

ERIE INDEMNITY CO  
Form 10-K  
February 26, 2015  
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

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

For the fiscal year ended December 31, 2014

OR

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

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)  
(814) 870-2000

16530  
(Zip code)

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Class A common stock, stated value \$0.0292 per share, listed on the NASDAQ Stock Market, LLC

(Title of each class)

(Name of each exchange on which  
registered)

Securities registered pursuant to Section 12(g) of the Act: None

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 if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the 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).



Table of Contents

## INDEX

PART	ITEM NUMBER AND CAPTION	PAGE
I	<u>Item 1. Business</u>	<u>3</u>
	<u>Item 1A. Risk Factors</u>	<u>9</u>
	<u>Item 1B. Unresolved Staff Comments</u>	<u>19</u>
	<u>Item 2. Properties</u>	<u>19</u>
	<u>Item 3. Legal Proceedings</u>	<u>19</u>
	<u>Item 4. Mine Safety Disclosures</u>	<u>20</u>
II	<u>Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>21</u>
	<u>Item 6. Selected Consolidated Financial Data</u>	<u>23</u>
	<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>24</u>
	<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>63</u>
	<u>Item 8. Financial Statements and Supplementary Data</u>	<u>67</u>
	<u>Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>123</u>
	<u>Item 9A. Controls and Procedures</u>	<u>123</u>
	<u>Item 9B. Other Information</u>	<u>123</u>
III	<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>125</u>
	<u>Item 11. Executive Compensation</u>	<u>126</u>
	<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>126</u>
	<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>126</u>
	<u>Item 14. Principal Accountant Fees and Services</u>	<u>126</u>
IV	<u>Item 15. Exhibits and Financial Statement Schedules</u>	<u>127</u>
	<u>Signatures</u>	<u>128</u>

Table of Contents

PART I

ITEM 1. BUSINESS

General

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

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

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

The Exchange, together with its wholly owned subsidiaries, Erie Insurance Company (“EIC”), Erie Insurance Company of New York (“ENY”), Erie Insurance Property and Casualty Company (“EPC”), and Flagship City Insurance Company (“Flagship”), operate as a property and casualty insurer and are collectively referred to as the “Property and Casualty Group”. The Property and Casualty Group operates in 12 Midwestern, Mid-Atlantic, and Southeastern states and the District of Columbia and writes primarily private passenger automobile, homeowners, commercial multi-peril, commercial automobile, and workers compensation lines of insurance.

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

The Property & Casualty Group and EFL began writing private passenger automobile, home insurance, personal excess liability insurance, and life insurance and annuity products in Kentucky in the fourth quarter of 2014.

All property and casualty and life insurance operations are owned by the Exchange and Indemnity functions solely as the management company.

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

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

Business Segments

We operate our business as four reportable segments – management operations, property and casualty insurance operations, life insurance operations, and investment operations. Financial information about these segments is set forth in and referenced to Item 8. “Financial Statements and Supplementary Data - Note 5, Segment Information, of Notes to Consolidated Financial Statements” contained within this report. Further discussion of financial results by

operating segment is provided in and referenced to Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained within this report.

Management operations – We generate internal management fee revenue, which accrues to the Indemnity shareholder interest, as Indemnity provides services to the Exchange relating to the sales, underwriting, and issuance of policies. The Exchange is the sole customer of our management operations. Indemnity charges the Exchange a management fee, determined by our Board of Directors, not to exceed 25% of all premiums written or assumed by the Exchange for its services as attorney-in-fact. Management fee revenue is eliminated upon consolidation.

3

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## Table of Contents

Property and casualty insurance operations – The Property and Casualty Group generates revenue, which accrues to the noncontrolling interest, by insuring preferred and standard risks, with personal lines comprising 71% of the 2014 direct written premiums and commercial lines comprising the remaining 29%. The principal personal lines products based upon 2014 direct written premiums were private passenger automobile (43%) and homeowners (27%). The principal commercial lines products based upon 2014 direct written premiums were commercial multi-peril (13%), commercial automobile (7%), and workers compensation (7%).

The members of the Property and Casualty Group pool 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.

Historically, due to policy renewal and sales patterns, the Property and Casualty Group's direct written premiums are greater in the second and third quarters than in the first and fourth quarters of the calendar year. Property and casualty insurance premiums earned accounted for approximately 86% of our total consolidated revenue in 2014, 77% in 2013, and 80% in 2012.

The Property and Casualty Group is represented by nearly 2,200 independent agencies comprising over 11,000 licensed property and casualty representatives, which is our sole distribution channel. In addition to their principal role as salespersons, the independent agents play a significant role as underwriting and service providers and are fundamental to the Property and Casualty Group's success.

The Property and Casualty Group writes business in Illinois, Indiana, Kentucky, Maryland, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, Wisconsin, and the District of Columbia. The states of Pennsylvania, Maryland, Virginia, North Carolina and Ohio made up 74% of the Property and Casualty Group's direct written premium in 2014.

While sales, underwriting, and policy issuance services are centralized at our home office, the Property and Casualty Group maintains 25 field offices throughout its operating region to provide claims services to policyholders and marketing support for the independent agencies that represent us.

The Property and Casualty Group ranked as the 12<sup>th</sup> largest automobile insurer in the United States based upon 2013 direct premiums written and as the 16<sup>th</sup> largest property and casualty insurer in the United States based upon 2013 total lines net premiums written according to A.M. Best Company.

Life insurance operations – Our life insurance operations generate revenue from the sale of individual and group life insurance policies and fixed annuities. These products are offered through our property and casualty insurance agency force to provide an opportunity to cross-sell both personal and commercial accounts. EFL writes business in 11 states including Illinois, Indiana, Kentucky, Maryland, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, Wisconsin, and the District of Columbia. The state of Pennsylvania made up 46% of EFL's 2014 premium and annuity considerations, with Maryland, Virginia, and Ohio making up nearly 10% each.

Investment operations – Our investment operations generate revenue from our fixed maturity, equity security, and limited partnership investment portfolios to support our underwriting business. The Indemnity and Exchange portfolios are managed with the objective of maximizing after-tax returns on a risk-adjusted basis, while the EFL portfolio is managed to be closely aligned to its liabilities and to maintain a sufficient yield to meet profitability targets. We actively evaluate the portfolios for impairments. We record impairment writedowns on investments in instances where the fair value of the investment is substantially below cost, and we conclude that the decline in fair value is other-than-temporary, which includes consideration for intent to sell. Revenues and losses included in investment operations consist of net investment income, net realized gains and losses, net impairment losses

recognized in earnings for our fixed maturity and preferred equity portfolios, and equity in earnings and losses from our limited partnership investments, which include private equity, mezzanine debt, and real estate limited partnerships. The volatility inherent in the financial markets has the potential to impact our investment portfolio from time-to-time. Net revenues from our investment operations accounted for approximately 12% of our total consolidated revenue in 2014, 21% in 2013, and 18% in 2012.

4

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## Table of Contents

### Competition

Property and casualty insurers generally compete on the basis of customer service, price, consumer recognition, coverages offered, claims handling, financial stability, and geographic coverage. Vigorous competition, particularly in the personal lines automobile and homeowners lines of business, is provided by large, well-capitalized national companies, some of which have broad distribution networks of employed or captive agents, by smaller regional insurers, and by large companies who market and sell personal lines products directly to consumers. In addition, because the insurance products of the Property and Casualty Group are marketed exclusively through independent insurance agents, the Property and Casualty Group faces competition within its appointed agencies based upon ease of doing business, product, price, and service relationships.

Market competition bears directly on the price charged for insurance products and services subject to regulatory limitations. Growth is driven by a company's ability to provide insurance services and competitive prices while maintaining target profit margins. Industry capital levels can also significantly affect prices charged for coverage. Growth is a product of a company's ability to retain existing customers and to attract new customers, as well as movement in the average premium per policy.

The Erie Insurance Group has a strategic focus that we believe will result in long-term underwriting performance. First, we employ an underwriting philosophy and product mix targeted to produce a Property and Casualty Group underwriting profit on a long-term basis through careful risk selection and rational pricing. The careful selection of risk allows for lower claims frequency and loss severity, thereby enabling insurance to be offered at favorable prices. The Property and Casualty Group has continued to refine its risk measurement and price sophistication models used in the underwriting and pricing processes. Second, the Property and Casualty Group focuses on consistently providing superior service to policyholders and agents. Third, the Property and Casualty Group's business model is designed to provide the advantages of localized marketing and claims servicing with the economies of scale and low cost of operations from centralized accounting, administrative, underwriting, investment, information management, and other support services.

Finally, we carefully select the independent agencies that represent the Property and Casualty Group. The Property and Casualty Group seeks to be the lead insurer with its agents in order to enhance the agency relationship and the likelihood of receiving the most desirable underwriting opportunities from its agents. We have ongoing, direct communications with our agency force. Agents have access to a number of venues we sponsor designed to promote the sharing of ideas, concerns and suggestions with the senior management of the Property and Casualty Group, with the goal of improving communications and service. We continually evaluate new ways to support our agents' efforts, from marketing programs to identifying potential customer leads, to grow the business of the Property and Casualty Group and sustain our long-term agency relationships. High agency penetration and long-term relationships allow for greater efficiency in providing agency support and training.

EFL, our life insurer, is subject to many of the same structural advantages and environmental challenges as the Property and Casualty Group. Term life business accounts for the majority of policies issued by EFL, and this product line is extremely competitive and increasingly transparent due in part to the proliferation of on-line quoting services. Besides price, ease of application and processing improvements represent areas where companies are finding ways to differentiate themselves among independent producers. EFL continues to progress in these areas using state-of-the-art technology and third-party vendors. Historically, sound underwriting and disciplined approaches to pricing and investing have contributed to favorable operating results. While EFL will be challenged to maintain these trends in the face of intensified competition going forward, we continually shape our strategy and core processes to respond more effectively to the needs of our policyholders and independent agents.

### Employees

We employed nearly 4,700 full-time people at December 31, 2014.





Table of Contents

## Reserves for Property and Casualty Losses and Loss Expenses

Loss reserves are established to account for the estimated ultimate costs of losses and loss expenses for claims that have been reported but not yet settled and claims that have been incurred but not reported. While we exercise professional diligence to establish reserves at the end of each period that are fully reflective of the ultimate value of all claims incurred, these reserves are, by nature, only estimates and cannot be established with absolute certainty. The factors which may potentially cause the greatest variation between current reserve estimates and the actual future paid amounts include unforeseen changes in statutory or case law altering the amounts to be paid on existing claim obligations, new medical procedures and/or drugs with costs significantly different from those seen in the past, inflation, and claims patterns on current business that differ significantly from historical claims patterns. A discussion of our property and casualty loss reserve methodology can be found in and is referenced to Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Estimates" contained within this report.

Losses and loss expense reserves are presented on the Consolidated Statements of Financial Position on a gross basis. The table that follows provides a reconciliation of our loss and loss expense reserve beginning and ending balances established for the Property and Casualty Group for the years ended December 31:

(in millions)	Property and Casualty Group		
	2014	2013	2012
Losses and loss expense reserves, beginning of year – Gross	\$3,747	\$3,598	\$3,499
Less: reinsurance recoverable, beginning of year	156	154	151
Losses and loss expense reserves, beginning of year – Net	3,591	3,444	3,348
Incurred losses and loss expenses related to:			
Current accident year	3,969	3,379	3,494
Prior accident years	(116	) (19	) (115
Total incurred losses and loss expenses	3,853	3,360	3,379
Paid losses and loss expenses related to:			
Current accident year	2,513	2,007	2,166
Prior accident years	1,220	1,206	1,117
Total paid losses and loss expenses	3,733	3,213	3,283
Losses and loss expense reserves, end of year – Net	3,711	3,591	3,444
Add: reinsurance recoverable, end of year	142	156	154
Losses and loss expense reserves, end of year – Gross	\$3,853	\$3,747	\$3,598

The Property and Casualty Group estimates loss reserves at ultimate cost except for workers compensation loss reserves, which are discounted on a nontabular basis as prescribed by the Insurance Department of the Commonwealth of Pennsylvania. An interest rate of 2.5% is used to discount these reserves based upon the Property and Casualty Group's historical workers compensation payout patterns. Loss and loss expense reserves were reduced by \$89 million, \$85 million, and \$85 million at December 31, 2014, 2013, and 2012, respectively, as a result of this discounting.

The Property and Casualty Group's reserves for losses and loss expenses are reported net of receivables for salvage and subrogation which totaled \$171 million, \$149 million, and \$150 million at December 31, 2014, 2013, and 2012, respectively.

Additional discussions of our property and casualty loss reserve activity can be found in and is referenced to Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations, Property and Casualty Insurance Operations” and “Financial Condition” sections contained within this report.

