comparable to that presented in the preceding table (fourth quarter of 2009 and first three quarters of 2010), total partnership valuation adjustment gains were \$4 billion and total partnership net income was \$3 billion.

See also Note 12, Commitments and Contingencies, for investment commitments related to limited partnerships.

**Note 8. Bank Line of Credit**

As of September 30, 2011, Indemnity has available a \$100 million line of credit that expires on December 31, 2011. There were no borrowings outstanding on the line of credit as of September 30, 2011. Bonds with a fair value of \$137 million were pledged as collateral on the line at September 30, 2011.

On November 3, 2011, Indemnity entered into a new five year revolving credit facility for the same amount which expires on November 3, 2016.

As of September 30, 2011, the Exchange has available a \$200 million revolving line of credit that expires on September 30, 2012. There were no borrowings outstanding on the line of credit as of September 30, 2011. Bonds with a fair value of \$262 million were pledged as collateral on the line at September 30, 2011.

On October 28, 2011, the Exchange amended its revolving credit facility increasing the amount available from \$200 million to \$300 million and extending the term five years, which expires on October 28, 2016.

Securities pledged as collateral on both lines have no restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position as of September 30, 2011. The banks require compliance with certain covenants, which include minimum net worth and leverage ratios for Indemnity's line of credit and statutory surplus and risk based capital ratios for the Exchange's line of credit. We are in compliance with all covenants at September 30, 2011.

**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 statement or tax returns. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. At September 30, 2011, we recorded a net deferred tax liability of \$103 million on our Consolidated Statements of Financial Position. Of this amount, \$97 million is attributable to the Exchange and \$6 million is attributable to Indemnity. There was no deferred tax valuation allowance recorded at September 30, 2011. Our effective tax rate is calculated after consideration of permanent differences related to our investment revenues. Given that these amounts represent 98% of the total permanent differences, the effective tax rate is approximately 35% for both Indemnity and the Exchange when the investment related permanent differences are excluded.

**Note 10. Postretirement Benefits**

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The liabilities for the plans described in this note are presented in total for all employees of the Erie Insurance Group. The gross liability for the pension plans is presented in the Consolidated Statements of Financial Position as part of other liabilities. A portion of annual expenses related to the pension plans is allocated to related entities within the Erie Insurance Group.

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

The components of net periodic benefit cost for our pension benefits are:

| <i>(in millions)</i>               | Erie Insurance Group                |      |                                    |       |
|------------------------------------|-------------------------------------|------|------------------------------------|-------|
|                                    | Three months ended<br>September 30, |      | Nine months ended<br>September 30, |       |
|                                    | 2011                                | 2010 | 2011                               | 2010  |
| Service cost                       | \$ 4                                | \$ 3 | \$ 13                              | \$ 11 |
| Interest cost                      | 6                                   | 5    | 17                                 | 15    |
| Expected return on plan assets     | (7)                                 | (6)  | (20)                               | (19)  |
| Amortization of prior service cost | 1                                   | 1    | 1                                  | 1     |
| Amortization of actuarial loss     | 1                                   | 1    | 4                                  | 3     |
| Net periodic benefit cost          | \$ 5                                | \$ 4 | \$ 15                              | \$ 11 |

**Note 11. Reconciliation of Shareholders' Equity**

A reconciliation of shareholders' equity follows for the year-to-date December 31, 2010 and September 30, 2011:

| <i>(in millions, except per share data)</i>  | Indemnity<br>shareholders<br>interest | Exchange<br>noncontrolling<br>interest | Erie<br>Insurance<br>Group |
|--|---------------------------------------|--|----------------------------|
| <b>Balance at December 31, 2009</b>  | <b>\$902</b>                          | <b>\$4,823</b>                         | <b>\$5,725</b>             |
| Comprehensive income:  |                                       |  |                            |
| Net income   | 162                                   | 498                                    | 660                        |
| Other comprehensive income, net of tax:  |                                       |  |                            |
| Unrealized gains on securities   | 9                                     | 101                                    | 110                        |
| Reclassification of unrealized gain on sale of P&C affiliated subsidiaries             | (15)                                  |  | (15)                       |
| Postretirement plans:  |                                       |  |                            |
| Amortization of prior service cost   | 0                                     |  | 0                          |
| Amortization of net actuarial loss   | 2                                     |  | 2                          |
| Net actuarial loss during year   | (6)                                   |  | (6)                        |
| Loss due to plan changes during year   | 0                                     |  | 0                          |
| Curtailment/settlement loss arising during year  | 0                                     |  | 0                          |
| Postretirement plans   | (4)                                   |  | (4)                        |
| Other comprehensive (loss) income, net of tax  | (10)                                  | 101                                    | 91                         |
| Reclassification of unrealized gain on sale of P&C affiliated subsidiaries, net of tax | 15                                    |  | 15                         |
| Comprehensive income   | 167                                   | 599                                    | 766                        |
| Purchase of treasury stock   | (58)                                  |  | (58)                       |
| Dividends declared:  |                                       |  |                            |
| Class A \$1.995 per share  | (99)                                  |  | (99)                       |
| Class B \$293.25 per share   | 0                                     |  | 0                          |
| <b>Balance at December 31, 2010</b>  | <b>\$912</b>                          | <b>\$5,422</b>                         | <b>\$6,334</b>             |
| Comprehensive income:  |                                       |  |                            |
| Net income (loss)  | 143                                   | (156)                                  | (13)                       |
| Other comprehensive income, net of tax:  |                                       |  |                            |
| Unrealized loss on securities  | (2)                                   | (13)                                   | (15)                       |
| Reclassification of unrealized gain on sale of EFL                                     | (9)                                   |  | (9)                        |
| Other comprehensive loss, net of tax   | (11)                                  | (13)                                   | (24)                       |
| Reclassification of unrealized gain on sale of EFL, net of tax                         | 9                                     |  | 9                          |
| Comprehensive income (loss)  | 141                                   | (169)                                  | (28)                       |
| Purchase of treasury stock   | (131)                                 |  | (131)                      |
| Dividends declared:  |                                       |  |                            |
| Class A \$1.545 per share  | (77)                                  |  | (77)                       |
| Class B \$231.75 per share   | 0                                     |  | 0                          |
| <b>Balance at September 30, 2011</b>   | <b>\$845</b>                          | <b>\$5,253</b>                         | <b>\$6,098</b>             |



**Note 12. Commitments and Contingencies**

Indemnity has contractual commitments to invest up to \$41 million related to its limited partnership investments at September 30, 2011. These commitments are split between private equity securities of \$18 million, mezzanine debt securities of \$11 million and real estate activities of \$12 million. These commitments will be funded as required by the partnership agreements.

The Exchange, including EFL, has contractual commitments to invest up to \$392 million related to its limited partnership investments at September 30, 2011. These commitments are split between private equity securities of \$176 million, mezzanine debt securities of \$109 million and real estate activities of \$107 million. These commitments will be funded as required by the partnership agreements.

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

For certain legal proceedings, we cannot reasonably estimate losses or a range of loss, particularly for proceedings that are in their early stages of development or where the plaintiffs seek indeterminate damages. Various factors, including, but not limited to, the outcome of potentially lengthy discovery and the resolution of important factual questions, may need to be determined before probability can be established or before a loss or range of loss can be reasonably estimated. If the loss contingency in question is not both probable and reasonably estimable, we do not establish an accrual and the matter will continue to be monitored for any developments that would make the loss contingency both probable and reasonably estimable. The outcome of this pending litigation is uncertain, but in our opinion the outcome of each case, individually and in the aggregate, is not expected to be material to our consolidated financial condition, operations or cash flows. We review all litigation on an ongoing basis when making accrual and disclosure decisions.

**Note 13. Statutory Information**

Cash and securities with a carrying value of \$14 million were deposited by the property and casualty and life entities with regulatory authorities under statutory requirements at both September 30, 2011 and December 31, 2010.

**Note 14. Indemnity Supplemental Information**

Erie Insurance Group  
**Consolidating Statement of Financial Position**  
September 30, 2011

| <i>(in millions)</i>  | Indemnity<br>shareholder<br>interest | Exchange<br>noncontrolling<br>interest | Reclassifications<br>and<br>eliminations | Erie<br>Insurance<br>Group |
|---|--------------------------------------|--|--|----------------------------|
| <b>Assets</b>   |                                      |  |  |                            |
| <b>Investments</b>  |                                      |  |  |                            |
| Available-for-sale securities, at fair value:                       |                                      |  |  |                            |
| Fixed maturities  | \$ 517                               | \$ 7,331                               | \$                                       | \$ 7,848                   |
| Equity securities   | 22                                   | 591                                    |  | 613                        |
| Trading securities, at fair value                                   | 26                                   | 2,085                                  |  | 2,111                      |
| Limited partnerships  | 223                                  | 1,187                                  |  | 1,410                      |
| Other invested assets   | 1                                    | 19                                     |  | 20                         |
| Total investments   | 789                                  | 11,213                                 |  | 12,002                     |
| Cash and cash equivalents   | 34                                   | 42                                     |  | 76                         |
| Premiums receivable from policyholders                              |                                      | 1,035                                  |  | 1,035                      |
| Reinsurance recoverable   |                                      | 197                                    |  | 197                        |
| Deferred acquisition costs  |                                      | 495                                    |  | 495                        |
| Other assets  | 109                                  | 349                                    |  | 458                        |
| Receivables from Exchange and other affiliates                      | 269                                  |  | (269)                                    |                            |
| Note receivable from EFL  | 25                                   |  | (25)                                     |                            |
| Total assets  | \$1,226                              | \$13,331                               | \$(294)                                  | \$14,263                   |
| <b>Liabilities</b>  |                                      |  |  |                            |
| Losses and loss expense reserves                                    | \$                                   | \$ 3,686                               | \$                                       | \$ 3,686                   |
| Life policy and deposit contract reserves                           |                                      | 1,659                                  |  | 1,659                      |
| Unearned premiums   |                                      | 2,249                                  |  | 2,249                      |
| Deferred income taxes   | 6                                    | 97                                     |  | 103                        |
| Other liabilities   | 375                                  | 387                                    | (294)                                    | 468                        |
| Total liabilities   | 381                                  | 8,078                                  | (294)                                    | 8,165                      |
| <b>Shareholders' equity and noncontrolling interest</b>             |                                      |  |  |                            |
| Total Indemnity shareholders' equity                                | 845                                  |  |  | 845                        |
| Noncontrolling interest in consolidated entity                      |                                      |  |  |                            |
| Exchange  |                                      | 5,253                                  |  | 5,253                      |
| Total equity  | 845                                  | 5,253                                  |  | 6,098                      |
| Total liabilities, shareholders' equity and noncontrolling interest | \$1,226                              | \$13,331                               | \$(294)                                  | \$14,263                   |

Erie Insurance Group  
**Consolidating Statement of Financial Position**  
December 31, 2010

| <i>(in millions)</i>   | Indemnity<br>shareholder<br>interest | Exchange<br>noncontrolling<br>interest | Reclassifications<br>and<br>eliminations | Erie<br>Insurance<br>Group |
|--|--------------------------------------|--|--|----------------------------|
| <b>Assets</b>  |                                      |  |  |                            |
| <b>Investments</b>   |                                      |  |  |                            |
| Available-for-sale securities, at fair value:                      |                                      |  |  |                            |
| Fixed maturities   | \$ 264                               | \$ 7,279                               | \$                                       | \$ 7,543                   |
| Equity securities  | 24                                   | 570                                    |  | 594                        |
| Trading securities, at fair value                                  | 28                                   | 2,306                                  |  | 2,334                      |
| Limited partnerships   | 216                                  | 1,108                                  |  | 1,324                      |
| Other invested assets  | 1                                    | 19                                     |  | 20                         |
| Total investments  | 533                                  | 11,282                                 |  | 11,815                     |
| Cash and cash equivalents  | 310                                  | 120                                    |  | 430                        |
| Premiums receivable from policyholders                             |                                      | 942                                    |  | 942                        |
| Reinsurance recoverable  |                                      | 201                                    |  | 201                        |
| Deferred acquisition costs   |                                      | 467                                    |  | 467                        |
| Other assets   | 132                                  | 357                                    |  | 489                        |
| Receivables from Exchange and other affiliates                     | 232                                  |  | (232)                                    |                            |
| Note receivable from EFL   | 25                                   |  | (25)                                     |                            |
| Equity in EFL (1)  | 80                                   |  | (80)                                     |                            |
| Total assets   | \$1,312                              | \$13,369                               | \$(337)                                  | \$14,344                   |
| <b>Liabilities</b>   |                                      |  |  |                            |
| Losses and loss expense reserves                                   | \$                                   | \$ 3,584                               | \$                                       | \$ 3,584                   |
| Life policy and deposit contract reserves                          |                                      | 1,603                                  |  | 1,603                      |
| Unearned premiums  |                                      | 2,082                                  |  | 2,082                      |
| Deferred income taxes  | 26                                   | 257                                    |  | 283                        |
| Other liabilities  | 374                                  | 341                                    | (257)                                    | 458                        |
| Total liabilities  | 400                                  | 7,867                                  | (257)                                    | 8,010                      |
| <b>Shareholders equity and noncontrolling interest</b>             |                                      |  |  |                            |
| Total Indemnity shareholders equity                                | 912                                  |  |  | 912                        |
| Noncontrolling interest in consolidated entity                     |                                      |  |  |                            |
| Exchange   |                                      | 5,502                                  | (80)                                     | 5,422                      |
| Total equity   | 912                                  | 5,502                                  | (80)                                     | 6,334                      |
| Total liabilities, shareholders equity and noncontrolling interest | \$1,312                              | \$13,369                               | \$(337)                                  | \$14,344                   |

(1) On March 31, 2011, Indemnity sold its 21.6% ownership interest in EFL to the Exchange. (See Note 1, Nature of Operations .)