6

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Table of Contents

The following table illustrates the change over time of our loss and loss expense reserve estimates established for the Property and Casualty Group at the end of the last ten calendar years:

(in millions)	Property and Casualty Group Reserves for Unpaid Losses and Loss Expenses At December 31,									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Gross liability for unpaid losses and loss expenses (LAE)	\$3,779	\$3,830	\$3,684	\$3,586	\$3,598	\$3,584	\$3,499	\$3,598	\$3,747	\$3,853
Gross liability re-estimated as of:										
One year later	3,651	3,559	3,487	3,502	3,336	3,282	3,385	3,581	3,614	
Two years later	3,508	3,467	3,409	3,320	3,068	3,216	3,389	3,456		
Three years later	3,464	3,412	3,307	3,101	3,043	3,223	3,289			
Four years later	3,437	3,358	3,111	3,084	3,053	3,152				
Five years later	3,404	3,174	3,102	3,097	3,004					
Six years later	3,224	3,170	3,113	3,062						
Seven years later	3,225	3,189	3,087							
Eight years later	3,243	3,173								
Nine years later	3,240									
Cumulative (deficiency) redundancy	\$539	\$657	\$597	\$524	\$594	\$432	\$210	\$142	\$133	N/A
Gross liability for unpaid losses and LAE	\$3,779	\$3,830	\$3,684	\$3,586	\$3,598	\$3,584	\$3,499	\$3,598	\$3,747	\$3,853
Reinsurance recoverable on unpaid losses <sup>(1)</sup>	155	183	190	187	200	188	151	154	156	142
Net liability for unpaid losses and LAE	\$3,624	\$3,647	\$3,494	\$3,399	\$3,398	\$3,396	\$3,348	\$3,444	\$3,591	\$3,711
Cumulative amount of gross liability paid through:										
One year later	\$1,067	\$1,019	\$1,042	\$1,033	\$955	\$1,042	\$1,121	\$1,212	\$1,226	
Two years later	1,630	1,621	1,573	1,538	1,474	1,591	1,705	1,819		
Three years later	2,016	1,962	1,889	1,862	1,817	1,935	2,064			
Four years later	2,235	2,147	2,079	2,070	2,018	2,152				
Five years later	2,342	2,270	2,216	2,193	2,145					
Six years later	2,427	2,368	2,291	2,274						
Seven years later	2,500	2,423	2,348							
Eight years later	2,542	2,470								
Nine years later	2,575									

(1) Reinsurance recoverable on unpaid losses represents the related ceded amounts.

**Government Regulation**

Property and casualty insurers are subject to supervision and regulation in the states in which business is transacted.

The extent of such regulation varies, but generally derives from state statutes that delegate regulatory, supervisory and

administrative authority to state insurance departments. Accordingly, the authority of the state insurance departments includes the establishment of standards of solvency that must be met and maintained by insurers, the licensing to do business of insurers and agents, the nature of the limitations on investments, the approval of premium rates for property and casualty insurance, the provisions that insurers must make for current losses and future liabilities, the deposit of securities for the benefit of policyholders, the approval of policy forms, notice requirements for the cancellation of policies, and the approval of certain changes in control. In addition, many states have enacted variations of competitive rate-making laws that allow insurers to set certain premium rates for certain classes of insurance without having to obtain the prior approval by the state insurance department. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of quarterly and annual reports relating to the financial condition of insurance companies.

The Property and Casualty Group is also required to participate in various involuntary insurance programs for automobile insurance, as well as other property and casualty lines, in states in which these companies operate. These involuntary programs provide various insurance coverages to individuals or other entities that are otherwise unable to purchase such coverages in the voluntary market. These programs include joint underwriting associations, assigned risk plans, fair access to insurance requirements ("FAIR") plans, reinsurance facilities, and windstorm plans.

Table of Contents

Legislation establishing these programs generally provides for participation in proportion to voluntary writings of related lines of business in that state. The loss ratio on insurance written under involuntary programs has traditionally been greater than the loss ratio on insurance in the voluntary market. Although currently the federal government does not directly regulate the insurance industry, federal programs, such as federal terrorism backstop legislation and the Federal Insurance Office established under the Dodd-Frank Act can also impact the insurance industry.

Our life insurer, EFL, is subject to similar state regulations as the Property and Casualty Group, although specific laws and statutes applicable to life insurance and annuity carriers govern its activities. Valuation laws require statutory reserves to be held at conservative levels, which can have a substantial impact on the amount of free surplus that is available for financing new business and other growth opportunities.

Most states have enacted legislation that regulates insurance holding company systems such as the Erie Insurance Group. Each insurance company in the holding company system is required to register with the insurance supervisory authority of its state of domicile and furnish information regarding the operations of companies within the holding company system that may materially affect the operations, management, or financial condition of the insurers within the system. Pursuant to these laws, the respective insurance departments may examine Indemnity, as the management company, the Property and Casualty Group and EFL at any time, and may require disclosure and/or prior approval of certain transactions with the insurers and Indemnity, as an insurance holding company.

All transactions within a holding company system affecting the member insurers of the holding company system must be fair and reasonable. Approval by the applicable insurance commissioner is required prior to the consummation of transactions affecting the control of an insurer. Approval by the applicable insurance commissioner is also required in order to declare extraordinary dividends. See Item 8, "Financial Statements and Supplementary Data – Note 21, Statutory Information, of Notes to Consolidated Financial Statements" contained within this report.

Website Access

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports are available free of charge on our website at [www.erieinsurance.com](http://www.erieinsurance.com) as soon as reasonably practicable after such material is filed electronically with the Securities Exchange Commission. Additionally, copies of our annual report on Form 10-K are available free of charge, upon written request, by contacting Investor Relations, Erie Indemnity Company, 100 Erie Insurance Place, Erie, PA 16530, or calling 1-800-458-0811.

Our Code of Conduct and Code of Ethics for Senior Financial Officers are also available on our website and in printed form upon request, and our information statement on Form 14(C) is available free of charge on our website at [www.erieinsurance.com](http://www.erieinsurance.com).

Table of Contents

ITEM 1A. RISK FACTORS

Our business involves various risks and uncertainties, including, but not limited to those discussed in this section. The risks and uncertainties described in the risk factors below, or any additional risk outside of those discussed below, could have a material adverse effect on our business, financial condition, operating results, cash flows, or liquidity if they were to develop into actual events. This information should be considered carefully together with the other information contained in this report and in other reports and materials we file periodically with the Securities and Exchange Commissions.

Risk Factors Related to the Indemnity Shareholder Interest

If the management fee rate paid to Indemnity by the Exchange is reduced or if there is a significant decrease in the amount of premiums written or assumed by the Exchange, Indemnity revenues and profitability could be materially adversely affected.

Indemnity is dependent upon management fees paid by the Exchange, which represent its principal source of revenue. Pursuant to the subscriber's agreements with the policyholders at the Exchange, Indemnity may retain up to 25% of all premiums written or assumed by the Exchange. Therefore, management fee revenue from the Exchange 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 arrangement. Accordingly, any reduction in direct premiums written by the Property and Casualty Group would have a negative effect on Indemnity's revenues and net income. See "Risk Factors Related to the Non-Controlling Interest Owned by the Exchange", which includes our Property and Casualty Group and EFL insurance operations, within this section for a discussion of risks impacting direct written premium.

The management fee rate is determined by our Board of Directors and may not exceed 25% of the premiums written or assumed by the Exchange. The Board of Directors sets the management fee rate each December for the following year. At their discretion, the rate can be changed at any time. The factors considered by the Board of Directors in setting the management fee rate include Indemnity's financial position in relation to the Exchange and the long-term needs of the Exchange for capital and surplus to support its continued growth and competitiveness. If the Exchange's surplus were significantly reduced, the management fee rate could be reduced and Indemnity's revenues and profitability could be materially adversely affected.

If the costs of providing services to the Exchange are not controlled, Indemnity's profitability could be materially adversely affected.

Pursuant to the subscriber's agreements with the policyholders at the Exchange, Indemnity is appointed to perform certain services. These services relate to the sales, underwriting, and issuance of policies on behalf of the Exchange. Indemnity incurs significant costs related to commissions, employees, and technology in order to provide these services.

Commissions to independent agents are the largest component of Indemnity's cost of operations. Commissions include scheduled commissions to agents based upon premiums written as well as additional commissions and bonuses to agents, which are earned by achieving certain targeted measures. Changes to commission rates or bonus programs may result in increased future costs and lower profitability.

Employees are an essential part of the operating costs related to providing services for the Exchange. As a result, Indemnity's profitability is affected by employee costs, including salaries, healthcare, pension, and other benefit costs. Recent regulatory developments, provider relationships, and economic factors that are beyond our control

indicate that employee healthcare costs will continue to increase. Although Indemnity actively manages these cost increases, there can be no assurance that future cost increases will not occur and reduce its profitability.

Technological development is necessary to facilitate ease of doing business for the agents and policyholders of the Property and Casualty group and employees of Indemnity. If we are unable to keep pace with advancements in technology, our ability to compete with other insurance companies may be negatively affected and result in lower revenues and reduced profitability for Indemnity. In order to achieve a greater ease of doing business, additional costs may be incurred as we invest in new technology and systems, which may negatively impact the profitability of Indemnity.

Our ability to attract, develop, and retain talented executives, key managers, and employees is critical to our success.

Our success is largely dependent upon our ability to attract and retain executives and other key management. The loss of the services and leadership of certain key officers and the failure to attract and develop talented new executives and managers



Table of Contents

could prevent us from successfully communicating, implementing, and executing business strategies, and therefore have a material adverse effect on our financial condition and results of operations.

Our success also depends on our ability to attract, develop, and retain a talented employee base. The inability to staff all functions of our business with employees possessing the appropriate technical expertise could have an adverse effect on our business performance. Staffing appropriately skilled employees for the handling of claims and servicing of customers, rendering of disciplined underwriting, and effective sales and marketing are critical to the core functions of our business. In addition, skilled employees in the actuarial, finance, and information technology areas are also essential to support our core functions.

If we are unable to ensure system availability, unable to secure sensitive information, or we make significant decisions based on inaccurate data, the Erie Insurance Group may experience adverse financial consequences and/or may be unable to compete effectively in the industry. Our business depends on the uninterrupted operations of our facilities, systems, and business functions.

Indemnity is responsible for providing the technological resources necessary to support the operations of the Erie Insurance Group. Our business is highly dependent upon the effective operations of our technology and information systems. We also conduct business functions and computer operations using the systems of third-party vendors, which may provide software, data storage, and other computer services to us. We rely upon our systems, and those of third-party vendors, to assist in key functions of core business operations including processing claims, applications, and premium payments, providing customer support, performing actuarial and financial analysis, and maintaining key data.

We necessarily collect, use, and hold data concerning individuals, businesses, strategic plans, and intellectual property. Threats to data security, including unauthorized access, cyber-attacks, and other computer related penetrations, expose us to additional costs for protection or remediation to secure our data in accordance with customer expectations and statutory and regulatory requirements, including data privacy laws. Preventative actions we take, or our third-party vendors take, to reduce the risk of cyber incidents and protect our information may be insufficient to prevent physical and electronic break-ins or other security breaches to our computer system. Additionally, a breach of security that results in unauthorized access to our data could expose us to an operational disruption, data loss, litigation, fines and penalties, increased compliance costs, and reputational damages. While we maintain cyber liability insurance to mitigate the amount of financial loss, our insurance coverage may not be sufficient to protect against all loss.

We depend on a large amount of data to price policies appropriately, track exposures, perform financial analysis, and ultimately make business decisions. Should this data be inaccurate or insufficient, risk exposure may be underestimated and/or poor business decisions may be made. This may in turn lead to adverse operational or financial performance.

We have an established business continuity plan to ensure the continuation of core business operations in the event that normal business operations could not be performed due to a catastrophic event. While we continue to test and assess our business continuity plan to ensure it meets the needs of our core business operations and addresses multiple business interruption events, there is no assurance that core business operations could be performed upon the occurrence of such an event. Systems failures or outages could compromise our ability to perform our business functions in a timely manner, which could harm our ability to conduct business and hurt our relationships with our business partners and customers. Our business continuity is also dependent on third-party systems on which our information technology systems interface and rely. Our systems and those of our third-party vendors may become vulnerable to damage or disruption due to circumstances beyond our or their control, such as from catastrophic events, power anomalies or outages, natural disasters, network failures, and viruses. The failure of our information systems

for any reason could result in a material adverse effect on our business, financial condition, or results of operations.

The performance of Indemnity's investment portfolio is subject to a variety of investment risks, which may in turn have a material adverse effect on its results of operations or financial condition.

Indemnity's investment portfolio is comprised principally of fixed-income maturities and limited partnerships. At December 31, 2014, Indemnity's investment portfolio consisted of approximately 80% fixed income securities, 16% limited partnerships, and 4% equity securities.

All of Indemnity's marketable securities are subject to market volatility. To the extent that future market volatility negatively impacts Indemnity's investments, its financial condition will be negatively impacted. We review the investment portfolio on a continuous basis to evaluate positions that might have incurred other-than-temporary declines in value. Inherent in management's evaluation of a security are assumptions and estimates about the operations of the issuer and its future earnings potential. The primary factors considered in our review of investment valuation include the extent and duration to which fair

## Table of Contents

value is less than cost, historical operating performance and financial condition of the issuer, short- and long-term prospects of the issuer and its industry, specific events that occurred affecting the issuer, including rating downgrades, and, depending on the type of security, our intent to sell or our ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value. As the process for determining impairments is highly subjective, changes in our assessments may have a material effect on Indemnity's operating results and financial condition. See also Item 7A. "Quantitative and Qualitative Disclosures about Market Risk".

If the fixed income, equity, or limited partnership portfolios were to suffer a substantial decrease in value, Indemnity's financial position could be materially adversely affected through increased unrealized losses or impairments.

Currently, 41% of the fixed-income portfolio is invested in municipal securities. The performance of the fixed-income portfolio is subject to a number of risks including, but not limited to:

**Interest rate risk** - the risk of adverse changes in the value of fixed-income securities as a result of increases in market interest rates. A sustained low interest rate environment would pressure our net investment income.

**Investment credit risk** - the risk that the value of certain investments may decrease due to the deterioration in financial condition of, or the liquidity available to, one or more issuers of those securities or, in the case of asset-backed securities, due to the deterioration of the loans or other assets that underlie the securities, which, in each case, also includes the risk of permanent loss.

**Sector/Concentration risk** - the risk that the portfolio may be too heavily concentrated in the securities of one or more issuers, sectors, or industries. Events or developments that have a negative impact on any particular industry, group of related industries, or geographic region may have a greater adverse effect on our investment portfolio to the extent that the portfolio is concentrated within those issuers, sectors, or industries.

**Liquidity risk** - the risk that Indemnity will not be able to convert investment securities into cash on favorable terms and on a timely basis, or that Indemnity will not be able to sell them at all, when desired. Disruptions in the financial markets or a lack of buyers for the specific securities that Indemnity is trying to sell, could prevent it from liquidating securities or cause a reduction in prices to levels that are not acceptable to Indemnity.

General economic conditions and other factors beyond our control can adversely affect the value of our equity investments and the realization of net investment income, or result in realized investment losses. In addition, downward economic trends also may have an adverse effect on our investment results by negatively impacting the business conditions and impairing credit for the issuers of securities held in their respective investment portfolios. This could reduce fair values of investments and generate significant unrealized losses or impairment charges which may adversely affect our financial results.

In addition to the fixed-income securities, a significant portion of Indemnity's portfolio is invested in limited partnerships. At December 31, 2014, Indemnity had investments in limited partnerships of \$113 million, or 9% of total assets. In addition, Indemnity is obligated to invest up to an additional \$24 million in limited partnerships, including private equity, mezzanine debt, and real estate partnership investments. Limited partnerships are significantly less liquid and generally involve higher degrees of price risk, the risk of potential loss in estimated fair value resulting from an adverse change in prices, than publicly traded securities. Limited partnerships, like publicly traded securities, have exposure to market volatility; but unlike fixed-income securities, cash flows and return expectations are less predictable. In addition, a portion of Indemnity's limited partnership portfolio is invested in partnerships denominated in currencies other than the U.S. dollar, and therefore exposed to foreign exchange rate risk. Indemnity does not hedge its exposure to foreign exchange rate risk inherent in these investments.

The primary basis for the valuation of limited partnership interests are financial statements prepared by the general partner. Because of the timing of the preparation and delivery of these financial statements, the use of the most recently available financial statements provided by the general partners result in a quarter delay in the inclusion of the limited partnership results in our Consolidated Statements of Operations. Due to this delay, Indemnity's financial statements at December 31, 2014, do not reflect market conditions experienced in the fourth quarter of 2014.

Indemnity's equity securities have exposure to price risk. Indemnity does not hedge its exposure to equity price risk inherent in its equity investments. Equity markets, sectors, industries, and individual securities may also be subject to some of the same risks that affect Indemnity's fixed-income portfolio, as discussed above.

## Table of Contents

Indemnity is subject to credit risk from the Exchange because the management fees from the Exchange are not paid immediately when premiums are written.

Indemnity recognizes management fees due from the Exchange as income when the premiums are written because at that time Indemnity has performed substantially all of the services it is required to perform, including sales, underwriting, and policy issuance activities. However, such fees are not paid to Indemnity by the Exchange until the Exchange collects the premiums from policyholders. As a result, Indemnity holds receivables for management fees since such fees are based upon premiums that have been written and assumed. Indemnity also holds receivables from the Exchange for costs it pays on the Exchange's behalf. The receivable from the Exchange totaled \$335 million or 25% of our total assets at December 31, 2014.

Deteriorating capital and credit market conditions or a failure to accurately estimate capital needs may significantly affect Indemnity's ability to meet liquidity needs and access capital.

Sufficient liquidity and capital levels are required to pay operating expenses, income taxes, and to provide the necessary resources to fund future growth opportunities, pay dividends on common stock, and repurchase common stock. Management estimates the appropriate level of capital necessary based upon current and projected results, which include a loading for potential risks. Failure to accurately estimate Indemnity's capital needs may have a material adverse effect on its financial condition until additional sources of capital can be located. Further, a deteriorating financial condition may create a negative perception of Indemnity by third parties, including rating agencies, investors, agents, and customers which could impact Indemnity's ability to access additional capital in the debt or equity markets.

The primary sources of liquidity for Indemnity are management fees and cash flows generated from its investment portfolio. In the event Indemnity's current sources do not satisfy its liquidity needs, Indemnity has the ability to access its \$100 million bank revolving line of credit, from which there were no borrowings as of December 31, 2014, or sell assets in its investment portfolio. Volatility in the financial markets could impair Indemnity's ability to sell certain of its fixed income securities or, to a greater extent, its significantly less liquid limited partnership investments, or cause such investments to sell at deep discounts.

In the event these traditional sources of liquidity are not available, Indemnity may have to seek additional financing. Indemnity's access to funds will depend upon a number of factors including current market conditions, the availability of credit, market liquidity, and credit ratings. In deteriorating market conditions, there can be no assurance that Indemnity will obtain additional financing, or, if available, that the cost of financing will not substantially increase and affect our overall profitability.

Indemnity is subject to applicable insurance laws, tax statutes, and regulations, as well as claims and legal proceedings, which, if determined unfavorably, could have a material adverse effect on Indemnity's business, results of operations, or financial condition.

Indemnity faces a significant risk of litigation and regulatory investigations and actions in the ordinary course of operating its businesses including the risk of class action lawsuits. Indemnity's pending legal and regulatory actions include proceedings specific to Indemnity and others generally applicable to business practices in the industries in which it operates. In Indemnity's operations, we are, have been, or may become subject to class actions and individual suits alleging, among other things, issues relating to sales or underwriting practices, payment of contingent or other sales commissions, product design, product disclosure, policy issuance and administration, additional premium charges for premiums paid on a periodic basis, charging excessive or impermissible fees on products, recommending unsuitable products to customers, and breaching alleged fiduciary or other duties (including our obligations to indemnify directors and officers in connection with certain legal matters). Indemnity is also subject to litigation

arising out of its general business activities such as its contractual and employment relationships. Plaintiffs in class action and other lawsuits against Indemnity may seek very large or indeterminate amounts, including punitive and treble damages, which may remain unknown for substantial periods of time. Indemnity is also subject to various regulatory inquiries, such as information requests, subpoenas, and books and record examinations from state and federal regulators and authorities. Changes in the way regulators administer those laws, tax statutes, or regulations could adversely impact Indemnity's business, results of operations, or financial condition. See "Risk Factors Related to the Non-Controlling Interest Owned by the Exchange, which includes the Property and Casualty Group and EFL," that follows for additional discussion of litigation risks.

## Table of Contents

### Risk Factors Related to the NonControlling Interest Owned by the Exchange, which Includes the Property and Casualty Group and EFL

Deteriorating general economic conditions may have an adverse effect on our operating results and financial condition.

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

The Property and Casualty Group depends on independent insurance agents, which exposes the Property and Casualty Group to risks not applicable to companies with exclusive agents or other forms of distribution.

The Property and Casualty Group markets and sells its insurance products through independent, non-exclusive insurance agencies. These agencies are not obligated to sell only the Property and Casualty Group's insurance products, and generally also sell competitors' insurance products. We must offer insurance products that meet the needs of these agencies and their clients and maintain good relationships with these agencies. The results of operations and business of the Property and Casualty Group could be adversely affected by the following:

Agencies' marketing efforts not being maintained at their current levels or agencies binding the Property and Casualty Group to unacceptable insurance risks, failing to comply with established underwriting guidelines, or otherwise improperly marketing the Property and Casualty Group's products.

Agencies placing business with competing insurers due to compensation arrangements, real or perceived product or price differences, ease of doing business, including the perception that our technology solutions do not match their needs, perceived delivery of customer service, or other reasons.

If the Property and Casualty Group is unsuccessful in maintaining and/or increasing the number of agencies in its independent agent distribution system.

- Computer systems of our independent agencies experiencing cyber-attacks and other security breaches, loss or corruption of information, or systems failures or outages.

Consumer preferences, especially in personal lines insurance products, causing the insurance industry to migrate to a delivery system other than independent agencies.

Our ability to maintain our reputation is a key factor to the Property and Casualty Group's success.

The Property and Casualty Group maintains a brand recognized for customer service. The perceived performance, actions, and behaviors of employees, independent insurance agency representatives, and third party service partners may result in reputational harm to the Property and Casualty Group's brand and the potential for a reduction in business. Specific incidents which may cause harm include but are not limited to disputes, long customer wait times, errors in processing a claim, failure to protect sensitive customer data, and inappropriate social media communications. The degree of control we have over these events varies based upon the event type and who is responsible for causing the incident. If an extreme catastrophic event were to occur in a heavily concentrated area of policyholders, an extraordinarily high number of claims could have the potential to strain claims processing and affect

our ability to satisfy our customers. While we maintain and execute processes to minimize these events, we cannot completely eliminate this risk.

If our third party service providers fail to perform as anticipated, we may experience operational difficulties, increased costs, reputational damage and a loss of business that may have an adverse effect on our results of operations or financial condition.

The Property and Casualty Group faces significant competition from other regional and national insurance companies. Failure to keep pace with competitors may result in lower market share and revenues, which may have a material adverse effect on the Property and Casualty Group's financial condition.

The Property and Casualty Group competes with regional and national property and casualty insurers including direct writers of insurance coverage. Many of these competitors are larger and many have greater financial, technical, and operating resources.

If we are unable to perform at industry best practice levels in terms of quality, cost containment, and speed-to-market due to inferior operating resources and/or problems with external relationships, the Property and Casualty Group's business



## Table of Contents

performance may suffer. As the business environment changes, if we are unable to adapt timely to emerging industry changes, or if our people do not conform to the changes, the Property and Casualty Group's business could be materially impacted.

The property and casualty insurance industry is highly competitive on the basis of product, price, and service. If competitors offer property and casualty products with more coverage and/or better service or offer lower rates, and we are unable to implement product or service improvements quickly enough to keep pace, the Property and Casualty Group's ability to grow and renew its business may be adversely impacted. In addition, due to our focus on the automobile and homeowners insurance markets, we may be more sensitive to trends that could affect auto and home insurance coverages and rates over time. For example, if economic conditions, demographic trends, changing driving patterns, advancements in vehicle or home technology or safety features, or other factors, were to result in decreased demand for auto or home insurance or decreased auto or home insurance rates for an extended period, the automobile and homeowners insurance markets as a whole could shrink and our ability to generate revenue growth could be significantly impacted.

Insurance customers are increasingly expecting to perform service interactions digitally, including but not limited to shopping, paying bills, and reporting and monitoring claims. Examples of digital channels used in these interactions include traditional websites, social media sites, and mobile device applications. We expect competitors to continue to grow these channels, particularly those with some form of direct to consumer sales distribution. Failure to position our digital servicing and distribution technology effectively in light of these trends could inhibit the Property and Casualty Group's ability to grow and maintain its customer base.

Changes in applicable insurance laws, regulations, or changes in the way regulators administer those laws or regulations could adversely change the Property and Casualty Group's operating environment and increase its exposure to loss or put it at a competitive disadvantage.