Note receivable from EFL

Indemnity is due \$25 million from EFL in the form of a surplus note that was issued in 2003. The note may be repaid only out of unassigned surplus of EFL. Both principal and interest payments are subject to prior approval by the Pennsylvania Insurance Commissioner. The note bears an annual interest rate of 6.7% and will be payable on demand on or after December 31, 2018, with interest scheduled to be paid semi-annually, subject to prior approval by the Pennsylvania Insurance Commissioner. EFL accrued interest to Indemnity of \$0.4 million in each of the third quarters ended September 30, 2011 and 2010.



| Erie Indemnity Company<br>Income attributable to<br>Indemnity shareholder interest |           |                                     |       |                                    |       |
|--|-----------|-------------------------------------|-------|------------------------------------|-------|
| (in millions)  |           |                                     |       |                                    |       |
|  | Percent   | Three months ended<br>September 30, |       | Nine months ended<br>September 30, |       |
|  |           | 2011                                | 2010  | 2011                               | 2010  |
| <b>Management operations:</b>  |           |                                     |       |                                    |       |
| Management fee revenue, net  | 100.0%    | \$280                               | \$266 | \$816                              | \$773 |
| Service agreement revenue  | 100.0%    | 8                                   | 9     | 25                                 | 26    |
| Total revenue from management operations   |           | 288                                 | 275   | 841                                | 799   |
| Cost of management operations  | 100.0%    | 226                                 | 217   | 667                                | 626   |
| <b>Income from management operations before taxes</b>                              |           | 62                                  | 58    | 174                                | 173   |
| <b>Property and casualty insurance operations: (2)</b>                             |           |                                     |       |                                    |       |
| Net premiums earned  | 5.5% (2)  |                                     | 55    |                                    | 161   |
| Losses and loss expenses   | 5.5% (2)  |                                     | 38    |                                    | 118   |
| Policy acquisition and underwriting expenses                                       | 5.5% (2)  |                                     | 16    |                                    | 46    |
| <b>Income (loss) from property and casualty insurance operations before taxes</b>  |           |                                     | 1     |                                    | (3)   |
| <b>Life insurance operations: (1)</b>  |           |                                     |       |                                    |       |
| Total revenue  | 21.6% (3) |                                     | 10    | 10                                 | 28    |
| Total benefits and expenses  | 21.6% (3) |                                     | 7     | 7                                  | 20    |
| <b>Income from life insurance operations before taxes</b>                          |           |                                     | 3     | 3                                  | 8     |
| <b>Investment operations:</b>  |           |                                     |       |                                    |       |
| Net investment income (2)  |           | 4                                   | 10    | 12                                 | 28    |
| Net realized (losses) gains on investments (2)                                     |           | (6)                                 | 5     | 1                                  | 7     |
| Net impairment losses recognized in earnings (2)                                   |           | 0                                   | 0     | 0                                  | (1)   |
| Equity in earnings of limited partnerships   |           | 7                                   | 5     | 25                                 | 11    |
| <b>Income from investment operations before taxes (2)</b>                          |           | 5                                   | 20    | 38                                 | 45    |
| <b>Income from operations before income taxes</b>                                  |           | 67                                  | 82    | 215                                | 223   |
| Provision for income taxes   |           | 20                                  | 28    | 72                                 | 73    |
| <b>Net income</b>  |           | \$ 47                               | \$ 54 | \$143                              | \$150 |

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

(2) Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results and all investment results for these companies accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. (See Note 1, Nature of Operations .)

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

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Direct method of cash flows

Indemnity's components of direct cash flows as presented in the Consolidated Statements of Cash Flows are as follows:

| <i>(in millions)</i>                                 | Erie Indemnity Company             |        |
|--|------------------------------------|--------|
|  | <b>Direct method of cash flows</b> |        |
|  | Nine months ended<br>September 30, |        |
|  | 2011                               | 2010   |
| Management fee received                              | \$ 791                             | \$ 713 |
| Service agreement fee received                       | 25                                 | 26     |
| Premiums collected (1)                               |                                    | 166    |
| Net investment income received (1)                   | 17                                 | 33     |
| Limited partnership distributions                    | 14                                 | 14     |
| Decrease in reimbursements collected from affiliates | (13)                               | (5)    |
| Commissions and bonuses paid to agents               | (450)                              | (414)  |
| Salaries and wages paid                              | (95)                               | (80)   |
| Pension contribution and employee benefits paid      | (32)                               | (29)   |
| Losses paid (1)                                      |                                    | (99)   |
| Loss expenses paid (1)                               |                                    | (17)   |
| Other underwriting and acquisition costs paid (1)    |                                    | (42)   |
| General operating expenses paid                      | (93)                               | (87)   |
| Income taxes paid                                    | (51)                               | (50)   |
| Net cash provided by operating activities            | 113                                | 129    |
| Net cash used in investing activities                | (180)                              | (14)   |
| Net cash used in financing activities                | (209)                              | (118)  |
| Net decrease in cash and cash equivalents            | (276)                              | (3)    |
| Cash and cash equivalents at beginning of period     | 310                                | 76     |
| Cash and cash equivalents at end of period           | \$ 34                              | \$ 73  |

(1) Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results and all investment results for these companies accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. (See Note 1, Nature of Operations.)

**Note 15. Capital Stock**

Stock repurchase program

In December 2010, 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 \$14 million of repurchase authority remaining under this program at September 30, 2011.

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.

**Note 16. Subsequent Events**

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

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

The following discussion of financial condition and results of operations highlights significant factors influencing the Erie Insurance Group ( we, us, our ). This discussion should be read in conjunction with the historical financial information and the related notes thereto included in Item 1. Financial Statements of this Quarterly Report on Form 10-Q and with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2010 contained in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 24, 2011.

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

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

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

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



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- dependence on 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 the uninterrupted operations of our business, including our information technology systems;
- factors affecting the quality and liquidity of our investment portfolio;
- credit risk from the Exchange;
- ability to meet liquidity needs and access capital; and
- outcome of pending and potential litigation against us.

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

- general business and economic conditions;
- dependence on the independent agency system;
- ability to maintain our reputation for superior customer service;
- factors affecting price competition;
- government regulation of the insurance industry, including approval of rate increases and rating factors such as credit and prior experience, and required processes related to underwriting and claims handling;
- the uncertain role of the federal government, and the ongoing role of the states, in regulating the property/casualty or life insurance industries;
- 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;
- ability to acquire reinsurance coverage and collectability from reinsurers;
- factors affecting the quality and liquidity of our investment portfolio;
- ability to meet liquidity needs and access capital;
- ability to maintain acceptable financial strength rating;
- outcome of pending and potential litigation against us; and
- dependency on service provided by Indemnity.

A forward-looking statement speaks only as of the date on which it is made and reflects Indemnity's analysis only as of that date. Indemnity undertakes 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, all of which are not expected to have a material impact on our future financial condition, results of operations or cash flows.

## **OPERATING OVERVIEW**

### **Overview**

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

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

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

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).

Indemnity shareholder interest in income generally comprises:

- a management fee of up to 25% of all property and casualty insurance premiums written or assumed by the Exchange, less the costs associated with the sales, underwriting and issuance of these policies;
- a 5.5% interest in the net underwriting results of the property and casualty insurance operations through December 31, 2010(1);
- a 21.6% equity interest in the net earnings of EFL through March 31, 2011(2);
- net investment income and results on investments that belong to Indemnity(1); and
- other income and expenses, including income taxes, that are the responsibility of Indemnity.

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

- a 94.5% interest in the net underwriting results of the property and casualty insurance operations through December 31, 2010 (1);
- a 78.4% equity interest in the net earnings of EFL through March 31, 2011(2);
- net investment income and results on investments that belong to the Exchange and its subsidiaries, which include Flagship through December 31, 2010(1) and EFL; and
- other income and expenses, including income taxes, that are the responsibility of the Exchange and its subsidiaries.

(1) Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results and all investment results for these companies accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

(2) Prior to and through March 31, 2011, Indemnity retained a 21.6% ownership interest in EFL, which accrued to the Indemnity shareholder interest, and the Exchange retained a 78.4% ownership interest in EFL, which accrued to the interest of the subscribers (policyholders) of the Exchange or noncontrolling interest. Due to the sale of Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, 100% of the life insurance results of EFL accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after March 31, 2011. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

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

The following tables represent a breakdown of the composition of the income attributable to Indemnity and the income attributable to the noncontrolling interest (Exchange) for the three and nine months ended September 30, 2011. For purposes of this discussion, EFL's investments are included in the life insurance operations.

| <i>(in millions)</i>   | Indemnity shareholder interest |                                       | Noncontrolling interest (Exchange) |                                       | Eliminations of related party transactions |                                       | Erie Insurance Group                  |                                       |          |        |
|--|--------------------------------|---------------------------------------|------------------------------------|---------------------------------------|--|---------------------------------------|---------------------------------------|---------------------------------------|----------|--------|
|  | Percent                        | Three months ended September 30, 2011 | Percent                            | Three months ended September 30, 2010 | Three months ended September 30, 2011      | Three months ended September 30, 2010 | Three months ended September 30, 2011 | Three months ended September 30, 2010 |          |        |
| <b>Management operations:</b>  |                                |                                       |                                    |                                       |  |                                       |                                       |                                       |          |        |
| Management fee revenue, net  | 100.0%                         | \$280                                 | \$266                              |                                       | \$   | \$                                    | \$(280)                               | \$(266)                               | \$       | \$     |
| Service agreement revenue  | 100.0%                         | 8                                     | 9                                  |                                       |  |                                       |                                       |                                       | 8        | 9      |
| Total revenue from management operations   |                                | 288                                   | 275                                |                                       |  |                                       | (280)                                 | (266)                                 | 8        | 9      |
| Cost of management operations  | 100.0%                         | 226                                   | 217                                |                                       |  |                                       | (226)                                 | (217)                                 |          |        |
| <b>Income from management operations before taxes</b>                                |                                | 62                                    | 58                                 |                                       |  |                                       | (54)                                  | (49)                                  | 8        | 9      |
| <b>Property and casualty insurance operations: (2)</b>                               |                                |                                       |                                    |                                       |  |                                       |                                       |                                       |          |        |
| Net premiums earned  | 5.5% (2)                       |                                       | 55                                 | 94.5% (2)                             | 1,045                                      | 935                                   |                                       |                                       | 1,045    | 990    |
| Losses and loss expenses   | 5.5% (2)                       |                                       | 38                                 | 94.5% (2)                             | 823  | 652                                   | (1)                                   | (1)                                   | 822      | 689    |
| Policy acquisition and underwriting expenses   | 5.5% (2)                       |                                       | 16                                 | 94.5% (2)                             | 302  | 272                                   | (56)                                  | (51)                                  | 246      | 237    |
| <b>Income (loss) from property and casualty insurance operations before taxes</b>    |                                |                                       | 1                                  |                                       | (80)                                       | 11                                    | 57                                    | 52                                    | (23)     | 64     |
| <b>Life insurance operations: (1)</b>  |                                |                                       |                                    |                                       |  |                                       |                                       |                                       |          |        |
| Total revenue  | 21.6% (3)                      |                                       | 10                                 | 78.4% (3)                             | 46   | 33                                    | 0                                     | (1)                                   | 46       | 42     |
| Total benefits and expenses  | 21.6% (3)                      |                                       | 7                                  | 78.4% (3)                             | 33   | 20                                    | 0                                     | (1)                                   | 33       | 26     |
| <b>Income from life insurance operations before taxes</b>                            |                                |                                       | 3                                  |                                       | 13   | 13                                    | 0                                     | 0                                     | 13       | 16     |
| <b>Investment operations:</b>  |                                |                                       |                                    |                                       |  |                                       |                                       |                                       |          |        |
| Net investment income (2)  |                                | 4                                     | 10                                 |                                       | 83   | 79                                    | (3)                                   | (3)                                   | 84       | 86     |
| Net realized (losses) gains on investments (2)                                       |                                | (6)                                   | 5                                  |                                       | (421)                                      | 197                                   |                                       |                                       | (427)    | 202    |
| Net impairment losses recognized in earnings (2)                                     |                                | 0                                     | 0                                  |                                       | 0  | 0                                     |                                       |                                       | 0        | 0      |
| Equity in earnings of limited partnerships   |                                | 7                                     | 5                                  |                                       | 33   | 23                                    |                                       |                                       | 40       | 28     |
| <b>Income (loss) from investment operations before taxes (2)</b>                     |                                | 5                                     | 20                                 |                                       | (305)                                      | 299                                   | (3)                                   | (3)                                   | (303)    | 316    |
| <b>Income (loss) from operations before income taxes and noncontrolling interest</b> |                                |                                       |                                    |                                       |  |                                       |                                       |                                       |          |        |
|  |                                | 67                                    | 82                                 |                                       | (372)                                      | 323                                   |                                       |                                       | (305)    | 405    |
| Provision for income taxes   |                                | 20                                    | 28                                 |                                       | (145)                                      | 102                                   |                                       |                                       | (125)    | 130    |
| <b>Net income (loss)</b>   |                                | \$ 47                                 | \$ 54                              |                                       | \$ (227)                                   | \$ 221                                | \$                                    | \$                                    | \$ (180) | \$ 275 |

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

(2) Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and

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*casualty underwriting results and all investment results for these companies accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)*

*(3) Prior to and through March 31, 2011, Indemnity retained a 21.6% ownership interest in EFL, which accrued to the Indemnity shareholder interest, and the Exchange retained a 78.4% ownership interest in EFL, which accrued to the interest of the subscribers (policyholders) of the Exchange or noncontrolling interest. Due to the sale of Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, 100% of the life insurance results of EFL accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after March 31, 2011. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)*

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| (in millions)  | Indemnity shareholder interest |                                      | Noncontrolling interest (Exchange) |           | Eliminations of related party transactions |               | Erie Insurance Group                 |           |                |               |
|--|--------------------------------|--------------------------------------|------------------------------------|-----------|--|---------------|--------------------------------------|-----------|----------------|---------------|
|  | Percent                        | Nine months ended September 30, 2011 | 2010                               | Percent   | Nine months ended September 30, 2011       | 2010          | Nine months ended September 30, 2011 | 2010      |                |               |
| <b>Management operations:</b>  |                                |                                      |                                    |           |  |               |                                      |           |                |               |
| Management fee revenue, net  | 100.0%                         | \$816                                | \$773                              |           | \$   | \$            | \$(816)                              | \$(773)   | \$             | \$            |
| Service agreement revenue  | 100.0%                         | 25                                   | 26                                 |           |  |               |                                      |           | 25             | 26            |
| Total revenue from management operations   |                                | 841                                  | 799                                |           |  |               | (816)                                | (773)     | 25             | 26            |
| Cost of management operations  | 100.0%                         | 667                                  | 626                                |           |  |               | (667)                                | (626)     |                |               |
| <b>Income from management operations before taxes</b>                                |                                |                                      |                                    |           |  |               |                                      |           |                |               |
|  |                                | 174                                  | 173                                |           |  |               | (149)                                | (147)     | 25             | 26            |
| <b>Property and casualty insurance operations: (2)</b>                               |                                |                                      |                                    |           |  |               |                                      |           |                |               |
| Net premiums earned  | 5.5% (2)                       |                                      | 161                                | 94.5% (2) | 3,089                                      | 2,765         |                                      |           | 3,089          | 2,926         |
| Losses and loss expenses   | 5.5% (2)                       |                                      | 118                                | 94.5% (2) | 2,653                                      | 2,027         | (4)                                  | (4)       | 2,649          | 2,141         |
| Policy acquisition and underwriting expenses   | 5.5% (2)                       |                                      | 46                                 | 94.5% (2) | 882  | 783           | (154)                                | (151)     | 728            | 678           |
| <b>(Loss) income from property and casualty insurance operations before taxes</b>    |                                |                                      |                                    |           |  |               |                                      |           |                |               |
|  |                                |                                      | (3)                                |           | (446)                                      | (45)          | 158                                  | 155       | (288)          | 107           |
| <b>Life insurance operations: (1)</b>  |                                |                                      |                                    |           |  |               |                                      |           |                |               |
| Total revenue  | 21.6% (3)                      | 10                                   | 28                                 | 78.4% (3) | 124  | 99            | (1)                                  | (2)       | 133            | 125           |
| Total benefits and expenses  | 21.6% (3)                      | 7                                    | 20                                 | 78.4% (3) | 89   | 70            | 0                                    | (2)       | 96             | 88            |
| <b>Income from life insurance operations before taxes</b>                            |                                |                                      |                                    |           |  |               |                                      |           |                |               |
|  |                                | 3                                    | 8                                  |           | 35   | 29            | (1)                                  | 0         | 37             | 37            |
| <b>Investment operations:</b>  |                                |                                      |                                    |           |  |               |                                      |           |                |               |
| Net investment income (2)  |                                | 12                                   | 28                                 |           | 252  | 232           | (8)                                  | (8)       | 256            | 252           |
| Net realized gains (losses) on investments (2)                                       |                                | 1                                    | 7                                  |           | (247)                                      | 99            |                                      |           | (246)          | 106           |
| Net impairment losses recognized in earnings (2)                                     |                                | 0                                    | (1)                                |           | 0  | (3)           |                                      |           | 0              | (4)           |
| Equity in earnings of limited partnerships   |                                | 25                                   | 11                                 |           | 124  | 47            |                                      |           | 149            | 58            |
| <b>Income from investment operations before taxes (2)</b>                            |                                |                                      |                                    |           |  |               |                                      |           |                |               |
|  |                                | 38                                   | 45                                 |           | 129  | 375           | (8)                                  | (8)       | 159            | 412           |
| <b>Income (loss) from operations before income taxes and noncontrolling interest</b> |                                |                                      |                                    |           |  |               |                                      |           |                |               |
|  |                                | 215                                  | 223                                |           | (282)                                      | 359           |                                      |           | (67)           | 582           |
| Provision for income taxes   |                                | 72                                   | 73                                 |           | (126)                                      | 103           |                                      |           | (54)           | 176           |
| <b>Net income (loss)</b>   |                                | <b>\$143</b>                         | <b>\$150</b>                       |           | <b>\$ (156)</b>                            | <b>\$ 256</b> | <b>\$</b>                            | <b>\$</b> | <b>\$ (13)</b> | <b>\$ 406</b> |

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

(2) Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results and all investment results for these companies accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

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



*Nature of Operations, contained within this report.)*

Net income in the third quarter of 2011 was impacted by adverse results in our investment and property and casualty insurance operations compared to the third quarter of 2010. Our investment operations were impacted primarily by net realized losses on investments, compared to gains in the third quarter of 2010, offset somewhat by increased equity in earnings on limited partnerships. The Exchange's property and casualty insurance operations losses were higher due to a significant increase in catastrophe losses, offset somewhat by favorable development on prior accident years and a 5.7% increase in earned premium, which was driven by increases in policies in force and the average premium per policy.

**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 income generated from management operations, life insurance operations (1), property and casualty insurance underwriting operations (2), net investment income (2), and equity in earnings or losses of limited partnerships, net of related federal income taxes. It does not include 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: (1) (2)

| <i>(in millions, except per share data)</i>                  | Indemnity Shareholder Interest       |        |                                      |        |
|--|--------------------------------------|--------|--------------------------------------|--------|
|  | Three months ended                   |        | Nine months ended                    |        |
|  | September 30,<br>2011<br>(Unaudited) | 2010   | September 30,<br>2011<br>(Unaudited) | 2010   |
| Operating income attributable to Indemnity                   | \$51                                 | \$51   | \$142                                | \$146  |
| Net realized (losses) gains and impairments on investments   | (6)                                  | 5      | 1                                    | 6      |
| Income tax benefit (expense)                                 | 2                                    | (2)    | 0                                    | (2)    |
| Realized (losses) gains and impairments, net of income taxes | (4)                                  | 3      | 1                                    | 4      |
| Net income attributable to Indemnity                         | \$47                                 | \$54   | \$143                                | \$150  |
| <b>Per Indemnity Class A common share-diluted:</b>           |                                      |        |                                      |        |
| Operating income attributable to Indemnity                   | \$0.93                               | \$0.89 | \$2.57                               | \$2.55 |
| Net realized (losses) gains and impairments on investments   | (0.09)                               | 0.08   | 0.03                                 | 0.11   |
| Income tax benefit (expense)                                 | 0.03                                 | (0.03) | (0.01)                               | (0.04) |
| Realized (losses) gains and impairments, net of income taxes | (0.06)                               | 0.05   | 0.02                                 | 0.07   |
| Net income attributable to Indemnity                         | \$0.87                               | \$0.94 | \$2.59                               | \$2.62 |

(1) Prior to and through March 31, 2011, Indemnity retained a 21.6% ownership interest in EFL, which accrued to the Indemnity shareholder interest, and the Exchange retained a 78.4% ownership interest in EFL, which accrued to the interest of the subscribers (policyholders) of the Exchange or noncontrolling interest. Due to the sale of Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, 100% of the life insurance results of EFL accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after March 31, 2011. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

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(2) *Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results and all investment results for these companies accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)*

**Summary of Results Indemnity Shareholder Interest**

Three months ended September 30, 2011

- Net income attributable to Indemnity per share-diluted was \$0.87 per share in the third quarter of 2011 compared to net income per share-diluted of \$0.94 per share in the third quarter of 2010. The third quarter 2010 net income amount includes \$0.13 per share related to operations sold to the Exchange.
- Operating income attributable to Indemnity per share-diluted (excluding net realized gains or losses, impairments on investments and related taxes) was \$0.93 per share in the third quarter of 2011 compared to \$0.89 in the third quarter of 2010. The third quarter 2010 operating income amount includes \$0.12 per share related to operations sold to the Exchange.

Nine months ended September 30, 2011

- Net income attributable to Indemnity per share-diluted was \$2.59 per share for the nine months ended September 30, 2011, compared to \$2.62 per share for the nine months ended September 30, 2010. The net income for 2011 and 2010 includes \$0.02 and \$0.33 per share, respectively, related to operations sold to the Exchange.
- Operating income attributable to Indemnity per share-diluted (excluding net realized gains or losses, impairments on investments and related taxes) was \$2.57 per share in the first nine months of 2011, compared to \$2.55 in the first nine months of 2010. The 2011 and 2010 operating income amounts include \$0.02 and \$0.29 per share, respectively, related to operations sold to the Exchange.

**Operating Segments**

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

Management operations

Management operations generate internal management fee revenue, which accrues to the Indemnity shareholder interest, as Indemnity provides services relating to the sales, underwriting and issuance of policies on behalf of the Exchange. Management fee revenue is based upon all premiums written or assumed by the Exchange and the management fee rate, which is not to exceed 25%. Our Board of Directors establishes the management fee rate at least annually, generally in December for the following year, and considers factors such as the relative financial strength of Indemnity and the Exchange and projected revenue streams. The management fee rate was set at 25% for both 2011 and 2010. Management fee revenue is eliminated upon consolidation.

Property and casualty insurance operations

The property and casualty insurance industry is highly 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 premiums of the Property and Casualty Group.

The property and casualty insurance business is driven by premium growth, the combined ratio and investment returns. The property and casualty insurance operation's premium growth strategy focuses on growth by expansion of existing operations including a careful agency selection process and increased market penetration in existing operating territories. Expanding the size of our existing agency force of over 2,100 independent agencies, with over 9,500 licensed representatives, will contribute to future growth as new agents build their books of business with the Property and Casualty Group.