Property and casualty insurers are subject to extensive supervision in the states in which they do business. This regulatory oversight includes, by way of example, matters relating to licensing examination, rate setting, market conduct, policy forms, limitations on the nature and amount of certain investments, claims practices, mandated participation in involuntary markets and guaranty funds, reserve adequacy, insurer solvency, restrictions on underwriting standards, accounting standards, and transactions between affiliates. Such regulation and supervision are primarily for the benefit and protection of policyholders and not for the benefit of shareholders. For instance, members of the Property and Casualty Group are subject to involuntary participation in specified markets in various states in which they operate, and the rate levels the Property and Casualty Group is permitted to charge do not always correspond with the underlying costs associated with the coverage issued. Additionally, certain transactions and agreements between Indemnity and the Exchange must be approved by the appropriate state insurance department(s). Although currently the federal government does not directly regulate the insurance industry, federal programs, such as federal terrorism backstop legislation and the Federal Insurance Office established under the Dodd-Frank Act can also impact the insurance industry. In addition to specific insurance regulation, the Property and Casualty Group must also comply with other regulatory, legal, and ethical requirements relating to the general operation of a business.

Premium rates and reserves must be established for members of the Property and Casualty Group from forecasts of the ultimate costs expected to arise from risks underwritten during the policy period. The Property and Casualty Group's underwriting profitability could be adversely affected to the extent such premium rates or reserves are too low or by the effects of inflation.

One of the distinguishing features of the property and casualty insurance industry in general is that its products are priced before its costs are known, as premium rates are generally determined before losses are reported. Consequently, in establishing premium rates, we attempt to anticipate claims frequency and 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 impact personal and commercial auto, general liability, workers compensation and commercial multi-peril lines of insurance written by the Property and Casualty Group. Accordingly, premium rates must be established from forecasts of the ultimate costs expected to arise from risks underwritten during the policy period. These premium rates may prove to be inadequate if future claims frequency and/or inflation are significantly higher than the estimates anticipated in pricing.

Property and casualty insurers establish reserves for losses and loss expenses that will not be paid and settled for many years. Numerous factors affect both the current estimates and final settlement value of these losses and loss expenses. It is possible that the ultimate liability for these losses and loss expenses will exceed these reserves because of unanticipated changes in the future development of known losses, the unanticipated emergence of losses that have occurred but are currently unreported, and larger than expected settlements on pending and unreported claims. The process of estimating reserves is inherently judgmental and can be influenced by factors that are subject to variation. If pricing or reserves of the Property and Casualty Group are not sufficient, the Property and Casualty Group's financial condition may be adversely impacted.

Table of Contents

The property and casualty insurance industry has historically been cyclical with periods of intense price competition. The Property and Casualty Group seeks an appropriate balance between profitability and premium growth. Periods of intense price competition in the cycle could adversely affect the Property and Casualty Group's financial condition, profitability, or cash flows.

Emerging claims and coverage issues in the insurance industry are unpredictable and could cause an adverse effect on the Property and Casualty Group's results of operations or financial condition.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect the Property and Casualty Group's business by either extending coverage beyond its underwriting intent or by increasing the number or size of claims. In some instances, these emerging issues may not become apparent for some time after the Property and Casualty Group has issued the affected insurance policies. As a result, the full extent of liability under the Property and Casualty Group's insurance policies may not be known for many years after the policies are issued.

Changes in reserve estimates may adversely affect EFL's operating results.

Reserves for life-contingent contract benefits are computed on the basis of long-term actuarial assumptions of future investment yields, mortality, morbidity, persistency, and expenses. We periodically review the adequacy of these reserves on an aggregate basis and, if future experience differs significantly from assumptions, adjustments to reserves and amortization of deferred policy acquisition costs may be required, which could have a material adverse effect on EFL's operating results.

The financial performance of members of the Property and Casualty Group could be adversely affected by severe weather conditions or other catastrophic losses, including terrorism. The financial performance of EFL could be adversely affected by pandemic events.

The Property and Casualty Group's insurance operations expose us to claims arising out of catastrophes. A single catastrophic occurrence or aggregation of multiple smaller occurrences could adversely affect the results of operations of members of the Property and Casualty Group. Common natural catastrophic events include hurricanes, earthquakes, tornadoes, hail storms, and severe winter weather. The extent of losses from a catastrophe is a function of both the total amount of insured exposures in the area affected by the event and the severity of the event. The frequency and severity of these catastrophes is inherently unpredictable. Changing climate conditions have added to the unpredictability, frequency and severity of natural disasters and have created additional uncertainty as to future trends and exposures. We cannot predict the impact that changing climate conditions may have on our results of operations.

Our ability to appropriately manage catastrophe risk depends partially on catastrophe models that are based on historical data, current risk exposure, damageability assumptions and meteorological assumption. The unpredictability of some of these inputs and the long-term impact of climate change create uncertainty in the frequency and severity of future events.

The Property and Casualty Group maintains an excess property catastrophe reinsurance program which became effective January 1, 2015. The multi-layer program affords coverage up to a \$1.1 billion catastrophe, providing a total of \$682 million in coverage excess of the Property and Casualty Group's per occurrence loss retention of \$300 million. If a major catastrophic loss exceeds the reinsurance limit, this catastrophe reinsurance could be inadequate resulting in an adverse effect on the Property and Casualty Group's underwriting profitability and financial position. There is also a risk that the reinsurance counterparties could default on their obligations.

Terrorist attacks could also cause losses from insurance claims related to the property and casualty insurance operations. The federal Terrorism Risk Insurance Program Reauthorization Act ("TRIA") of 2015 requires that some coverage for terrorist losses be offered by primary commercial property insurers and provides federal assistance for recovery of claims. While the Property and Casualty Group is exposed to terrorism losses in commercial lines and workers compensation, these lines are afforded a limited backstop above insurer deductibles for acts of terrorism under this federal program. There is no federal assistance for personal lines terrorism losses. The Property and Casualty Group could incur large net losses if terrorist attacks were to occur. The current federal TRIA expires at the end of 2020.

An epidemic or pandemic affecting one or more of the states in which EFL conducts substantial business could adversely affect its financial and operational results, particularly if the event affected a broad range of the population.

Table of Contents

The inability to acquire reinsurance coverage at reasonable rates or collect amounts due from reinsurers could have an adverse effect on the Exchange.

The availability and cost of reinsurance are subject to prevailing market conditions, both in terms of price and available capacity. The availability of reinsurance capacity can be impacted by general economic conditions and conditions in the reinsurance market, such as the occurrence of significant reinsured events. The availability and cost of reinsurance could affect the Property and Casualty Group's business volume and profitability.

Although the reinsurer is liable to the Property and Casualty Group to the extent of the ceded reinsurance, reinsurance contracts do not relieve the Property and Casualty Group from its primary obligations to its policyholders. As a result, ceded reinsurance arrangements do not eliminate the Property and Casualty Group's obligation to pay claims. The Property and Casualty Group is subject to credit risk with respect to its ability to recover amounts due from reinsurers. The Property and Casualty Group's inability to collect a material recovery from a reinsurer could have an adverse effect on its underwriting profitability and financial condition.

The performance of the Exchange's investment portfolio is subject to a variety of investment risks, which may in turn have a material adverse effect on its results of operations or financial condition.

The Exchange's investment portfolio is comprised principally of fixed-income maturities, common stocks, and limited partnerships. At December 31, 2014, the Exchange's investment portfolio consisted of approximately 65% fixed income securities, 24% common stocks, 6% limited partnerships, and 5% preferred equity securities.

All of the Exchange's marketable securities are subject to market volatility. To the extent that future market volatility negatively impacts these investments, the financial condition of the Exchange will be negatively impacted. We review the investment portfolio on a continuous basis to evaluate positions that might have incurred other-than-temporary declines in value. Inherent in management's evaluation of a security are assumptions and estimates about the operations of the issuer and its future earnings potential. The primary factors considered in our review of investment valuation include the extent and duration to which fair value is less than cost, historical operating performance and financial condition of the issuer, short- and long-term prospects of the issuer and its industry, specific events that occurred affecting the issuer including rating downgrades, and, depending on the type of security, our intent to sell or our ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value. As the process for determining impairments is highly subjective, changes in our assessments may have a material effect on the Exchange's operating results and financial condition. See also Item 7A. "Quantitative and Qualitative Disclosures about Market Risk".

If the fixed-income, equity, or limited partnership portfolios were to suffer a substantial decrease in value, the Exchange's financial position could be materially adversely affected through increased unrealized losses or impairments. A significant decrease in the Exchange's portfolio could also put it, or its subsidiaries, at risk of failing to satisfy regulatory or rating agency minimum capital requirements.

The Exchange's fixed-income portfolio is invested in 34% in financial sector securities and 16% in municipal securities. These results may vary depending on the market environment. The performance of the fixed-income portfolio is subject to a number of risks including, but not limited to:

• Interest rate risk - the risk of adverse changes in the value of fixed-income securities as a result of increases in market interest rates. A sustained low interest rate environment would pressure our net investment income.

• Investment credit risk - the risk that the value of certain investments may decrease due to the deterioration in financial condition of, or the liquidity available to, one or more issuers of those securities or, in the case of asset-backed

securities, due to the deterioration of the loans or other assets that underlie the securities, which, in each case, also includes the risk of permanent loss.

Sector/Concentration risk - the risk that the portfolio may be too heavily concentrated in the securities of one or more issuers, sectors, or industries. Events or developments that have a negative impact on any particular industry, group of related industries or geographic region may have a greater adverse effect on our investment portfolio to the extent that the portfolio is concentrated within those issuers, sectors, or industries.

Liquidity risk - the risk that we will not be able to convert investment securities into cash on favorable terms and on a timely basis, or that we will not be able to sell them at all, when desired. Disruptions in the financial markets, or a lack of buyers for the specific securities that we are trying to sell, could prevent it from liquidating securities or cause a reduction in prices to levels that are not acceptable to us.

## Table of Contents

The Exchange's common and preferred equity securities have exposure to price risk, the risk of potential loss in estimated fair value resulting from an adverse change in prices. In addition, a portion of the Exchange's common stock portfolio is invested in securities denominated in currencies other than the U.S. dollar. These investments also have exposure to foreign exchange rate risk, or the potential loss in estimated fair value resulting from adverse changes in foreign exchange rates. The Exchange does not hedge its exposure to equity price risk or foreign exchange rate risk inherent in the equity investments. The Exchange's common and preferred equity securities may also be subject to some of the same risks that affect the Exchange's fixed-income portfolio, as discussed above. General economic conditions and other factors beyond our control can adversely affect the value of our equity investments and the realization of net investment income, or result in realized investment losses. In addition, downward economic trends also may have an adverse effect on our investment results by negatively impacting the business conditions and impairing credit for the issuers of securities held in their respective investment portfolios. This could reduce fair values of investments and generate significant unrealized losses or impairment charges which may adversely affect our financial results.

A portion of the portfolio is invested in limited partnerships, including private equity, mezzanine debt, and real estate partnership investments. At December 31, 2014, the Exchange had investments in limited partnerships of \$866 million, or 5% of total assets, with an obligation to invest up to an additional \$459 million. Limited partnerships are significantly less liquid and generally involve higher degrees of price risk than publicly traded securities. Limited partnerships, like publicly traded securities, have exposure to market volatility; but unlike fixed income securities, cash flows and return expectations are less predictable. In addition, a portion of the Exchange's limited partnership portfolio is invested in partnerships denominated in currencies other than the U.S. dollar, and therefore exposed to foreign exchange rate risk. The Exchange does not hedge its exposure to foreign exchange rate risk inherent in these investments.

The primary basis for the valuation of limited partnership interests are financial statements prepared by the general partner. Because of the timing of the preparation and delivery of these financial statements, the use of the most recently available financial statements provided by the general partners result in a quarter delay in the inclusion of the limited partnership results in our Consolidated Statements of Operations. Due to this delay, the Exchange's financial statements at December 31, 2014 do not reflect market conditions experienced in the fourth quarter of 2014.

Deteriorating capital and credit market conditions or a failure to accurately estimate capital needs may significantly affect the Exchange's ability to meet liquidity needs and access capital.

Sufficient liquidity and capital levels are required to pay claims, claims-related expenses, and income taxes as well as to build the Exchange's investment portfolio, provide for additional protection against possible large, unexpected losses, and maintain adequate surplus amounts. Management estimates the appropriate level of capital necessary based upon current and projected results, which include a loading for potential risks. Failure to accurately estimate the Exchange's capital needs may have a material adverse effect on the Exchange's financial condition until additional sources of capital can be located. Further, a deteriorating financial condition may create a negative perception of the Exchange by third parties, including rating agencies, investors, agents, and customers which could impact the Exchange's ability to access additional capital in the debt or equity markets.