The property and casualty insurance operations insure standard and preferred risks while adhering to a set of consistent underwriting standards. Nearly 50% of premiums are derived from personal auto, 20% from homeowners and 30% from commercial lines. Pennsylvania, Maryland and Virginia made up 63% of the property and casualty lines insurance business 2010 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. Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010.

The combined ratio, expressed as a percentage, is the key measure of underwriting profitability traditionally used in the property and casualty insurance industry. 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 loss and loss expenses include the frequency and severity of losses, the nature and severity of catastrophic losses, the quality of risks underwritten and underlying claims and settlement expenses.

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

#### Life insurance operations

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

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

#### Investment operations

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

Our investment operations reflected the downturn experienced in the stock market in the third quarter of 2011. Realized losses totaled \$422 million in the third quarter of 2011 compared to realized gains of \$205 million in the same period in 2010. In the third quarter of 2011 and 2010, there were no significant impairments of securities. Equity in earnings of limited partnerships was \$40 million in the third quarter of 2011 compared to \$28 million in the third quarter of 2010. The valuation adjustments for limited partnerships are based on financial statements received from our general partners, which are generally received on a quarter lag. As a result, our third quarter earnings from limited partnerships benefited from the favorable financial market conditions experienced in the second quarter of 2011, but do not reflect the market conditions experienced in the third quarter of 2011.

#### **General Conditions and Trends Affecting Our Business**

Economic conditions

Although the financial markets have shown some signs of improvement recently, overall economic conditions remain uncertain. 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 reserves and 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.

Market volatility

Our portfolio of fixed income, preferred and common stocks and limited partnerships are subject to market volatility especially in periods of instability in the worldwide financial markets. Depending upon market conditions, which are unpredictable and remain uncertain, considerable fluctuation could exist in our reported total investment income, which could have an adverse impact on our financial condition, results of operations and cash flows.

**RESULTS OF OPERATIONS**

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

**Management Operations**

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

| <i>(dollars in millions)</i>                   | Erie Insurance Group             |       |          |                                 |       |            |
|--|----------------------------------|-------|----------|---------------------------------|-------|------------|
|  | Three months ended September 30, |       |          | Nine months ended September 30, |       |            |
|  | 2011                             | 2010  | % Change | 2011                            | 2010  | % Change   |
| <b>Indemnity</b>                               | (Unaudited)                      |       |          | (Unaudited)                     |       |            |
| Management fee revenue                         | \$280                            | \$266 | 5.2 %    | \$816                           | \$773 | 5.5 %      |
| Service agreement revenue                      | 8                                | 9     | (4.1)    | 25                              | 26    | (2.8)      |
| Total revenue from management operations       | 288                              | 275   | 4.9      | 841                             | 799   | 5.2        |
| Cost of management operations                  | 226                              | 217   | 4.1      | 667                             | 626   | 6.5        |
| Income from management operations Indemnity(1) | \$ 62                            | \$ 58 | 7.8 %    | \$174                           | \$173 | 0.7 %      |
| Gross margin                                   | 21.7%                            | 21.1% | 0.6 pts. | 20.7%                           | 21.7% | (1.0) pts. |

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

**Management fee revenue**

Management fee revenue is based upon all premiums written or assumed by the Exchange and the management fee rate, which is determined by our Board of Directors at least annually. Management fee revenue is calculated by multiplying the management fee rate by the direct premiums written by the Exchange and the other members of the Property and Casualty Group, which are assumed by the Exchange under an intercompany pooling agreement. The following table presents the calculation of management fee revenue.

| <i>(dollars in millions)</i>   | Erie Insurance Group             |         |          |                                 |         |          |
|--|----------------------------------|---------|----------|---------------------------------|---------|----------|
|  | Three months ended September 30, |         |          | Nine months ended September 30, |         |          |
|  | 2011                             | 2010    | % Change | 2011                            | 2010    | % Change |
| <b>Indemnity</b>   | (Unaudited)                      |         |          | (Unaudited)                     |         |          |
| Property and Casualty Group direct written premiums                      | \$1,119                          | \$1,062 | 5.4 %    | \$3,271                         | \$3,098 | 5.6 %    |
| Management fee rate  | 25.00%                           | 25.00%  |          | 25.00%                          | 25.00%  |          |
| Management fee revenue, gross  | \$ 280                           | \$ 265  | 5.4 %    | \$ 818                          | \$ 774  | 5.6 %    |
| Change in allowance for management fee returned on cancelled policies(1) |                                  | 1       | NM       | (2)                             | (1)     | NM       |



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|  |        |        |       |        |        |       |
|--|--------|--------|-------|--------|--------|-------|
| Management fee revenue, net of allowance | \$ 280 | \$ 266 | 5.2 % | \$ 816 | \$ 773 | 5.5 % |
|--|--------|--------|-------|--------|--------|-------|

NM = not meaningful

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

Direct written premiums of the Property and Casualty Group increased 5.4% in the third quarter of 2011, compared to the third quarter of 2010, due to a 2.6% increase in policies in force and increases in average premium. The year-over-year average premium per policy for all lines of business increased 2.9% at September 30, 2011, compared to an increase of 0.4% at September 30, 2010. The policy retention ratio was 90.8% at September 30, 2011, compared to 90.7% at December 31, 2010 and 90.6% at September 30, 2010. See the Property and casualty insurance operations segment that follows for a complete discussion of property and casualty direct written premiums.

The management fee rate was set at 25%, the maximum rate, for both 2011 and 2010. Changes in the management fee rate can affect the segment's revenue and net income significantly.

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### 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 \$8 million and \$9 million in the third quarters of 2011 and 2010, respectively, and \$25 million and \$26 million for the nine months ended September 30, 2011 and 2010, respectively.

### Cost of management operations

| <i>(in millions)</i>                | Erie Insurance Group             |       |          |                                 |       |          |
|-------------------------------------|----------------------------------|-------|----------|---------------------------------|-------|----------|
|                                     | Three months ended September 30, |       |          | Nine months ended September 30, |       |          |
|                                     | 2011                             | 2010  | % Change | 2011                            | 2010  | % Change |
|                                     | (Unaudited)                      |       |          | (Unaudited)                     |       |          |
| <b>Indemnity</b>                    |                                  |       |          |                                 |       |          |
| Commissions                         | \$151                            | \$149 | 1.6 %    | \$446                           | \$426 | 4.7 %    |
| Non-commission expense              | 75                               | 68    | 9.6      | 221                             | 200   | 10.3     |
| Total cost of management operations | \$226                            | \$217 | 4.1 %    | \$667                           | \$626 | 6.5 %    |

*Commissions* Commissions increased \$2 million in the third quarter of 2011, compared to the third quarter of 2010, primarily as a result of the 5.4% increase in direct written premiums of the Property and Casualty Group, offset by a decrease in Agent bonuses due to factoring in the most recent year's underwriting data.

For the nine months ended September 30, 2011, commissions increased \$20 million compared to the nine months ended September 30, 2010, driven primarily by the 5.6% increase in direct written premiums of the Property and Casualty Group.

*Non-commission expense* Non-commission expense increased \$7 million in the third quarter of 2011, compared to the third quarter of 2010. Personnel costs increased \$2 million primarily as a result of increases in salaries and benefits. Professional fees increased \$3 million and software expenses increased \$2 million related to our technology initiatives.

The gross margin for the third quarter of 2011 was 21.7% compared to 21.1% recorded in the same period in 2010.

For the nine months ended September 30, 2011, non-commission expense increased \$21 million compared to the nine months ended September 30, 2010. Personnel costs increased \$9 million primarily as a result of increases in salaries and benefits. Professional fees increased \$3 million and software expenses increased \$4 million related to our technology initiatives, while the 2010 expenses included a \$5 million reduction for a favorable court ruling.

The gross margin of 21.7% for the nine months ended September 30, 2010 was positively impacted by a \$5 million reduction for a favorable court ruling. Excluding this adjustment, the gross margin would have been 21.0%, compared to 20.7% for the nine months ended September 30, 2011.



**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.

| (dollars in millions)                             | Property and Casualty Group      |         |          |                                 |         |           |
|---|----------------------------------|---------|----------|---------------------------------|---------|-----------|
|   | Three months ended September 30, |         |          | Nine months ended September 30, |         |           |
|   | 2011                             | 2010    | % Change | 2011                            | 2010    | % Change  |
|   | (Unaudited)                      |         |          | (Unaudited)                     |         |           |
| Direct written premium                            | \$1,119                          | \$1,062 | 5.4 %    | \$3,271                         | \$3,098 | 5.6 %     |
| Reinsurance assumed and ceded                     | (4)                              | (5)     | 15.7     | (12)                            | (11)    | (7.1)     |
| Net written premium                               | 1,115                            | 1,057   | 5.4      | 3,259                           | 3,087   | 5.6       |
| Change in unearned premium                        | 70                               | 67      | 2.2      | 170                             | 161     | 4.8       |
| Net premiums earned                               | 1,045                            | 990     | 5.7      | 3,089                           | 2,926   | 5.6       |
| Losses and loss expenses                          | 823                              | 690     | 19.4     | 2,653                           | 2,145   | 23.7      |
| Policy acquisition and underwriting expenses      | 302                              | 288     | 5.3      | 882                             | 829     | 6.5       |
| Total losses and expenses                         | 1,125                            | 978     | 15.3     | 3,535                           | 2,974   | 18.9      |
| Underwriting (loss) income Erie Insurance Group   | \$ (80)                          | \$ 12   | NM       | \$ (446)                        | \$ (48) | NM        |
| Underwriting income (loss) Indemnity (1)          | \$                               | \$ 1    |          | \$                              | \$ (3)  |           |
| Underwriting (loss) income Exchange (1)           | \$ (80)                          | \$ 11   |          | \$ (446)                        | \$ (45) |           |
| Loss and loss expense ratio                       | 78.8%                            | 69.7%   | 9.1 pts. | 85.9%                           | 73.3%   | 12.6 pts. |
| Policy acquisition and underwriting expense ratio | 28.9                             | 29.0    | (0.1)    | 28.6                            | 28.4    | 0.2       |
| Combined ratio                                    | 107.7%                           | 98.7%   | 9.0 pts. | 114.5%                          | 101.7%  | 12.8 pts. |

NM = not meaningful

(1) Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

We measure profit or loss for our property and casualty insurance segment based upon underwriting results, which represents net premiums earned less losses and loss expenses and policy acquisition and other underwriting expenses on a pre-tax basis. Loss and combined ratios are key performance indicators that we use to assess business trends and to make comparisons to industry results. Investment results of our underwriting business are included in our investment operations segment.

Direct written premiums

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Direct written premiums of the Property and Casualty Group increased 5.4% to over \$1.1 billion in the third quarter of 2011 from the third quarter of 2010, driven by an increase in policies in force and increases in average premium per policy. Year-over-year policies in force for all lines of business increased by 2.6% in the third quarter of 2011 as the result of continuing strong policyholder retention, compared to an increase of 3.4% in the third quarter of 2010. The year-over-year average premium per policy for all lines of business increased 2.9% at September 30, 2011, compared to an increase of 0.4% at September 30, 2010. The combined impact of these increases in the third quarter of 2011 was seen primarily in our renewal business premiums.

Premiums generated from new business increased 1.8% to \$121 million in the third quarter of 2011, compared to 4.3%, or \$119 million, in the third quarter of 2010. Underlying the trend in new business premiums was a decrease in new business policies in force of 4.3%, in the third quarter of 2011, compared to an increase of 4.4% in the third quarter of 2010, while the year-over-year average premium per policy on new business increased 5.8% at September 30, 2011, compared to an increase of 2.1% at September 30, 2010.

Premiums generated from renewal business increased 5.8% to \$998 million in the third quarter of 2011, compared to an increase of 5.4%, or \$943 million, in the third quarter of 2010. Underlying the trend in renewal business premiums was an increase in renewal business policies in force of 3.6% in the third quarter of 2011, compared to 3.3% in the third quarter of 2010, and an increase in the renewal business year-over-year average premium per policy of 2.5% at September 30, 2011, compared to an increase of 0.3% at September 30, 2010. The Property and Casualty Group's year-over-year policy retention ratio was 90.8% at September 30, 2011, and 90.7% at December 31, 2010, and 90.6% at September 30, 2010.

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*Personal lines* Total personal lines premiums written increased 4.6% to \$840 million in the third quarter of 2011, from \$803 million in the third quarter of 2010, driven by an increase of 2.5% in total personal lines policies in force and an increase of 2.6% in the total personal lines year-over-year average premium per policy.

New business premiums written on personal lines increased 1.4% in the third quarter of 2011, compared to a decrease of 0.6% in the third quarter of 2010. Personal lines new business policies in force decreased 5.6% in the third quarter of 2011, compared to an increase of 3.2% in the third quarter of 2010, while the year-over-year average premium per policy on personal lines new business increased 3.8% at September 30, 2011, compared to 1.7% at September 30, 2010.

- Private passenger auto new business premiums written increased 0.6% in the third quarter of 2011, compared to a decrease of 0.6% in the third quarter of 2010. New business policies in force for private passenger auto decreased 4.6% in the third quarter of 2011, compared to an increase of 2.2% in the third quarter of 2010, while the new business year-over-year average premium per policy for private passenger auto increased 2.1% at September 30, 2011, compared to 2.2% at September 30, 2010.

- Homeowners new business premiums written increased 3.9% in the third quarter of 2011, compared to a decrease of 3.9% in the third quarter of 2010. New business policies in force for homeowners decreased 8.1% in the third quarter of 2011, compared to an increase of 4.9% in the third quarter of 2010. The new business year-over-year average premium per policy for homeowners increased 5.6% at September 30, 2011, compared to 1.5% at September 30, 2010.

Renewal premiums written on personal lines increased 4.9% in the third quarter of 2011, compared to 6.5% in the third quarter of 2010, driven by an increase in average premium per policy and steady policy retention trends. The year-over-year average premium per policy on personal lines renewal business increased 2.4% at September 30, 2011, compared to 2.0% at September 30, 2010. The personal lines year-over-year policy retention ratio was 91.6% at September 30, 2011, 91.5% at December 31, 2010, and 91.4% at September 30, 2010.

- Private passenger auto renewal premiums written increased 2.0% in the third quarter of 2011, compared to 5.1% in the third quarter of 2010. The year-over-year average premium per policy on private passenger auto renewal business increased 1.2% at September 30, 2011, compared to 1.8% at September 30, 2010. The private passenger auto year-over-year policy retention ratio was 91.7% at September 30, 2011, compared to 91.8% at December 31, 2010 and September 30, 2010.

- Homeowners renewal premiums written increased 10.6% in the third quarter of 2011, compared to 9.3% in the third quarter of 2010. The year-over-year average premium per policy on homeowners renewal business increased 7.1% at September 30, 2011, compared to 4.1% at September 30, 2010, while the homeowners year-over-year policyholder retention ratio was 91.4% at September 30, 2011, 91.2% at December 31, 2010, and 91.0% at September 30, 2010.

*Commercial lines* Total commercial lines premiums written increased 7.8%, to \$279 million in the third quarter of 2011 from \$259 million in the third quarter of 2010, driven by a 3.6% increase in total commercial lines policies in force and a 3.1% increase in the total commercial lines year-over-year average premium per policy.

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New business premiums written on commercial lines increased 2.6% in the third quarter of 2011, compared to 15.4% in the third quarter of 2010. Commercial lines new business policies in force increased 1.3% in the third quarter of 2011, compared to 9.9% in the third quarter of 2010, while the year-over-year average premium per policy on commercial lines new business increased 6.1% at September 30, 2011, compared to remaining flat at September 30, 2010.

Renewal premiums for commercial lines increased 8.7% in the third quarter of 2011, compared to an increase of 1.9% in the third quarter of 2010. The improvement seen in the commercial lines renewal premiums was driven by an increase in the average premium per policy combined with steady policy retention trends, the combined impact of which was seen primarily in the commercial multi-peril and workers compensation lines of business. The year-over-year average premium per policy on commercial lines renewal business increased 2.5% at September 30, 2011, compared to a decline of 4.0% at September 30, 2010. The commercial multi-peril and workers compensation year-over-year average premium per policy on renewal business increased 3.7% and 4.8%, respectively, at September 30, 2011, compared to decreases of 1.6% and 10.6%, respectively, at September 30, 2010. Contributing to the lower

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average premium per policy in the third quarter of 2010 were shifts in the mix of our book of business and lower exposures for the commercial multi-peril and workers compensation lines of business. The year-over-year policy retention ratio for commercial lines was 85.3% at September 30, 2011 and December 31, 2010, and 85.2% at September 30, 2010.

*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, which have a direct bearing on Indemnity's management fee. 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 book of business with the Property and Casualty Group. At September 30, 2011, we had over 2,100 agencies with over 9,500 licensed representatives. Our continued focus on underwriting discipline and the maturing of our pricing segmentation model has contributed to the Property and Casualty Group's ability to retain existing and attract new policyholders resulting in growth in new policies in force and steady retention ratios. We expect our pricing actions to result in a net increase in direct written premium in 2012, however, exposure reductions and changes in our mix of business as a result of economic conditions could impact the average premium written by the Property and Casualty Group, as customers may continue to reduce coverages.

### Current year losses and loss expenses

The current accident year loss and loss expense ratio, excluding catastrophe losses, was 71.4% in the third quarter of 2011 compared to 72.2% in the third quarter of 2010, and 67.7% in the first nine months of 2011 compared to 70.0% in the first nine months of 2010.

The personal lines loss and loss expense ratio related to the current accident year, excluding catastrophe losses, was 71.8% in the third quarter of 2011 compared to 72.6% in the third quarter of 2010, and 68.2% in the first nine months of 2011 compared to 70.2% in the first nine months of 2010.

The commercial lines loss and loss expense ratio related to the current accident year, excluding catastrophe losses, was 70.2% in the third quarter of 2011 compared to 71.0% in the third quarter of 2010, and 66.4% in the first nine months of 2011 compared to 69.5% in the first nine months of 2010.

### Catastrophe losses

Catastrophes are an inherent risk of the property and casualty insurance business and can have a material impact on our 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 sufficient property catastrophe reinsurance coverage from unaffiliated reinsurers and no longer participates in the voluntary assumed reinsurance business, which lowers the variability of the underwriting results of the Property and Casualty Group.

Catastrophe losses, as defined by the Property and Casualty Group, totaled \$174 million in the third quarter of 2011, compared to \$52 million in the third quarter of 2010, and contributed 16.7 points and 5.2 points to the loss ratios at September 30, 2011 and 2010, respectively. In the third quarter of 2011, the states of Pennsylvania, Maryland, North Carolina, and Virginia experienced an increase in storm activity including flooding, hurricane, tornado and wind storms resulting in an increase in claims compared to the third quarter of 2011. Catastrophe losses incurred for the first nine months of 2011 and 2010 totaled \$777 million and \$245 million, respectively, and contributed 25.1 points and 8.3 points to the combined ratio, respectively.





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### Prior year loss reserve development

The following table provides the details of our property and casualty insurance operations prior year loss reserve development by type of business:

(in millions)

|   | Erie Insurance Group |        |                   |         |
|---|----------------------|--------|-------------------|---------|
|   | Three months ended   |        | Nine months ended |         |
|   | September 30,        |        | September 30,     |         |
|   | 2011                 | 2010   | 2011              | 2010    |
|   | (Unaudited)          |        | (Unaudited)       |         |
| <b>Prior year loss development:</b>               |                      |        |                   |         |
| Direct business including salvage and subrogation | \$(92)               | \$(49) | \$(203)           | \$(105) |
| Assumed reinsurance business                      | (5)                  | (26)   | (9)               | (37)    |
| Ceded reinsurance business                        | 0                    | (1)    | (4)               | (6)     |
| Total prior year loss development                 | \$(97)               | \$(76) | \$(216)           | \$(148) |

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

*Direct business including salvage and subrogation* Favorable development of prior accident years, including the effects of salvage and subrogation recoveries, improved the combined ratio by 8.8 points in the third quarter of 2011, compared to 4.9 points in the third quarter of 2010. The favorable development in the third quarter of 2011 was primarily driven by the closing of two massive injury lifetime medical benefits claims in the workers compensation line of business and the closing of one massive injury lifetime medical benefits claim in the personal auto line of business. In the third quarter of 2010, the favorable development was primarily driven by improved severity trends in the workers compensation, private passenger auto and commercial multi-peril lines of business.

Favorable development of prior accident years, including the effects of salvage and subrogation recoveries, improved the combined ratio by 6.6 points in the first nine months of 2011, compared to 3.6 points in the first nine months of 2010. The favorable development in the first nine months of 2011 was primarily driven by better than expected severity trends on uninsured/underinsured motorist bodily injury, improved annual claim cost expectations on massive injury lifetime medical benefits and the closing of two massive injury lifetime medical benefits claims in the personal auto line of business, the closing of six massive injury lifetime medical benefits claims in the workers compensation line of business, and better than expected severity trends on liability claims in the commercial multi-peril and homeowners lines of business. In the first nine months of 2010, the favorable development was primarily driven by improvements in severity trends and the settlement of one large claim in the homeowners line of business.

*Assumed reinsurance* The Property and Casualty Group experienced favorable development of prior accident year loss reserves on its assumed reinsurance business totaling \$5 million in the third quarter of 2011, compared to \$26 million in the third quarter of 2010. For the first nine months of 2011, favorable development of prior accident year loss reserves on assumed reinsurance totaled \$9 million, compared to \$37 million in the first nine months of 2010. The favorable development in 2011 and 2010 was due to less than anticipated growth in involuntary reinsurance.

*Ceded reinsurance* The Property and Casualty Group's increase in ceded reinsurance reserves, which is reflected as favorable development of prior accident year loss reserves, was relatively flat in the third quarter of 2011, compared to \$1 million in the third quarter of 2010, and \$4 million in the first nine months of 2011, compared to \$6 million in the first nine months of 2010.

Policy acquisition and underwriting expenses

Our expense ratio remained relatively flat in the third quarter of 2011, decreasing only 0.1 points. The management fee rate was 25% for the periods ending September 30, 2011 and September 30, 2010.

**Life Insurance Operations**

EFL is a Pennsylvania-domiciled life insurance company which operates in 10 states and the District of Columbia and underwrites and sells individual and group life insurance policies and fixed annuities.

| (in millions)                                       | Erie Family Life Insurance Company |      |          |                   |       |          |
|---|------------------------------------|------|----------|-------------------|-------|----------|
|   | Three months ended                 |      |          | Nine months ended |       |          |
|   | 2011                               | 2010 | % Change | 2011              | 2010  | % Change |
|   | September 30,                      |      |          | September 30,     |       |          |
|   | (Unaudited)                        |      |          | (Unaudited)       |       |          |
| Individual life premiums, net of reinsurance        | \$16                               | \$15 | 6.0 %    | \$ 48             | \$ 46 | 3.8 %    |
| Group life and other premiums                       | 0                                  | 1    | NM       | 2                 | 2     | 2.2      |
| Other revenue                                       | 1                                  | 0    | NM       | 1                 | 0     | NM       |
| Total net policy revenue                            | 17                                 | 16   | 5.3      | 51                | 48    | 3.6      |
| Net investment income                               | 24                                 | 24   | (3.6)    | 70                | 71    | (0.9)    |
| Net realized gains on investments                   | 5                                  | 3    | 28.9     | 12                | 11    | 2.6      |
| Impairment losses recognized in earnings            | 0                                  | 0    | NM       | 0                 | (2)   | 85.3     |
| Equity in earnings (losses) of limited partnerships | 0                                  | 0    | NM       | 1                 | (1)   | NM       |
| Total revenues                                      | 46                                 | 43   | 1.7      | 134               | 127   | 3.9      |
| Benefits and other changes in policy reserves       | 26                                 | 21   | 20.6     | 75                | 67    | 11.3     |
| Amortization of deferred policy acquisition costs   | 3                                  | 3    | 11.6     | 10                | 12    | (16.3)   |
| Other operating expenses                            | 4                                  | 3    | 29.2     | 11                | 11    | 2.2      |
| Total benefits and expenses                         | 33                                 | 27   | 20.5     | 96                | 90    | 6.5      |
| Income before income taxes                          | \$13                               | \$16 | (27.5)%  | \$ 38             | \$ 37 | (2.1)%   |
| Income before taxes Indemnity(1)                    | \$                                 | \$ 3 | NM       | \$ 3              | \$ 8  | (66.2)%  |
| Income before taxes Exchange(1)                     | \$13                               | \$13 | (7.5)%   | \$ 35             | \$ 29 | 15.6 %   |

NM = not meaningful

(1) Prior to and through March 31, 2011, Indemnity retained a 21.6% ownership interest in EFL, which accrued to the Indemnity shareholder interest, and the Exchange retained a 78.4% ownership interest in EFL, which accrued to the interest of the subscribers (policyholders) of the Exchange or noncontrolling interest. Due to the sale of Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, 100% of the life insurance results of EFL accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after March 31, 2011. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

**Premiums**

Gross policy revenues increased 4.3% to \$27 million in the third quarter of 2011, compared to \$26 million in the third quarter of 2010. With the introduction of its new life products, effective June 1, 2011, EFL reinsures new individual life business amounts in excess of its \$1 million per life retention limit. Previously, EFL reinsured 75% of its risk on new term business. Ceded reinsurance premiums were \$9 million and \$10 million in the third quarters of 2011 and 2010, respectively. For the first nine months of 2011, compared to the first nine months of 2010, gross policy revenues totaled \$82 million and \$78 million, respectively, while ceded reinsurance premiums totaled \$31 million and \$30 million, respectively.