The primary sources of liquidity for the Exchange are insurance premiums and cash flow generated from its investment portfolio. In the event the Exchange's current sources do not satisfy its liquidity needs, the Exchange has the ability to access its \$300 million bank revolving line of credit, from which there were no borrowings as of December 31, 2014, or sell assets in its investment portfolios. Volatility in the financial markets could impair the Exchange's ability to sell certain fixed income securities or, to a greater extent, our significantly less liquid limited partnership investments, or cause such investments to sell at deep discounts. In the event these traditional sources of liquidity are not available, the Exchange may have to seek additional financing. The Exchange's access to funds will

depend upon a number of factors including current market conditions, the availability of credit, market liquidity, and credit ratings. In deteriorating market conditions, there can be no assurance that the Exchange will obtain additional financing, or, if available, that the cost of financing will not substantially increase and affect our overall profitability.

If there were a failure to maintain commercially acceptable financial strength ratings, the Exchange's competitive position in the insurance industry would be adversely affected.

Financial strength ratings are an important factor in establishing the competitive position of insurance companies.

Higher ratings generally indicate greater financial stability and a stronger ability to meet ongoing obligations to policyholders. Ratings are assigned by rating agencies to insurers based upon factors that the rating agencies believe are relevant to policyholders. The Property and Casualty Group's pooled A.M. Best rating is currently A+

("Superior"). EFL's A.M. Best rating is currently

A ("Excellent"). Rating agencies periodically review insurers' ratings and change their ratings criteria; therefore, our current ratings may not be maintained in the future. A significant downgrade in this or other ratings would reduce the competitive



Table of Contents

position of the Property and Casualty Group and EFL, making it more difficult to attract profitable business in the highly competitive property and casualty insurance market resulting in reduced sales of our products.

The Property and Casualty Group is subject to claims and legal proceedings, which, if determined unfavorably to the Property and Casualty Group, could have a material adverse effect on our business, results of operations, or financial condition.

The Property and Casualty Group faces a significant risk of litigation and regulatory investigations and actions in the ordinary course of operating its businesses including the risk of class action lawsuits. The Property and Casualty Group's pending legal and regulatory actions include proceedings specific to the Property and Casualty Group and others generally applicable to business practices in the industries in which it operates. In the Property and Casualty Group's insurance operations, we are, have been, or may become subject to class actions and individual suits alleging, among other things, issues relating to claims payments and procedures, denial or delay of benefits, charging excessive or impermissible fees on products, and breaching fiduciary or other duties to customers. The Property and Casualty Group is also subject to litigation arising out of its general business activities such as its contractual relationships. Plaintiffs in class action and other lawsuits against the Property and Casualty Group may seek very large or indeterminate amounts, including punitive and treble damages, which may remain unknown for substantial periods of time. The Property and Casualty Group is also subject to various regulatory inquiries, such as information requests, subpoenas, and books and record examinations from state and federal regulators and authorities. See "Risk Factors Related to the Indemnity Shareholder Interest," within this section for additional discussion of litigation risks.

The Exchange is dependent upon Indemnity to perform certain services, including sales, underwriting, and the issuance of policies and the uninterrupted operation of our facilities, systems and business functions. Failure to perform these services effectively may have a material adverse effect on the financial condition of the Exchange.

Pursuant to the attorney-in-fact agreements with the policyholders at the Exchange, Indemnity is responsible for performing key functions for the Exchange including management and operational services, including the technology and systems to perform business functions. The Board of Directors of Indemnity has the responsibility for Exchange-related activities such as setting the management fee paid by the Exchange to Indemnity. The business and financial condition of the Exchange would be materially adversely affected if Indemnity was not able to provide the necessary operating and management services required by the Exchange.

An inability to access our facilities, or a failure of technology or other systems could significantly impair the ability to perform business functions in a timely and effective manner. If our business continuity plan does not sufficiently consider and address the circumstances of an interruption, including without limitation natural events, terrorist attacks, medical epidemics, computer security breaches or cyber-attacks, or interruptions of our data processing and storage systems or the systems of third-party vendors, our operating results and financial condition could be adversely effected.

Table of Contents

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The companies comprising the Erie Insurance Group share a corporate home office complex in Erie, Pennsylvania, which comprises approximately 521,000 square feet.

The Erie Insurance Group also operates 25 field offices in 12 states. Of these field offices, 16 provide both agency support and claims services and are referred to as branch offices, while seven provide only claims services and are referred to as claims offices, and two provide only agency support and are referred to as sales offices. Seven field offices are owned by the Erie Insurance Group, while the remaining 18 field offices, one office building and one warehouse facility are leased from unaffiliated parties.

ITEM 3. LEGAL PROCEEDINGS

State Court Lawsuit Against Erie Indemnity Company

Erie Indemnity Company (“Indemnity”) was named as a defendant in a complaint filed on August 1, 2012 by alleged subscribers of the Erie Insurance Exchange (the “Exchange”) in the Court of Common Pleas Civil Division of Fayette County, Pennsylvania captioned Erie Insurance Exchange, an unincorporated association, by Joseph S. Sullivan and Anita Sullivan, Patricia R. Beltz, and Jenna L. DeBord, trustees ad litem v. Erie Indemnity Co. (the “Sullivan” lawsuit). As subsequently amended, the complaint alleges that, beginning on September 1, 1997, Indemnity retained “Service Charges” (installment fees) and “Added Service Charges” (late fees and policy reinstatement charges) on policies written by the Exchange and its insurance subsidiaries, which allegedly should have been paid to the Exchange, in the amount of approximately \$308 million. In addition to their claim for monetary relief on behalf of the Exchange, the plaintiffs seek an accounting of all so-called intercompany transactions between Indemnity and the Exchange from 1996 to date. Plaintiffs allege that Indemnity breached its contractual, fiduciary, and equitable duties by retaining Service Charges and Added Service Charges that should have been retained by the Exchange. Plaintiffs bring these same claims under three separate derivative-type theories. First, plaintiffs purport to bring suit as members of the Exchange on behalf of the Exchange. Second, plaintiffs purport to bring suit as trustees ad litem on behalf of the Exchange. Third, plaintiffs purport to bring suit on behalf of the Exchange pursuant to Rule 1506 of the Pennsylvania Rules of Civil Procedure, which allows shareholders to bring suit derivatively on behalf of a corporation or similar entity. Indemnity filed a motion in the state court in November 2012 seeking dismissal of the lawsuit. On December 19, 2013, the court granted Indemnity’s motion in part, holding that the Pennsylvania Insurance Holding Company Act “provides the [Pennsylvania Insurance] Department with special competence to address the subject matter of plaintiff’s claims” and referring “all issues” in the Sullivan lawsuit to the Pennsylvania Insurance Department (the “Department”) for “its views and any determination.” The court stayed all further proceedings and reserved decision on all other grounds for dismissal raised by Indemnity. Plaintiffs sought reconsideration of the court’s order, and on January 13, 2014, the court entered a revised order affirming its prior order and clarifying that the Department “shall decide any and all issues within its jurisdiction.” On January 30, 2014, Plaintiffs asked the court to certify its order to permit an immediate appeal to the Superior Court and to stay any proceedings in the Department pending completion of any appeal. On February 18, 2014, the court issued an order denying Plaintiffs’ motion. On March 20, 2014, Plaintiffs filed a petition for review with the Superior Court of Pennsylvania. Indemnity filed an answer to the petition on April 3, 2014. On May 5, 2014, the Superior Court denied Plaintiffs’ petition for review. The Sullivan matter is currently proceeding before the Department and has been assigned to an Administrative Judge for determination. The parties agreed that an evidentiary hearing was not required and they entered into a stipulated record. Briefing in the Department was completed on December 19, 2014, and oral argument was held before the Administrative Judge on January 6, 2015. A ruling by the Department has not yet been made.

Indemnity believes that it has meritorious legal and factual defenses and intends to vigorously defend against all allegations and requests for relief.

19

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Table of Contents

Federal Court Lawsuit Against Directors

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

As subsequently amended, the Beltz lawsuit asserts many of the same allegations and claims for monetary relief as in the Sullivan lawsuit. Plaintiffs purport to sue on behalf of all policyholders of the Exchange, or, alternatively, on behalf of the Exchange itself. Indemnity filed a motion to intervene as a Party Defendant in the Beltz lawsuit in July 2013, and the Directors filed a motion to dismiss the lawsuit in August 2013. On February 10, 2014, the court entered an order granting Indemnity’s motion to intervene and permitting Indemnity to join the Directors’ motion to dismiss; granting in part the Directors’ motion to dismiss; referring the matter to the Department to decide any and all issues within its jurisdiction; denying all other relief sought in the Directors’ motion as moot; and dismissing the case without prejudice. To avoid duplicative proceedings and expedite the Department’s review, the Parties have stipulated that only the Sullivan action will proceed before the Department and any final and non-appealable determinations made by the Department in the Sullivan action will be applied to the Beltz action. On March 7, 2014, Plaintiffs filed a notice of appeal to the United States Court of Appeals for the Third Circuit. Indemnity filed a motion to dismiss the appeal on March 26, 2014. On November 17, 2014, the Third Circuit deferred ruling on Indemnity’s motion to dismiss the appeal and instructed the parties to address that motion, as well as the merits of Plaintiffs’ appeal, in the parties’ briefing. Plaintiffs filed their Opening Brief on January 12, 2015. Defendants’ responsive briefing is currently due on March 3, 2015.

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

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

## Common Stock Market Prices and Dividends

Indemnity's Class A, non-voting common stock trades on The NASDAQ Stock Market<sup>SM</sup> LLC under the symbol "ERIE." No established trading market exists for the Class B voting common stock. American Stock Transfer & Trust Company serves as Indemnity's transfer agent and registrar. As of February 20, 2015, there were approximately 724 beneficial shareholders of record for the Class A non-voting common stock and 10 beneficial shareholders of record for the Class B voting common stock.

Historically, Indemnity has declared and paid cash dividends on a quarterly basis at the discretion of its Board of Directors. The payment and amount of future dividends on the common stock will be determined by the Board of Directors and will depend upon, among other things, Indemnity's operating results, financial condition, cash requirements, and general business conditions at the time such payment is considered. Indemnity's common stock high and low sales prices and cash dividends declared for each full quarter of the last two years were as follows:

Quarter ended	Indemnity Shareholder Interest							
	2014				2013			
	Stock sales price		Cash dividend declared		Stock sales price		Cash dividend declared	
	High	Low	Class A	Class B	High	Low	Class A	Class B
March 31	\$74.57	\$66.63	\$0.635	\$95.25	\$76.66	\$69.28	\$0.5925	\$88.875
June 30	76.71	68.72	0.635	95.25	82.64	72.69	0.5925	88.875
September 30	78.48	72.63	0.635	95.25	82.59	72.47	0.5925	88.875
December 31	93.35	75.72	0.681	102.15	74.23	69.42	0.6350	95.250
Total			\$2.586	\$387.90			\$2.4125	\$361.875

## Stock Performance

The following graph depicts the cumulative total shareholder return, assuming reinvestment of dividends, for the periods indicated for Indemnity's Class A common stock compared to the Standard & Poor's 500 Stock Index and the Standard & Poor's Supercomposite Insurance Industry Group Index. The Standard & Poor's Supercomposite Insurance Industry Group Index is made up of 56 constituent members represented by property casualty insurers, insurance brokers, and life insurers, and is a capitalization weighted index.

	2009	2010	2011	2012	2013	2014
Erie Indemnity Company Class A common stock	\$100	(1) \$171	\$210	\$199	\$215	\$275
Standard & Poor's 500 Stock Index	100	(1) 115	117	136	179	204
Standard & Poor's Supercomposite Insurance Industry Group Index	100	(1) 116	108	128	187	203

Assumes \$100 invested at the close of trading, on the last trading day preceding the first day of the fifth preceding (1) fiscal year, in Indemnity's Class A common stock, the Standard & Poor's 500 Stock Index, and the Standard & Poor's Supercomposite Insurance Industry Group Index.

Table of Contents

Issuer Purchases of Equity Securities

Indemnity may purchase shares, from time-to-time, in the open market, through trading plans entered into with one or more brokerage firms pursuant to Rule 10b5-1 under the Securities Exchange Act of 1934, or through privately negotiated transactions. The purchase of shares is dependent upon prevailing market conditions and alternate uses of capital, and at times and in a manner that is deemed appropriate.

On January 1, 2004, our Board of Directors authorized a stock repurchase program allowing the repurchase of Indemnity's outstanding Class A nonvoting common stock. Various approvals for continuation of this program have since been authorized, with the most recent occurring in October 2011 for \$150 million, which was authorized with no time limitation. There were no repurchases of Indemnity's Class A common stock during the quarter ending December 31, 2014. We had approximately \$18 million of repurchase authority remaining under this program at December 31, 2014, based upon trade date. During 2014, shares repurchased under this program totaled 272,057 at a total cost of \$19.2 million, based upon trade date. As of February 20, 2015, we had approximately \$18 million of repurchase authority remaining under this program.