Premiums received on annuity and universal life products totaled \$19 million in the third quarter of 2011, compared to \$26 million in the third quarter of 2010. Of this amount, annuity and universal life premiums which are recorded as deposits, and therefore not reflected in revenue on the Consolidated Statements of Operations, totaled \$15 million and \$22 million in the third quarters of 2011 and 2010, respectively. For the first nine months of 2011 compared to the first nine months of 2010, premiums received on annuity and universal life products totaled \$68 million and \$89 million, respectively, while annuity and universal life deposits totaled \$56 million and \$77 million, respectively.

#### Investments

EFL experienced a slight increase in net realized gains on investments and continued to experience low levels of impairments in the third quarter and first nine months of 2011. See the discussion of investments in the Investment Operations segment that follows for further information.

#### Benefits and expenses

The third quarter of 2011 benefits and other changes in policy reserves were impacted by increases in death benefits and interest on annuity deposits compared to the third quarter of 2010.

**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.

| <i>(in millions)</i>                             | Erie Insurance Group                |       |          |                                    |       |          |
|--|-------------------------------------|-------|----------|------------------------------------|-------|----------|
|  | Three months ended<br>September 30, |       |          | Nine months ended<br>September 30, |       |          |
|  | 2011                                | 2010  | % Change | 2011                               | 2010  | % Change |
|  | (Unaudited)                         |       |          | (Unaudited)                        |       |          |
| <b>Indemnity</b>                                 |                                     |       |          |                                    |       |          |
| Net investment income (1)                        | \$ 4                                | \$ 10 | (56.4)%  | \$ 12                              | \$ 28 | (56.4)%  |
| Net realized (losses) gains on investments (1)   | (6)                                 | 5     | NM       | 1                                  | 7     | NM       |
| Net impairment losses recognized in earnings (1) | 0                                   | 0     | NM       | 0                                  | (1)   | NM       |
| Equity in earnings of limited partnerships       | 7                                   | 5     | 25.0 %   | 25                                 | 11    | NM       |
| Net revenue from investment operations           |                                     |       |          |                                    |       |          |
| Indemnity (1)                                    | \$ 5                                | \$ 20 | (70.9)%  | \$ 38                              | \$ 45 | (15.4)%  |
| <b>Exchange</b>                                  |                                     |       |          |                                    |       |          |
| Net investment income (1)                        | \$ 106                              | \$100 | 6.5 %    | \$322                              | \$294 | 9.9 %    |
| Net realized (losses) gains on investments (1)   | (416)                               | 200   | NM       | (235)                              | 110   | NM       |
| Net impairment losses recognized in earnings (1) | 0                                   | 0     | NM       | 0                                  | (5)   | NM       |
| Equity in earnings of limited partnerships       | 33                                  | 23    | 48.7 %   | 125                                | 47    | NM       |
| Net revenue from investment operations           |                                     |       |          |                                    |       |          |
| Exchange (1) (2)                                 | \$(277)                             | \$323 | NM       | \$212                              | \$446 | (52.2)%  |

NM = not meaningful

(1) As a result of the sale of Indemnity's property and casualty insurance subsidiaries, EIC, ENY and EPC, to the Exchange on December 31, 2010, investment revenue and losses generated from these entities will no longer accrue to the Indemnity shareholder interest after this date. Investment revenue from these entities totaled \$7 million in the third quarter of 2010 and \$22 million in the first nine months of 2010. These components of investment income now accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, in 2011 and thereafter. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

(2) The Exchange's investment results for the third quarter of 2011 and 2010 include net investment revenues from EFL's operations of \$29 million and \$27 million, respectively. The Exchange's investment results for the first nine months of 2011 and 2010 include net investment revenues from EFL's operations of \$83 million and \$79 million, respectively.

Net investment income

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Net investment income primarily includes interest and dividends on our fixed maturity and equity security portfolios. Indemnity net investment income decreased \$6 million in the third quarter of 2011 and \$16 million in the first nine months of 2011 compared to 2010. The Exchange's net investment income increased \$6 million and \$28 million for the same respective periods. These variances were primarily caused by the sale of EIC, ENY, and EPC from Indemnity to the Exchange on December 31, 2010. These entities generated net investment income of \$6 million and \$19 million in the third quarter and first nine months of 2010, respectively.

### Net realized gains on investments

Indemnity generated realized losses of \$6 million in the third quarter of 2011 compared to gains of \$5 million in the third quarter of 2010. The Exchange generated realized losses of \$416 million in the third quarter of 2011 compared to gains of \$200 million in the same period in 2010. The realized losses generated in the third quarter of 2011 for Indemnity and the Exchange were primarily due to decreases in the valuation on their common stock portfolios. EIC, ENY, and EPC generated net realized gains of \$1 million and \$4 million in the third quarter and first nine months of 2010, respectively.

### Net impairment losses recognized in earnings

The Exchange's impairment losses recognized in earnings were unchanged for the third quarter of 2011 and decreased by \$5 million for the first nine months of 2011 compared to the same periods in 2010. EIC, ENY, and EPC generated no net impairment losses in the third quarter of 2010 and \$1 million for the first nine months of 2010.

### Equity in earnings of limited partnerships

Indemnity's equity in earnings of limited partnerships increased \$2 million in the third quarter of 2011 and increased \$14 million in the first nine months of 2011 compared to the same periods in 2010 while the Exchange's equity in earnings of limited partnerships increased \$10 million and \$78 million, respectively. The results were due to improved performance in the real estate and private equity sectors.

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

| (in millions)                                     | Erie Insurance Group                |       |                                    |       |
|---|-------------------------------------|-------|------------------------------------|-------|
|   | Three months ended<br>September 30, |       | Nine months ended<br>September 30, |       |
|   | 2011                                | 2010  | 2011                               | 2010  |
|   | (Unaudited)                         |       | (Unaudited)                        |       |
| <b>Indemnity</b>                                  |                                     |       |                                    |       |
| Securities sold:                                  |                                     |       |                                    |       |
| Fixed maturities                                  | \$ 0                                | \$ 1  | \$ 2                               | \$ 4  |
| Preferred stock equity securities                 | 0                                   | 1     | 3                                  | 1     |
| Common stock equity securities                    | 0                                   | 3     | 2                                  | 4     |
| Common stock valuation adjustments                | (6)                                 | 0     | (6)                                | (2)   |
| Total net realized (losses) gains Indemnity(1)    | \$ (6)                              | \$ 5  | \$ 1                               | \$ 7  |
| <b>Exchange</b>                                   |                                     |       |                                    |       |
| Securities sold:                                  |                                     |       |                                    |       |
| Fixed maturities                                  | \$ 10                               | \$ 6  | \$ 44                              | \$ 22 |
| Preferred stock equity securities                 | 3                                   | 3     | 18                                 | 9     |
| Common stock equity securities                    | 21                                  | 4     | 124                                | 63    |
| Common stock valuation adjustments                | (450)                               | 187   | (421)                              | 16    |
| Total net realized (losses) gains Exchange(1) (2) | \$(416)                             | \$200 | \$(235)                            | \$110 |

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

(2) The Exchange's results for the third quarter of 2011 and 2010 include net realized gains from EFL's operations of \$5 million and \$3 million, respectively. The Exchange's results for the first nine months of 2011 and 2010 include net realized gains from EFL of \$12 million and \$11 million, respectively.

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

| (in millions)  | Erie Insurance Group                |      |                                    |      |
|--|-------------------------------------|------|------------------------------------|------|
|  | Three months ended<br>September 30, |      | Nine months ended<br>September 30, |      |
|  | 2011                                | 2010 | 2011                               | 2010 |
|  | (Unaudited)                         |      | (Unaudited)                        |      |
| <b>Indemnity</b>   |                                     |      |                                    |      |
| Private equity   | \$ 2                                | \$ 1 | \$ 13                              | \$ 9 |
| Real estate  | 3                                   | 3    | 7                                  | (3)  |
| Mezzanine debt   | 2                                   | 1    | 5                                  | 5    |
| Total equity in earnings of limited partnerships Indemnity   | \$ 7                                | \$ 5 | \$ 25                              | \$11 |
| <b>Exchange</b>  |                                     |      |                                    |      |
| Private equity   | \$12                                | \$ 7 | \$ 69                              | \$44 |
| Real estate  | 15                                  | 9    | 35                                 | (16) |
| Mezzanine debt   | 6                                   | 7    | 21                                 | 19   |
| Total equity in earnings of limited partnerships Exchange(1) | \$33                                | \$23 | \$125                              | \$47 |



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*(1) The Exchange's results for the third quarter of 2011 and 2010 did not include any equity in earnings of limited partnerships from EFL. The Exchange's results for the first nine months of 2011 include equity in earnings of limited partnerships from EFL of \$1 million compared to losses of \$1 million recorded for the first nine months of 2010.*

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

We experienced an increase in earnings as a result of fair value increases in our private equity and real estate limited partnerships. Limited partnership earnings tend to be cyclical based on market conditions, the age of the partnership and the nature of the investments. Generally, limited partnership earnings are recorded on a quarter lag from financial statements we receive from our general partners. As a consequence, earnings from limited partnerships reported at September 30, 2011 reflect investment valuation changes resulting from the financial markets and the economy through June 30, 2011.

**FINANCIAL CONDITION****Investments**

Prior to and through December 31, 2010, the investment results from EIC, ENY and EPC accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, the investment results for these companies accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. (See Item 1.

Financial Statements - Note 1, Nature of Operations, contained within this report.)

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

**Distribution of investments**

| <i>(in millions)</i>                   | Erie Insurance Group                                      |            |   |            |
|--|---|------------|---|------------|
|  | Carrying value at<br>September 30,<br>2011<br>(Unaudited) | % to total | Carrying value at<br>December 31,<br>2010 | % to total |
| <b>Indemnity</b>                       |   |            |   |            |
| Fixed maturities                       | \$ 517  | 66%        | \$ 264                                    | 50%        |
| Equity securities:                     |   |            |   |            |
| Preferred stock                        | 22  | 3          | 24  | 4          |
| Common stock                           | 26  | 3          | 28  | 5          |
| Limited partnerships:                  |   |            |   |            |
| Private equity                         | 89  | 11         | 86  | 16         |
| Real estate                            | 92  | 12         | 83  | 16         |
| Mezzanine debt                         | 42  | 5          | 47  | 9          |
| Real estate mortgage loans             | 1   | 0          | 1   | 0          |
| Total investments Indemnity            | \$789   | 100%       | \$533                                     | 100%       |
| <b>Exchange</b>                        |   |            |   |            |
| Fixed maturities                       | \$ 7,331  | 65%        | \$ 7,279                                  | 65%        |
| Equity securities:                     |   |            |   |            |
| Preferred stock                        | 591   | 5          | 570                                       | 5          |
| Common stock                           | 2,085   | 19         | 2,306                                     | 20         |
| Limited partnerships:                  |   |            |   |            |
| Private equity                         | 584   | 5          | 555                                       | 5          |
| Real estate                            | 388   | 4          | 339                                       | 3          |
| Mezzanine debt                         | 215   | 2          | 214                                       | 2          |
| Policy loans                           | 15  | 0          | 15  | 0          |
| Real estate mortgage loans             | 4   | 0          | 4   | 0          |
| Total investments Exchange             | \$11,213  | 100%       | \$11,282                                  | 100%       |
| Total investments Erie Insurance Group | \$12,002  |            | \$11,815                                  |            |

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

We individually analyze all positions with emphasis on those that have, in management's opinion, declined significantly below cost. In compliance with impairment guidance for debt securities, we perform further analysis to determine if a credit-related impairment has occurred. Some of the factors considered in determining whether a debt security is credit impaired include potential for the default of interest and/or principal, level of subordination, collateral of the issue, compliance with financial covenants, credit ratings and industry conditions. We have the intent to sell all credit-impaired debt securities, therefore the entire amount of the impairment charges are included in earnings and no credit impairments are recorded in other comprehensive income. For available-for-sale equity

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securities, a charge is recorded in the Consolidated Statements of Operations for positions that have experienced other-than-temporary impairments due to credit quality or other factors. (See the Investment Operations section herein for further information.) Management believes its investment valuation philosophy and accounting practices result in appropriate and timely measurement of value and recognition of impairment.

### Fixed maturities

Under our investment strategy, we maintain a fixed maturities portfolio that is of high quality and well diversified within each market sector. This investment strategy also achieves a balanced maturity schedule. The fixed maturities portfolio is managed with the goal of achieving reasonable returns while limiting exposure to risk. Our municipal bond portfolio accounts for \$224 million, or 43%, of the total fixed maturity portfolio for Indemnity and \$1.4 billion, or 19%, of the fixed maturity portfolio for the Exchange at September 30, 2011. The overall credit rating of the municipal portfolio without consideration of the underlying insurance is AA. Because of the rating downgrades of municipal bond insurers, the underlying insurance does not improve the overall credit rating.

Fixed maturities classified as available-for-sale are carried at fair value with unrealized gains and losses, net of deferred taxes, included in shareholders' equity. Indemnity's net unrealized gains on fixed maturities, net of deferred taxes, amounted to \$7 million at September 30, 2011 compared to \$5 million at December 31, 2010. At September 30, 2011, the Exchange had net unrealized gains on fixed maturities of \$295 million compared to net unrealized gains of \$270 million at December 31, 2010.

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

| <i>(in millions)</i> |                           | Erie Insurance Group (1) |              |              |              |                         |               |  |
|----------------------|---------------------------|--------------------------|--------------|--------------|--------------|-------------------------|---------------|--|
|                      |                           | At September 30, 2011    |              |              |              |                         |               |  |
|                      |                           | (Unaudited)              |              |              |              |                         |               |  |
| <b>Indemnity</b>     | Industry Sector           | AAA                      | AA           | A            | BBB          | Non-investment<br>grade | Fair<br>value |  |
|                      | Structured securities (2) | \$ 29                    | \$ 0         | \$ 0         | \$ 3         | \$1                     | \$ 33         |  |
|                      | Communications            | 0                        | 0            | 10           | 7            | 0                       | 17            |  |
|                      | Consumer                  | 0                        | 0            | 8            | 14           | 0                       | 22            |  |
|                      | Energy                    | 0                        | 0            | 11           | 9            | 0                       | 20            |  |
|                      | Financial                 | 0                        | 48           | 41           | 40           | 0                       | 129           |  |
|                      | Government-municipal      | 92                       | 97           | 24           | 11           | 0                       | 224           |  |
|                      | Industrial                | 0                        | 0            | 2            | 5            | 0                       | 7             |  |
|                      | Technology                | 0                        | 0            | 8            | 10           | 0                       | 18            |  |
|                      | Utilities                 | 0                        | 0            | 0            | 47           | 0                       | 47            |  |
|                      | <b>Total Indemnity</b>    | <b>\$121</b>             | <b>\$145</b> | <b>\$104</b> | <b>\$146</b> | <b>\$1</b>              | <b>\$517</b>  |  |

(1) Ratings are supplied by S&P, Moody's, and Fitch. The table is based on 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.



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Erie Insurance Group (1)  
At September 30, 2011  
(Unaudited)

(in millions)

| Exchange | Industry Sector             | AAA   | AA      | A       | BBB     | Non-investment grade | Fair value |
|----------|-----------------------------|-------|---------|---------|---------|----------------------|------------|
|          | Structured securities (2)   | \$ 79 | \$ 281  | \$ 20   | \$ 20   | \$ 10                | \$ 410     |
|          | Basic materials             | 0     | 0       | 58      | 166     | 6                    | 230        |
|          | Communications              | 0     | 0       | 224     | 290     | 14                   | 528        |
|          | Consumer                    | 0     | 31      | 247     | 393     | 67                   | 738        |
|          | Diversified                 | 0     | 0       | 22      | 0       | 0                    | 22         |
|          | Energy                      | 16    | 12      | 110     | 361     | 37                   | 536        |
|          | Financial                   | 7     | 312     | 1,122   | 761     | 128                  | 2,330      |
|          | Funds                       | 0     | 0       | 0       | 6       | 0                    | 6          |
|          | Government-municipal        | 399   | 787     | 195     | 34      | 2                    | 1,417      |
|          | Industrial                  | 0     | 6       | 81      | 203     | 25                   | 315        |
|          | U.S. treasury               | 0     | 6       | 0       | 0       | 0                    | 6          |
|          | Government sponsored entity | 0     | 29      | 2       | 0       | 0                    | 31         |
|          | Foreign government          | 0     | 0       | 15      | 6       | 0                    | 21         |
|          | Technology                  | 0     | 0       | 50      | 73      | 0                    | 123        |
|          | Utilities                   | 0     | 0       | 106     | 460     | 52                   | 618        |
|          | Total Exchange              | \$501 | \$1,464 | \$2,252 | \$2,773 | \$341                | \$7,331    |

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

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

Equity securities

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

The following tables present an analysis of the fair value of our non-redeemable preferred and common stock securities by sector for Indemnity and Exchange, respectively.

Erie Insurance Group  
Fair value at

(in millions)

| Indemnity | Industry sector | September 30, 2011<br>(Unaudited) |              | December 31, 2010 |              |
|-----------|-----------------|-----------------------------------|--------------|-------------------|--------------|
|           |                 | Preferred stock                   | Common stock | Preferred stock   | Common stock |
|           | Communications  | \$ 1                              | \$ 2         | \$ 1              | \$ 2         |
|           | Consumer        | 0                                 | 13           | 0                 | 14           |
|           | Diversified     | 0                                 | 1            | 0                 | 0            |

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|                 |      |      |      |      |
|-----------------|------|------|------|------|
| Energy          | 0    | 1    | 0    | 2    |
| Financial       | 11   | 5    | 11   | 6    |
| Industrial      | 0    | 3    | 2    | 3    |
| Technology      | 3    | 1    | 3    | 1    |
| Utilities       | 7    | 0    | 7    | 0    |
| Total Indemnity | \$22 | \$26 | \$24 | \$28 |

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| <i>(in millions)</i> |                 | Erie Insurance Group              |              |                   |              |
|----------------------|-----------------|-----------------------------------|--------------|-------------------|--------------|
|                      |                 | Fair value at                     |              |                   |              |
|                      |                 | September 30, 2011<br>(Unaudited) |              | December 31, 2010 |              |
| <b>Exchange</b>      | Industry sector | Preferred stock                   | Common stock | Preferred stock   | Common stock |
|                      | Basic materials | \$ 0                              | \$ 79        | \$ 0              | \$ 124       |
|                      | Communications  | 9                                 | 180          | 9                 | 174          |
|                      | Consumer        | 5                                 | 658          | 5                 | 564          |
|                      | Diversified     | 0                                 | 12           | 0                 | 12           |
|                      | Energy          | 0                                 | 174          | 0                 | 185          |
|                      | Financial       | 441                               | 277          | 428               | 292          |
|                      | Funds           | 0                                 | 140          | 0                 | 309          |
|                      | Government      | 1                                 | 0            | 0                 | 0            |
|                      | Industrial      | 0                                 | 289          | 5                 | 324          |
|                      | Technology      | 15                                | 240          | 14                | 295          |
|                      | Utilities       | 120                               | 36           | 109               | 27           |
|                      | Total Exchange  | \$591                             | \$2,085      | \$570             | \$2,306      |

Our preferred stock equity securities are classified as available-for-sale and are carried at fair value on our Consolidated Statements of Financial Position with all changes in unrealized gains and losses reflected in other comprehensive income. At September 30, 2011, the unrealized gain on preferred stock classified as available-for-sale securities, net of deferred taxes amounted to \$1 million for Indemnity and \$21 million for the Exchange compared to a \$3 million gain for Indemnity and \$44 million gain for the Exchange at December 31, 2010.

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

Limited partnerships

In the third quarter of 2011, investments in limited partnerships increased modestly from the investment levels at December 31, 2010. The changes in partnership value are a function of contributions and distributions, adjusted for market value changes in the underlying investments. During 2011, the limited partnership market values and partnership earnings have been generally positive as the recent market conditions continue to show signs of improvement.

The components of limited partnership investments are as follows:

| <i>(in millions)</i> |                                      | Erie Insurance Group                 |                      |
|----------------------|--------------------------------------|--------------------------------------|----------------------|
|                      |                                      | At September 30, 2011<br>(Unaudited) | At December 31, 2010 |
| <b>Indemnity</b>     |                                      |                                      |                      |
|                      | Private equity                       | \$ 89                                | \$ 86                |
|                      | Real estate                          | 92                                   | 83                   |
|                      | Mezzanine debt                       | 42                                   | 47                   |
|                      | Total limited partnerships Indemnity | \$ 223                               | \$ 216               |
| <b>Exchange</b>      |                                      |                                      |                      |
|                      | Private equity                       | \$ 584                               | \$ 555               |
|                      | Real estate                          | 388                                  | 339                  |



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|                            |          |         |         |
|----------------------------|----------|---------|---------|
| Mezzanine debt             |          | 215     | 214     |
| Total limited partnerships | Exchange | \$1,187 | \$1,108 |

**Liabilities**Property and casualty loss reserves

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

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

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

As of December 31, 2010, all property and casualty insurance underwriting risk resides with the Exchange. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

| <i>(in millions)</i>                | Erie Insurance Group                    |                         |
|-------------------------------------|---|-------------------------|
|                                     | At September 30,<br>2011<br>(Unaudited) | At December 31,<br>2010 |
| <b>Exchange</b>                     |   |                         |
| Gross reserve liability:            |   |                         |
| Personal auto                       | \$1,085                                 | \$1,105                 |
| Automobile massive injury           | 373                                     | 440                     |
| Homeowners                          | 413                                     | 240                     |
| Workers compensation                | 470                                     | 481                     |
| Workers compensation massive injury | 108                                     | 154                     |
| Commercial auto                     | 289                                     | 286                     |
| Commercial multi-peril              | 612                                     | 566                     |
| All other lines of business         | 336                                     | 312                     |
| Gross reserves                      | 3,686                                   | 3,584                   |
| Reinsurance recoverable             | 188                                     | 188                     |
| Net reserve liability Exchange      | \$3,498                                 | \$3,396                 |

The reserves that have the greatest potential for variation are the massive injury claim reserves. The Property and Casualty Group is currently reserving for about 300 claimants requiring lifetime medical care, of which about 120 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 \$317 million at September 30, 2011, which is net of \$164 million of anticipated reinsurance recoverables, compared to \$428 million at December 31, 2010, which was net of \$166 million of anticipated reinsurance recoverables. The pre-1986 automobile massive injury reserves decreased at September 30, 2011, compared to December 31, 2010, primarily due to improved annual claim cost expectations on massive injury lifetime medical benefits claims and the closing of two massive injury lifetime medical benefits claims. The workers compensation massive injury reserves decreased at September 30, 2011, compared to December 31, 2010, primarily due to the closing of six massive injury lifetime medical benefits claims.

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 on 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 on the amount of policyholder deposits (less applicable insurance and expense charges) plus interest earned on those deposits. Life insurance and annuity reserves are supported primarily by EFL's long-term, fixed income investments as the underlying policy reserves are generally also of a long-term nature.

**IMPACT OF INFLATION**

Property and casualty insurance premiums are established before losses occur and before loss expenses are incurred, and therefore, before the extent to which inflation may impact such costs is known. Consequently, in establishing premium rates, we attempt to anticipate the potential impact of inflation, including medical cost inflation, construction and auto repair cost inflation and tort issues. Medical costs are a broad element of inflation that impacts personal and commercial auto, general liability, workers compensation and commercial multi-peril lines of insurance written by the Property and Casualty Group.