See Item 8. "Financial Statements and Supplementary Data – Note 17, Indemnity Capital Stock, of Notes to Consolidated Financial Statements" contained within this report for discussion of additional shares repurchased outside of this program.

Table of Contents

## ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

(dollars in millions, except share data)	ERIE INDEMNITY COMPANY				
	Years Ended December 31,				
	2014	2013	2012	2011	(1) 2010 (2)
<b>Operating Data:</b>					
Premiums earned	\$5,344	\$4,898	\$4,493	\$4,214	\$3,987
Net investment income	446	422	438	433	433
Realized gains (losses) on investments	189	758	418	(6 )	307
Equity in earnings of limited partnerships	113	161	131	149	128
Other income	32	32	32	34	35
Total revenues	6,124	6,271	5,512	4,824	4,890
Net income	573	1,048	619	268	660
Less: Net income attributable to noncontrolling interest in consolidated entity – Exchange	405	885	459	99	498
Net income attributable to Indemnity	168	163	160	169	162
<b>Per Share Data Attributable to Indemnity:</b>					
Net income per Class A share – diluted	\$3.18	\$3.08	\$2.99	\$3.08	\$2.85
Book value per share – Class A common and equivalent B shares	13.45	13.96	12.11	14.48	16.24
Dividends declared per Class A share	2.586	2.4125	4.25	2.0975	1.955
Dividends declared per Class B share	387.90	361.875	637.50	314.625	293.25
<b>Financial Position Data:</b>					
Total assets	\$17,758	\$16,676	\$15,441	\$14,348	\$14,344
Total equity	7,983	7,550	6,791	6,293	6,334
Less: Noncontrolling interest in consolidated entity – Exchange	7,280	6,816	6,149	5,512	5,422
Total equity attributable to Indemnity	703	734	642	781	912

(1) Due to the sale of Indemnity's 21.6% ownership interest in EFL to the Exchange on March 31, 2011, 100% of EFL's life insurance results accrue to the interest of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after March 31, 2011. 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.

(2) Due to the sale of Indemnity's property and casualty insurance 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. 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.





Table of Contents

## ITEM 7. 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 audited financial statements and related notes and all other items contained within this Annual Report on Form 10-K as these contain important information helpful in evaluating our financial condition and results of operations.

## INDEX

	Page Number
<u>Cautionary Statement Regarding Forward-Looking Information</u>	<u>24</u>
<u>Recent Accounting Standards</u>	<u>25</u>
<u>Operating Overview</u>	<u>26</u>
<u>Critical Accounting Estimates</u>	<u>31</u>
<u>Results of Operations</u>	<u>40</u>
<u>Management Operations</u>	<u>40</u>
<u>Property and Casualty Insurance Operations</u>	<u>42</u>
<u>Life Insurance Operations</u>	<u>47</u>
<u>Investment Operations</u>	<u>48</u>
<u>Financial Condition</u>	<u>51</u>
<u>Investments</u>	<u>51</u>
<u>Liabilities</u>	<u>54</u>
<u>Shareholders’ Equity</u>	<u>55</u>
<u>Impact of Inflation</u>	<u>55</u>
<u>Liquidity and Capital Resources</u>	<u>56</u>
<u>Transactions/Agreements Between Indemnity and Noncontrolling Interest (Exchange)</u>	<u>61</u>

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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

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

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

- dependence upon Indemnity’s relationship with the Exchange and the management fee under the agreement with the subscribers at the Exchange;
- costs of providing services to the Exchange under the subscriber’s agreement;

- ability to attract and retain talented management and employees;
- ability to maintain uninterrupted business operations;
- factors affecting the quality and liquidity of Indemnity's investment portfolio;
- credit risk from the Exchange;
- Indemnity's ability to meet liquidity needs and access capital; and
- outcome of pending and potential litigation.

Table of Contents

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

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

A forward-looking statement speaks only as of the date on which it is made and reflects our analysis only as of that date. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changes in assumptions, or otherwise.

**RECENT ACCOUNTING STANDARDS**

See Item 8. “Financial Statements and Supplementary Data - Note 2, Significant Accounting Policies, of Notes to Consolidated Financial Statements” contained within this report for a discussion of adopted and/or recently issued accounting standards, none of which are expected to have a material impact on our future financial condition, results of operations or cash flows.

Table of Contents

OPERATING OVERVIEW

Overview

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

The Exchange is a reciprocal insurance exchange organized under Article X of Pennsylvania's Insurance Company Law of 1921 under which individuals, partnerships, and corporations are authorized to exchange reciprocal or inter-insurance contracts with each other, or with individuals, partnerships, and corporations of other states and countries, providing indemnity among themselves from any loss which may be insured against under any provision of the insurance laws except life insurance. Each applicant for insurance to the Exchange signs a subscriber’s agreement, which contains an appointment of Indemnity as their attorney-in-fact to transact the business of the Exchange on their behalf.

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

The Indemnity shareholder interest includes Indemnity’s equity and income, but not the equity or income of the Exchange. The Exchange’s equity, which is comprised of its retained earnings and accumulated other comprehensive income, is held for the interest of its subscribers (policyholders) and meets the definition of a noncontrolling interest, which is reflected as such in our consolidated financial statements.

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

The Indemnity shareholder interest in income comprises:

• a management fee of up to 25% of all property and casualty insurance premiums written or assumed by the Exchange, less the costs associated with the sales, underwriting, and issuance of these policies;

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

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

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

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

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

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

Table of Contents

## Results of the Erie Insurance Group's Operations by Interest

The following table represents a breakdown of the composition of the income attributable to the Indemnity shareholder interest and the income attributable to the noncontrolling interest (Exchange). For purposes of this discussion, EFL's investments are included in the life insurance operations.

(in millions)	Indemnity shareholder interest			Noncontrolling interest (Exchange)			Eliminations of related party transactions			Erie Insurance Group		
	Years ended December 31,			Years ended December 31,			Years ended December 31,			Years ended December 31,		
	2014	2013	2012	2014	2013	2012	2014	2013	2012	2014	2013	2012
<b>Management operations:</b>												
Management fee revenue, net	\$1,376	\$1,266	\$1,157	\$—	\$—	\$—	\$(1,376)	\$(1,266)	\$(1,157)	\$—	\$—	\$—
Service agreement revenue	31	31	31	—	—	—	—	—	—	31	31	31
Total revenue from management operations	1,407	1,297	1,188	—	—	—	(1,376)	(1,266)	(1,157)	31	31	31
Cost of management operations	1,184	1,088	983	—	—	—	(1,184)	(1,088)	(983)	—	—	—
Income from management operations before taxes	223	209	205	—	—	—	(192)	(178)	(174)	31	31	31
<b>Property and casualty insurance operations:</b>												
Net premiums earned	—	—	—	5,260	4,820	4,422	—	—	—	5,260	4,820	4,422
Losses and loss expenses	—	—	—	3,859	3,365	3,384	(6)	(5)	(5)	3,853	3,360	3,379
Policy acquisition and underwriting expenses	—	—	—	1,502	1,387	1,284	(204)	(187)	(182)	1,298	1,200	1,102
(Loss) income from property and casualty insurance operations before taxes	—	—	—	(101)	68	(246)	210	192	187	109	260	(59)
<b>Life insurance operations:<sup>(1)</sup></b>												
Total revenue	—	—	—	192	192	178	(2)	(2)	(2)	190	190	176
Total benefits and expenses	—	—	—	143	144	132	0	0	0	143	144	132
Income from life insurance operations before taxes	—	—	—	49	48	46	(2)	(2)	(2)	47	46	44
<b>Investment operations:<sup>(1)</sup></b>												
Net investment income	16	15	16	350	325	338	(16)	(12)	(11)	350	328	343
Net realized gains on investments	1	1	5	183	753	404	—	—	—	184	754	409
Net impairment losses recognized in earnings	0	0	0	(3)	(12)	0	—	—	—	(3)	(12)	0
	11	22	15	101	138	116	—	—	—	112	160	131

Equity in earnings of limited partnerships													
Income from investment operations before taxes	28	38	36	631	1,204	858	(16)	)(12)	)(11)	)	643	1,230	883
Income from operations before income taxes and noncontrolling interest	251	247	241	579	1,320	658	—	—	—		830	1,567	899
Provision for income taxes	83	84	81	174	435	199	—	—	—		257	519	280
Net income	\$168	\$163	\$160	\$405	\$885	\$459	\$—	\$—	\$—		\$573	\$1,048	\$619

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

Net income decreased in 2014 when compared to 2013 due to an underwriting loss experienced in the property and casualty insurance operations in 2014 compared to an underwriting gain in 2013 and lower levels of income from our investment operations. The underwriting results in the property and casualty insurance operations were negatively impacted by an increase in current accident year losses and catastrophe losses compared to 2013, offset somewhat by favorable development on prior accident year loss reserves. Our income from investment operations recorded lower levels of net realized gains on investments and earnings from limited partnerships in 2014 compared to 2013 offset somewhat by higher levels of net investment income.

Net income increased in 2013 when compared to 2012 due to an underwriting gain experienced in the property and casualty insurance operations in 2013 compared to an underwriting loss in 2012 and increased income from our investment operations. The 2013 underwriting results in the property and casualty insurance operations were positively impacted by lower levels of catastrophe losses compared to 2012, offset somewhat by lower levels of favorable development on prior accident year loss reserves in 2013 compared to 2012. Our income from investment operations improved in 2013 compared to 2012 due primarily to an increase in net realized gains on investments.

The Exchange's property and casualty insurance operations experienced a 8.6% and 9.6% increase in direct written premium in 2014 and 2013, respectively, driven by increases in policies in force and the average premium per policy, which also positively impacted Indemnity's management fee revenue.

Table of Contents

## Reconciliation of Operating Income to Net Income

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

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

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

The following table reconciles operating income and net income for the Indemnity shareholder interest for the years ended December 31:

(in millions, except per share data)	Indemnity Shareholder Interest		
	2014	2013	2012
Operating income attributable to Indemnity	\$167	\$162	\$157
Net realized gains and impairments on investments	1	1	5
Income tax expense	0	0	(2)
Realized gains and impairments, net of income taxes	1	1	3
Net income attributable to Indemnity	\$168	\$163	\$160
Per Indemnity Class A common share-diluted:			
Operating income attributable to Indemnity	\$3.17	\$3.07	\$2.92
Net realized gains and impairments on investments	0.02	0.01	0.10
Income tax expense	(0.01)	) 0.00	(0.03)
Realized gains and impairments, net of income taxes	0.01	0.01	0.07
Net income attributable to Indemnity	\$3.18	\$3.08	\$2.99



## Table of Contents

### Operating Segments

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

### Management operations

Management operations generate internal management fee revenue, which accrues to the Indemnity shareholder interest, as Indemnity provides services relating to the sales, underwriting, and issuance of policies on behalf of the Exchange. Management fee revenue is based upon all premiums written or assumed by the Exchange and the management fee rate, which is not to exceed 25%. Our Board of Directors establishes the management fee rate at least annually, generally in December for the following year, and considers factors such as the relative financial strength of Indemnity and the Exchange and projected revenue streams. The management fee rate was set at 25% for 2014, 2013 and 2012. Our Board of Directors set the 2015 management fee rate again at 25%, its maximum level. Management fee revenue is eliminated upon consolidation.

### Property and casualty insurance operations

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

The property and casualty insurance operation's premium growth strategy focuses on growth by expansion of existing operations including a careful agency selection process and increased market penetration in existing operating territories. Expanding the size of our existing agency force of nearly 2,200 independent agencies, with over 11,000 licensed property and casualty representatives, will contribute to future growth as new agents build their books of business with the Property and Casualty Group.

Geographic expansion is also a component of the Property and Casualty Group's premium growth strategy. The Property and Casualty Group began writing private passenger automobile, home insurance, and personal excess liability insurance in Kentucky in the fourth quarter of 2014.

The property and casualty insurance operations insure preferred and standard risks while maintaining a disciplined underwriting approach. The Property and Casualty Group's principal personal lines products based upon 2014 direct written premiums were private passenger automobile (43%) and homeowners (27%), and the principal commercial lines products were commercial multi-peril (13%), commercial automobile (7%), and workers compensation (7%). Pennsylvania, Maryland, Virginia, North Carolina and Ohio made up 74% of the property and casualty lines insurance business direct written premium in 2014.