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

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

Volatility in the financial markets presents challenges to us as we do occasionally access our investment portfolio as a source of cash. Some of our fixed income investments, despite being publicly traded, are illiquid. Volatility in these markets could impair our ability to sell certain of our fixed income securities or cause such securities to sell at deep discounts. Additionally, our limited partnership investments are significantly less liquid. We believe we have sufficient liquidity to meet our needs from other sources even if market volatility persists throughout 2011.

**Cash flow activities - Erie Insurance Group**

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

| <i>(in millions)</i>                      | Erie Insurance Group |        |
|---|----------------------|--------|
|   | 2011                 | 2010   |
|   | (Unaudited)          |        |
| Net cash provided by operating activities | \$ 225               | \$ 465 |
| Net cash used in investing activities     | (395)                | (301)  |
| Net cash used in financing activities     | (184)                | (86)   |
| Net (decrease) increase in cash           | \$(354)              | \$ 78  |

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Cash flows provided by operating activities totaled \$225 million and \$465 million in the first nine months of 2011 and 2010, respectively. Decreased cash from operating activities in the first nine months of 2011 was primarily driven by increased losses paid to policyholders related to catastrophic events and commissions paid to agents as compared to the first nine months of 2010. Offsetting this decrease in the first nine months of 2011 was an increase in premiums collected by the Exchange and less income taxes paid compared to the first nine months of 2010.

At September 30, 2011, we recorded a net deferred tax liability of \$103 million. There was no valuation allowance at September 30, 2011.

Cash flows used in investing activities totaled \$395 million and \$301 million in the first nine months of 2011 and 2010, respectively. In the first nine months of 2011, we used more cash to purchase certain common stock investments, offset somewhat by an increase in proceeds generated from the sale of other common stocks as compared to the first nine months of 2010. At September 30, 2011, we had contractual commitments to invest up to \$433 million related to our

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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 \$194 million, real estate activities was \$119 million and mezzanine debt securities was \$120 million.

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

### Cash flow activities - Indemnity

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

| <i>(in millions)</i>                      | Indemnity   |        |
|---|-------------|--------|
|   | 2011        | 2010   |
|   | (Unaudited) |        |
| Net cash provided by operating activities | \$ 113      | \$ 129 |
| Net cash used in investing activities     | (180)       | (14)   |
| Net cash used in financing activities     | (209)       | (118)  |
| Net decrease in cash                      | \$(276)     | \$ (3) |

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

Indemnity's cash flows provided by operating activities decreased to \$113 million in the first nine months of 2011, compared to \$129 million in the first nine months of 2010. Decreased cash from operating activities in the first nine months of 2011 was primarily due to increases in commissions paid to agents and salaries and benefits paid to employees, combined with less net investment income received. This decrease was offset somewhat by an increase in management fee revenue received as compared to the first nine months of 2010. Management fee revenues were higher reflecting the increase in premiums written or assumed by the Exchange. Cash paid for agent commissions and bonuses increased to \$450 million in the first nine months of 2011, compared to \$414 million in the first nine months of 2010, as a result of the increase in premiums collected by the Exchange. Indemnity made a contribution to its pension plan of \$15 million in the third quarter of 2011, compared to \$13 million in the second quarter of 2010. 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 about 57% of the net periodic benefit cost of the pension plan from its affiliates.

At September 30, 2011, Indemnity recorded a net deferred tax liability of \$6 million. There was no valuation allowance at September 30, 2011. Indemnity's capital gain and loss strategies take into consideration its ability to offset gains and losses in future periods, carry-back of capital loss opportunities to the three preceding years, and capital loss carry-forward opportunities to apply against future capital gains over the next five years.

Net cash used in Indemnity investing activities totaled \$180 million in the first nine months of 2011, compared to \$14 million in the first nine months of 2010. In the first quarter of 2011, Indemnity received cash consideration from the Exchange of \$82 million as a result of the sale of

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Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, based upon an estimated purchase price. Final settlement of the transaction was made on April 25, 2011 for a final purchase price of \$82 million. Net after-tax cash proceeds to Indemnity from the sale were \$58 million. Also, on March 18, 2011, a payment of \$8 million was made by Indemnity to the Exchange as final settlement of the sale of EIC, ENY and EPC to the Exchange based upon the final purchase price. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

Indemnity's first nine months of 2011 investing activities also included increased cash used to purchase certain fixed maturities, offset somewhat by increased cash from the sale of other fixed maturities and common stocks as compared to the first nine months of 2010. Also impacting Indemnity's future investing activities are limited partnership commitments, which totaled \$41 million at September 30, 2011, 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 \$18 million, real estate activities was \$12 million and mezzanine debt securities was \$11 million.

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Net cash used in Indemnity financing activities totaled \$209 million and \$118 million in the first nine months of 2011 and 2010, respectively. The increase in cash used in financing activities in the first nine months of 2011 was primarily driven by an increase in the cash outlay for the purchase of treasury stock. Indemnity repurchased 0.6 million shares of its Class A nonvoting common stock in conjunction with its stock repurchase program at a total cost of \$42 million in the third quarter of 2011. During the first nine months of 2011, shares repurchased under this program totaled 1.9 million at a total cost of \$132 million. During the first nine months of 2010, 1.0 million shares were repurchased at a total cost of \$46 million. In December 2010, our Board of Directors approved a continuation of the current stock repurchase program for a total of \$150 million. Indemnity had approximately \$14 million of repurchase authority remaining under this program at September 30, 2011. 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.

In July 2011, Indemnity also repurchased 64,095 shares of its outstanding Class A nonvoting common stock outside of its publicly announced share repurchase program at a total cost of \$5 million. Of this amount, 57,695 shares were purchased for \$4.3 million, or \$73.72 per share, in conjunction with our long-term incentive plan, and 6,400 shares were purchased for \$0.5 million, or \$73.74 per share, for the vesting of stock-based awards for executive management. These shares were delivered to plan participants and executive management, respectively, in July 2011. During the first nine months of 2010, Indemnity repurchased 44,206 shares of its outstanding Class A nonvoting common stock outside of its publicly announced share repurchase program at a total cost of \$2 million. Of this amount, 39,406 shares were purchased in June 2010 for \$1.8 million, or \$45.92 per share, in conjunction with our long-term incentive plan, and 4,800 shares were purchased in July 2010 for \$0.2 million, or \$48.75 per share, for the vesting of stock-based awards for executive management. These shares were delivered to plan participants and executive management, respectively, in July 2010.

Dividends paid to shareholders totaled \$77 million in the first nine months of 2011, compared to \$74 million in the first nine months of 2010. Indemnity increased both its Class A and Class B shareholder quarterly dividends by 7.3% in 2011, compared to 2010. There are no regulatory restrictions on the payment of dividends to Indemnity's shareholders.

### Capital Outlook

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

*Indemnity* Outside of Indemnity's normal operating and investing cash activities, future funding requirements could be met through 1) Indemnity's cash and cash equivalents, which total approximately \$34 million at September 30, 2011, 2) a \$100 million bank 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 \$564 million at September 30, 2011. Volatility in the financial markets could impair Indemnity's ability to sell certain of its fixed income securities or cause such securities to sell at deep discounts. Additionally, Indemnity has the ability to curtail or modify discretionary cash outlays such as those related to shareholder dividends and share repurchase activities.

Indemnity had no borrowings under its line of credit at September 30, 2011. At September 30, 2011, bonds with fair values of \$137 million were pledged as collateral. These securities have no restrictions. The bank requires compliance with certain covenants, which include minimum net worth and leverage ratios. Indemnity was in compliance with its bank covenants at September 30, 2011. Additionally, on November 3, 2011, Indemnity entered into a new five year revolving credit facility for the same amount which expires on November 3, 2016.



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Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the Indemnity shareholder interest. Due to the sale of Indemnity's property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results and all investment results for these companies accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010. The net cash provided from these entities by operating activities totaled \$22 million for the nine months ended September 30, 2010. These operating cash flows accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, in 2011 and thereafter. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)

*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 \$42 million at September 30, 2011, 2) a \$200 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 \$9.7 billion at September 30, 2011. Volatility in the financial markets could impair the Exchange's ability to sell certain of its fixed income securities or cause such securities to sell at deep discounts.

The Exchange had no borrowings under its line of credit at September 30, 2011. At September 30, 2011, bonds with fair values of \$262 million were pledged as collateral. These securities have no restrictions. The bank requires compliance with certain covenants, which include statutory surplus and risk based capital ratios. The Exchange was in compliance with its bank covenants at September 30, 2011. Additionally, on October 28, 2011, the Exchange amended its revolving credit facility increasing the amount available from \$200 million to \$300 million and extending the term five years, which expires on October 28, 2016.

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 cash flow requirements in 2011.

#### **Off-Balance Sheet Arrangements**

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

#### **Surplus Notes**

Indemnity holds a surplus note for \$25 million from EFL that is payable on demand on or after December 31, 2018 with prior approval of the Pennsylvania Insurance Commissioner. EFL accrued interest to Indemnity on the surplus note of \$1.3 million through September 30, 2011 and 2010.

The Exchange holds a surplus note for \$20 million from EFL that is payable on demand on or after December 31, 2025 with prior approval of the Pennsylvania Insurance Commissioner. EFL accrued interest to the Exchange on the surplus note of \$0.9 million through September 30, 2011 and 2010.

#### **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 reserves for property/casualty insurance unpaid losses and loss adjustment expenses, life insurance and annuity policy reserves, valuation of investments, deferred acquisition costs related to life insurance and investment-type contracts, deferred taxes and retirement benefits. 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

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Operations, for the year ended December 31, 2010 of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 24, 2011. See Item 1. Financial Statements - Note 6, Fair Value, contained within this report for additional information on our valuation of investments.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our exposure to market risk is primarily related to fluctuations in prices and interest rates. Quantitative and qualitative disclosures about market risk resulting from changes in prices and interest rates for the year ended December 31, 2010 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 24, 2011. There have been no material changes that impact our portfolio or reshape our periodic investment reviews of asset allocations during the nine months ended September 30, 2011. For a recent discussion of conditions surrounding our investment portfolio, see the Operating Overview, Investment Operations, and Financial Condition, Investments discussions contained in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, within this report.

**ITEM 4. CONTROLS AND PROCEDURES**

We carried out an evaluation, with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Our management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, any change in our internal control over financial reporting and determined there has been no change in our internal control over financial reporting during the nine months ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION****ITEM 1A. RISK FACTORS**

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 as filed with the Securities and Exchange Commission on February 24, 2011.

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

The following table summarizes Indemnity's Class A common stock repurchased each month, based upon trade date, during the quarter ended September 30, 2011:

*(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 |
|------------------------|----------------------------------|------------------------------|--|--|
| July 1 - 31, 2011      | 162,530                          | \$73.49                      | 98,435   |  |
| August 1 - 31, 2011    | 261,984                          | \$70.19                      | 261,984  |  |
| September 1 - 30, 2011 | 225,592                          | \$72.01                      | 225,592  |  |
| Total                  | 650,106                          |                              | 586,011  | \$14   |

In December 2010, 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.

Additionally, 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 amount includes, and is not in addition to, any unspent amounts remaining under the prior authorization.

In addition, the month of July 2011 includes 64,095 shares of our outstanding Class A nonvoting common stock repurchased outside of our publicly announced share repurchase program at a total cost of \$5 million. Of this amount, 57,695 shares were purchased for \$4.3 million, or \$73.72 per share, in conjunction with our long-term incentive plan, and 6,400 shares were purchased for \$0.5 million, or \$73.74 per share, for

the vesting of stock-based awards for executive management. These shares were delivered to plan participants and executive management, respectively, in July 2011.

**ITEM 6. EXHIBITS**

| <u>Exhibit<br/>Number</u> | <u>Description of Exhibit</u>  |
|---------------------------|--|
| 10.1                      | Executive Retention Agreement between Erie Indemnity Company and James J. Tanous dated August 3, 2011. Such exhibit is incorporated by reference to the like titled exhibit in the Registrant's Form 8-K that was filed with the Securities and Exchange Commission on August 4, 2011. |
| 31.1                      | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 31.2                      | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 32                        | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |
| 101.INS                   | XBRL Instance Document   |
| 101.SCH                   | XBRL Taxonomy Extension Schema Document  |
| 101.CAL                   | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB                   | XBRL Taxonomy Extension Labels Linkbase Document   |
| 101.PRE                   | XBRL Taxonomy Extension Presentation Linkbase Document   |
| 101.DEF                   | XBRL Taxonomy Extension Definition Linkbase Document   |



**SIGNATURES**

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

Erie Indemnity Company  
(Registrant)

Date: November 3, 2011

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

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