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

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

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

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

Life insurance operations

EFL generates revenues through the sale of its individual and group life insurance policies and fixed annuities. These products provide our property and casualty agency force an opportunity to cross-sell both personal and commercial accounts. EFL's profitability depends principally on the ability to develop, price, and distribute insurance products, attract and retain deposit funds, generate investment returns, and manage expenses. Other drivers include mortality and morbidity experience, persistency experience to enable the recovery of acquisition costs, maintenance of interest spreads over the amounts credited to deposit funds, and the maintenance of strong ratings from rating agencies. EFL began writing life insurance and annuity products in Kentucky in the fourth quarter of 2014.

## Table of Contents

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

### Investment operations

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

### General Conditions and Trends Affecting Our Business

#### Economic conditions

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

#### Financial market volatility

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

Table of Contents

CRITICAL ACCOUNTING ESTIMATES

The consolidated financial statements include amounts based upon estimates and assumptions that have a significant effect on reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period and related disclosures. We consider an accounting estimate to be critical if 1) it requires assumptions to be made that were uncertain at the time the estimate was made, and 2) different estimates that could have been used, or changes in the estimate that are likely to occur from period-to-period, could have a material impact on our Consolidated Statements of Operations or Financial Position.

The following presents a discussion of those accounting policies surrounding estimates that we believe are the most critical to our reported amounts and require the most subjective and complex judgment. If actual events differ significantly from the underlying assumptions, there could be material adjustments to prior estimates that could potentially adversely affect our results of operations, financial condition, and cash flows. The estimates and the estimating methods used are reviewed continually, and any adjustments considered necessary are reflected in current earnings.

Property and Casualty Insurance Loss and Loss Expense Reserves

Property and casualty insurance loss and loss expense reserves are established to provide for the estimated costs of paying claims under insurance policies written by us. These reserves include estimates for both claims that have been reported (case) and those that have been incurred but not reported (IBNR) and include estimates of all future payments associated with processing and settling these claims.

The process of establishing loss reserves is complex and involves a variety of actuarial techniques. The loss reserve estimation process is based largely on the assumption that past development trends are an appropriate indicator of future events. Reserve estimates are based upon our assessment of known facts and circumstances, review of historical settlement patterns, estimates of trends in claims frequency and severity, legal theories of liability and other factors. Variables in the reserve estimation process can be affected by 1) internal factors, including changes in claims handling procedures and changes in the quality of risk selection in the underwriting process, and 2) external events, such as economic inflation and regulatory and legislative changes. Due to the inherent complexity of the assumptions used, final loss settlements may vary significantly from the current estimates, particularly when those settlements may not occur until well into the future.

How reserves are established

Case reserves are established by a claims handler on each individual claim and are adjusted as new information becomes known during the course of handling the claims. IBNR reserves represent the difference between the case reserves for actual reported loss and loss expenses and the estimated ultimate cost of all claims.

Our loss and loss expense reserves include amounts related to short-tail and long-tail lines of business. Tail refers to the time period between the occurrence of a loss and the final settlement of the claim. The longer the time span between the incidence of a loss and the settlement of the claim, the more the ultimate settlement amount can vary. Most of our loss and loss expense reserves relate to long-tail liability lines of business including workers compensation, bodily injury and other liability coverages, such as commercial liability. Short-tail lines of business, which represent a smaller percentage of our loss reserves, include personal auto physical damage and personal property.

Our actuaries review all direct reserve estimates on a quarterly basis for both current and prior accident years using the most current claim data. Reserves for massive injury lifetime medical claims, including auto no-fault and workers compensation claims, are reviewed at a more detailed level semi-annually. These massive injury claim reserves are relatively few in number and are very long-tail liabilities. In intervening quarters, development on massive injury

reserves is monitored to confirm that the estimate of ultimate losses should not change. If an unusual development is observed, a detailed review is conducted to determine whether the reserve estimate should change. Significant changes to the factors discussed above, which are either known or reasonably projected through analysis of internal and external data, are quantified in the reserve estimates each quarter.

Our actuaries review assumed reserve estimates annually for both current and prior accident years. The Property and Casualty Group ceased writing voluntary assumed business in 2003. Outstanding liabilities for the voluntary and involuntary assumed business are immaterial compared to the overall reserves. Our ceded reserves primarily relate to massive injury lifetime medical claims; the ceded estimates for these claims are adjusted when there is a change to the direct reserve estimate. The remainder of the ceded reserves is reviewed by our actuaries annually.

The quarterly reserve reviews incorporate a variety of actuarial methods and judgments and involve rigorous analysis. A comprehensive review is performed of the various estimation methods and reserve levels produced by each. The various

31

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## Table of Contents

methods generate different estimates of ultimate losses by product line and product coverage combination. Thus, reserves are comprised of a set of point estimates of the ultimate losses developed from the various methods. These multiple reserve point estimates are reviewed by our reserving actuaries and reserve best estimates are selected. The selected reserve estimates are discussed with management.

Numerous factors are considered in setting reserve levels, including, but not limited to, the assessed reliability of key loss trends and assumptions that may significantly influence the current actuarial indications, the maturity of the accident year, pertinent claims frequency and severity trends observed over recent years, the level of volatility within a particular line of business and the improvement or deterioration of actuarial rate indications in the current period as compared to prior periods. Certain methods are considered more credible for each product/coverage combination depending on the maturity of the accident quarter, the mix of business and the particular internal and external influences impacting the claims experience or the method.

The following is a discussion of the most common methods used:

**Paid development** – Paid loss development patterns are generated from historical data and applied to current paid losses to generate estimated ultimate losses. Paid development techniques do not use information about case reserves and therefore are not affected by changes in case reserving practices. These techniques are generally most useful for short-tailed segments since a high percentage of ultimate losses are paid in early periods of development.

**Incurred development** – Incurred loss development patterns (reflecting cumulative paid losses plus current case reserves) are generated from historical data. The patterns are applied to current incurred losses to generate estimated ultimate losses. Incurred methods and/or combinations of the paid and incurred methods are used in developing estimated ultimate losses for short-tail coverages and long-tail coverages,

**Expected loss ratio** – An expected loss ratio is developed through a review of historical loss ratios by accident quarter, adjusted for changes to earned premium, mix of business and other factors that are expected to impact the loss ratio for the accident quarter being evaluated. A preliminary estimate of ultimate losses is calculated by multiplying this expected loss ratio by earned premium.

**Bornhuetter-Ferguson** – Bornhuetter-Ferguson is a method of combining the results of the expected-loss-ratio method and the paid or incurred development method. It places more weight on the paid or incurred development method as the accident period matures. The Bornhuetter-Ferguson method is generally used for less mature accident periods on the long-tail coverages because a low percentage of losses are paid or incurred in the early period of development.

**Survival ratio** – This method measures the ratio of the average loss and loss expense amount paid annually to the total reserve for the product line or product coverage. The survival ratio represents the number of years of payments that the current level of reserves will cover. The reserve is established so that a particular ratio, representing the time to closing of all claims, is achieved. This method is also used as a reasonability check of reserve adequacy.

**Individual claim** – This method estimates the ultimate losses on a claim-by-claim basis. An annual payment assumption is made for each claimant and then projected into the future based upon a particular assumption of the future inflation rate and life expectancy of the claimant. This method is used for unusual, large claims.

**Weather event paid and reported development** – The historical patterns utilized in paid and reported development methods for weather events are derived from historical data for the same type of weather event. Initial weather event ultimate loss estimates are reviewed with claims management.

Line of business methods

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For each product line and product/coverage combination, certain methods are given more influence than other methods. The discussion below gives a general indication of which methods are preferred for each line of business. As circumstances change, the methods that are given greater weight can change.

Massive injury lifetime medical claims (such as certain auto no-fault and workers compensation claims) – These claims develop over a long period of time and are relatively few in number. We utilize the individual claim method to evaluate each claim's ultimate losses.

Personal auto physical damage and homeowners – These lines are fast-developing and we rely more on the paid and incurred development techniques.

32

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## Table of Contents

Personal auto liability (such as bodily injury and uninsured/underinsured motorist) – For auto liability, and bodily injury in particular, we review the results of a greater number of techniques than for physical damage. We tend to rely on the Bornhuetter-Ferguson method for more recent experience periods and paid and incurred development methods for the older accident periods.

Workers compensation and long-tailed liability (such as commercial liability) – We generally rely upon the expected loss ratio, Bornhuetter-Ferguson and incurred development techniques. These techniques are generally weighted together, relying more heavily on the Bornhuetter-Ferguson method at early ages of development and more on the incurred development method as the accident periods mature.

The methods used for estimating loss expenses are as follows:

Defense and cost containment expenses (D&CC) – D&CC is analyzed using paid development techniques and an analysis of the relationship between D&CC payments and loss payments.

Adjusting and other expenses (A&O) – A&O reserves are projected based upon an expected cost per claim year, the anticipated claim closure pattern, and the ratio of paid A&O to paid loss.

### Key assumptions for loss reserving

The accuracy of the various methods used to estimate reserves is a function of the degree to which underlying assumptions are satisfied. The most significant key assumptions are:

Development patterns – Historical paid and incurred amounts contain patterns which indicate how unpaid and IBNR amounts will emerge in future periods. Unless reasons or factors are identified that invalidate the extension of historical patterns into the future, these patterns can be used to make projections necessary for estimating loss and loss adjustment expense reserves. This is the most significant assumption and it applies to all methods.

Impact of inflation – Property and casualty insurance reserves are established before the extent to which inflation may impact such reserves is known. Consequently, in establishing reserves, we attempt to anticipate the potential impact of inflation, including medical cost inflation, construction and auto repair cost inflation and tort issues. Medical costs are a broad element of inflation that impacts personal and commercial auto, general liability, workers compensation and commercial multi-peril lines of insurance written by the Property and Casualty Group. Inflation assumptions take the form of explicit numerical values in the survival ratio, individual claim, and massive injury lifetime medical reserving methods. Inflation assumptions are implicitly derived through the selection of applicable loss development patterns for all other reserving methods.

Future cost increase assumptions are derived from a review of historical cost increases and are assumed to persist into the future. Future medical cost increases and claimant mortality assumptions utilized in the reserve estimates for massive injury lifetime medical claims are obtained from industry studies adjusted for our own experience. Reserve levels are sensitive to these assumptions because these amounts represent projections over 30 to 40 years into the future.

### Other internal and external factors

Occasionally, unusual aberrations in loss development patterns are caused by external and internal factors such as changes in claim reporting and/or settlement patterns, unusually large losses, process changes, legal or regulatory changes and other influences. In these instances, analyses of alternate development factor selections are performed to evaluate the effect of these factors and actuarial judgment is applied to make appropriate assumptions needed to develop a best estimate of ultimate losses.



Claims with atypical emergence patterns – Characteristics of certain subsets of claims, such as those with high severity, have the potential to distort patterns contained in historical paid loss and reported loss data. When testing indicates this to be the case for a particular subset of claims, our actuaries segregate these claims from the data and analyze them separately.

Changes in loss ratio trends – Prior loss ratio assumptions utilized in the Bornhuetter-Ferguson method are derived from projections of historical loss ratios based upon actual experience from more mature accident periods adjusted for assumed changes in average premiums, frequency and severity. These assumptions influence only the most recent accident periods, but the majority of reserves originate with the most recent accident periods. Reserve levels are highly sensitive to these assumptions.

Relationship of loss expense to losses – D&CC-to-loss ratio assumptions utilized in the Bornhuetter-Ferguson method are initially derived from historical relationships. These historical ratios are adjusted according to the impact of changing internal and external factors. The A&O-to-loss ratio assumption is similarly derived from historical relationships and adjusted as required for identified internal or external changes.

## Table of Contents

### Reserve discounting

Loss reserves are set at ultimate cost, except for workers compensation loss reserves, which are discounted on a nontabular basis using an interest rate of 2.5% and our historical workers compensation payout patterns. In our workers compensation discounting methodology, we segregate the workers compensation massive injury claims that have longer payout patterns from the non-massive injury workers compensation claims. The discount on workers compensation reserves was \$89 million at December 31, 2014. A 100-basis point increase in the discount rate would result in an increase to the discount of \$48 million at December 31, 2014.

### Reserve estimate variability

The property and casualty reserves with the greatest potential for variation are the massive injury lifetime medical reserves. These claims arise from the automobile no-fault law in Pennsylvania before 1986 and workers compensation policies which provide unlimited medical benefits. The estimate of ultimate liabilities for these claims is subject to significant judgment due to variations in claimant health, mortality over time and health care cost trends. These claims have been segregated from the total population of claims. Ultimate losses for these claims are estimated on a claim-by-claim basis. We are currently reserving for 245 claimants requiring lifetime medical care, of which 97 involve massive injuries. The annual payment is projected into the future based upon particular assumptions of the future inflation rate and life expectancy of the claimant. The most significant variable in estimating this liability is medical cost inflation. The life expectancy (mortality rate) assumption underlying the estimate reflects the gender specific disabled pensioner mortality table. Actual experience, however, may emerge in a manner that is different relative to the original assumptions, which could have a significant impact on our reserve estimates.

Auto no-fault (massive injury lifetime medical claims) - The automobile massive injury gross reserve carried by the Property and Casualty Group totaled \$330 million at December 31, 2014, compared to \$345 million at December 31, 2013. The slight decrease in the pre-1986 automobile massive injury reserves in 2014, compared to 2013, was due to continued payments on these claims. A 100-basis point increase in the medical cost inflation assumption would result in an increase in the Property and Casualty Group's gross year-end reserve of \$64 million. This increase in the medical cost inflation assumption would also increase the reinsurance recoverable related to these reserves by \$25 million, resulting in a \$39 million increase in the net reserve.

Workers compensation (massive injury lifetime medical claims) - The workers compensation massive injury reserve carried by the Property and Casualty Group totaled \$82 million at December 31, 2014, compared to \$94 million at December 31, 2013, net of discounting. The decrease in the workers compensation massive injury reserves in 2014, compared to 2013, was primarily due to the settlement of two claims, offset somewhat by the addition of two new claims. A 100-basis point increase in the medical cost inflation assumption would result in an increase in the Property and Casualty Group's December 31, 2014 gross reserve of \$20 million. This increase in the medical cost inflation assumption would also increase the related reinsurance recoverable and the workers compensation discount by \$16 million, resulting in a \$4 million increase in the net reserve.

### Reserve adequacy

We also perform analyses to evaluate the adequacy of past total reserve levels for the Property and Casualty Group. Previously established estimates for reserves were not materially different than those determined in these retrospective analyses. At December 31, 2014, our current estimate of direct loss reserves, including salvage and subrogation for accident years 2013 and prior is \$120 million, or 3.2% less than the reserve amount we had established at December 31, 2013. At December 31, 2013, our estimate of direct loss reserves, including salvage and subrogation recoveries for accident years 2012 and prior was \$2 million, or 0.1% higher than the reserve amount we had established at December 31, 2012. At December 31, 2012, our estimate of direct loss reserves, including salvage and subrogation recoveries for accident years 2011 and prior was

\$92 million, or 2.6% lower than the reserve amount we had established at December 31, 2011. See an additional discussion of our reserve development in the “Prior year loss reserve development” section.

#### Life Insurance and Annuity Policy Reserves

Reserves for traditional life insurance future policy benefits are computed primarily by the net level premium method. Generally, benefits are payable over an extended period of time and related reserves are calculated as the present value of future expected benefits to be paid reduced by the present value of future expected net premiums. Such reserves are established based upon methods and underlying assumptions in accordance with GAAP and applicable actuarial standards. Principal assumptions used in the establishment of policy reserves are mortality, lapses, expenses, and investment yields. Mortality assumptions are based upon tables typically used in the industry, modified to reflect actual experience and to include a provision for the risk of adverse deviation where appropriate. Lapse, expense, and investment yield assumptions are based upon actual company experience and may include a provision for the risk of adverse deviation. Assumptions on these policies are locked in at the time of issue and are not subject to change unless a premium deficiency exists. A premium deficiency exists if, based upon revised assumptions, the existing contract liabilities together with the present value of future gross premiums are not sufficient

## Table of Contents

to cover the present value of future expected benefits and maintenance costs and to recover unamortized acquisition costs. Historically, our reserves plus expected gross premiums have been demonstrated to be sufficient. There were no premium deficiencies in 2014, 2013 or 2012.

Reserves for income-paying annuity future policy benefits are computed as the present value of future expected benefits. Principal assumptions used in the establishment of policy reserves are mortality and investment yields. Interest rates used to discount future expected benefits are set at the policy level and range from 1.50% to 9.0%. The equivalent aggregate interest rate is 5.7%. If the aggregate interest rate was reduced by 100 basis points, the present value of future expected benefits would increase by \$16 million at December 31, 2014.

Reserves for universal life and deferred annuity plans are primarily based upon the contract account balance without reduction for surrender charges.

### Investment Valuation

#### Available-for-sale and trading securities

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

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

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

• An active market is one in which transactions for the assets being valued occur with sufficient frequency and volume to provide reliable pricing information.

• An inactive (illiquid) market is one in which there are few and infrequent transactions, where the prices are not current, price quotations vary substantially, and/or there is little information publicly available for the asset being valued.

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

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

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

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

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

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

Level 3 securities are valued based upon unobservable inputs, reflecting our estimates of value based upon assumptions used by market participants. Securities are assigned to Level 3 in cases where non-binding broker quotes are significant to the valuation and there is a lack of transparency as to whether these quotes are based upon information that is observable in the

35

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## Table of Contents

marketplace. Fair value estimates for securities valued using unobservable inputs require significant judgment due to the illiquid nature of the market for these securities and represent the best estimate of the fair value that would occur in an orderly transaction between willing market participants at the measurement date under current market conditions. Fair value for these securities are generally determined using comparable securities or non-binding broker quotes received from outside broker dealers based upon security type and market conditions. Remaining securities, where a price is not available, are valued using an estimate of fair value based upon indicative market prices that include significant unobservable inputs not based upon, nor corroborated by, market information, including the utilization of discounted cash flow analyses which have been risk-adjusted to take into account illiquidity and other market factors. This category primarily consists of corporate bonds priced using non-binding broker quotes as well as certain private securities.

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

Estimates of fair values for our investment portfolio are obtained primarily from a nationally recognized pricing service. Our Level 1 category includes those securities valued using an exchange traded price provided by the pricing service. The methodologies used by the pricing service that support a Level 2 classification of a financial instrument include multiple verifiable, observable inputs including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data. Pricing service valuations for Level 3 securities are based upon proprietary models and are used when observable inputs are not available in illiquid markets. In limited circumstances we adjust the price received from the pricing service when, in our judgment, a better reflection of fair value is available based upon corroborating information and our knowledge and monitoring of market conditions such as a disparity in price of comparable securities and/or non-binding broker quotes. In other circumstances, certain securities are internally priced because prices are not provided by the pricing service.

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

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

### Other-than-temporary impairments

Investments are evaluated monthly for other-than-temporary impairment loss. Some factors considered in evaluating whether or not a decline in fair value is other-than-temporary include:

- the extent and duration for which fair value is less than cost;
- historical operating performance and financial condition of the issuer;

short- and long-term prospects of the issuer and its industry based upon analysts' recommendations;  
specific events that occurred affecting the issuer, including rating downgrades;  
intent to sell or more likely than not be required to sell (debt securities); and  
ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value (equity securities).

For available-for-sale equity securities, a charge is recorded in the Consolidated Statements of Operations for positions that have experienced other-than-temporary impairments. For debt securities in which we do not expect full recovery of amortized cost, the security is deemed to be credit-impaired. Credit-related impairments and impairments on securities we intend to sell or more likely than not will be required to sell are recorded in the Consolidated Statements of Operations. It is our intention to sell all debt securities with credit impairments.

## Table of Contents

### Limited partnerships

The primary basis for the valuation of limited partnership interests is financial statements prepared by the general partner. Because of the timing of the preparation and delivery of these financial statements, the use of the most recently available financial statements provided by the general partners generally result in a quarter delay in the inclusion of the limited partnership results in our Consolidated Statements of Operations. Due to this delay, these financial statements do not reflect the market conditions experienced in the fourth quarter of 2014.

The majority of our limited partnership holdings are considered investment companies where the general partners record assets at fair value. These limited partnerships are recorded using the equity method of accounting. We also own some real estate limited partnerships that do not meet the criteria of an investment company. These partnerships prepare audited financial statements on a cost basis. We have elected to report these limited partnerships under the fair value option, which is based on the net asset value (NAV) from our partner's capital statement reflecting the general partner's estimate of fair value for the fund's underlying assets. Fair value provides consistency in the evaluation and financial reporting for these limited partnerships and limited partnerships accounted for under the equity method.

We have three types of limited partnership investments: private equity, mezzanine debt, and real estate. Our private equity and mezzanine debt partnerships are diversified among numerous industries and geographies to minimize potential loss exposure. Nearly all of the underlying investments in our limited partnerships are valued using a source other than quoted prices in active markets. The fair value amounts for our private equity and mezzanine debt partnerships are based upon the financial statements prepared by the general partners, who use various methods to estimate fair value including the market approach, income approach, and the cost approach. The market approach uses prices and other pertinent information from market-generated transactions involving identical or comparable assets or liabilities. Such valuation techniques often use market multiples derived from a set of comparables. The income approach uses valuation techniques to convert future cash flows or earnings to a single discounted present value amount. The measurement is based upon the value indicated by current market expectations about those future amounts. The cost approach is derived from the amount that is currently required to replace the service capacity of an asset. If information becomes available that would impair the cost of investments owned by the partnerships, then the general partner would adjust the investments to the net realizable value.

The fair value of investments in real estate limited partnerships is determined by the general partner based upon independent appraisals and/or internal valuations. Real estate projects under development are generally valued at cost and impairment tested by the general partner. We minimize the risk of market decline by avoiding concentration in a particular geographic area and are diversified across residential, commercial, industrial, and retail real estate investments.

While we perform various procedures in review of the general partners' valuations, we rely on the general partners' financial statements as the best available information to record our share of the partnership unrealized gains and losses resulting from valuation changes. Due to the limited market for these investments, there is the greatest potential for variability. We survey each of the general partners quarterly about expected significant changes (plus or minus 10% compared to previous quarter) to valuations prior to the release of the fund's quarterly and annual financial statements. Based upon that information from the general partner, we consider whether additional disclosure is warranted. We analyze limited partnerships measured at fair value based upon NAV to determine if the most recently available NAV reflects fair value at the balance sheet date, with an adjustment being made where appropriate (change of plus or minus 5% compared to most recent NAV.)

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

Acquisition costs that vary with and relate to the production of life insurance and investment-type contracts are deferred. Deferred acquisition costs ("DAC") are incremental direct costs of contract acquisition. These costs are limited to the successful acquisition of new and renewal contracts. Such costs consist principally of commissions and policy



issuance expenses.

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

DAC related to universal life products and deferred annuities is amortized over the estimated lives of the contracts in proportion to actual and expected future gross profits, which include investment, mortality, and expense margins and surrender charges. Both historical and anticipated investment returns, including realized gains and losses, are considered in determining the amortization of DAC. When the actual gross profits change from previously estimated gross profits, the cumulative DAC

37

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## Table of Contents

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

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

DAC is periodically reviewed for recoverability. For traditional life products, if the benefit reserves plus anticipated future premiums and interest earnings for a line of business are less than the current estimate of future benefits and expenses (including any unamortized DAC), a charge to income is recorded for additional DAC amortization or for increased benefit reserves. For universal life products and deferred annuities, if the current present value of future expected gross profits is less than the unamortized DAC, a charge to income is recorded for additional DAC amortization. There were no impairments to DAC in 2014, 2013 or 2012.

### Deferred Taxes

Deferred tax assets represent the tax benefit of future deductible temporary differences and operating loss and tax credit carry-forwards. Deferred tax assets are measured using the enacted tax rates expected to be in effect when such benefits are realized. We perform an analysis of our deferred tax assets to determine recoverability on a quarterly basis for each legal entity, by character of the income (ordinary or capital). Deferred tax assets are reduced by a valuation allowance, if based upon the weight of available evidence, it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. In determining the need for a valuation allowance, we consider carry-back capacity, reversal of existing temporary differences, future taxable income and tax planning strategies. The determination of the valuation allowance for our deferred tax assets requires us to make certain judgments and assumptions regarding future operations that are based upon our historical experience and our expectations of future performance. Our judgments and assumptions are subject to change given the inherent uncertainty in predicting future performance, which is impacted by such things as financial market conditions, policyholder behavior, competitor pricing, new product introductions, and specific industry and economic conditions.

Indemnity had a net deferred tax asset of \$37 million and \$2 million at December 31, 2014 and 2013, respectively. There was no valuation allowance recorded on Indemnity at December 31, 2014 or 2013. The Exchange had a net deferred tax liability of \$490 million and \$450 million at December 31, 2014 and 2013, respectively.

### Retirement Benefit Plans for Employees

Our pension plans consist of a noncontributory defined benefit pension plan covering substantially all employees and an unfunded supplemental employee retirement plan ("SERP") for certain members of executive and senior management of the Erie Insurance Group. Although Indemnity is the sponsor of these postretirement plans and records the funded status of these plans, the Exchange and EFL reimburse Indemnity for approximately 56% of the annual benefit expense of these plans, which represents pension benefits for Indemnity employees performing claims and EFL functions.

Our pension obligation is developed from actuarial estimates. Several statistical and other factors, which attempt to anticipate future events, are used in calculating the expense and liability related to the plans. Key factors include assumptions about the discount rates and expected rates of return on plan assets. We review these assumptions annually and modify them considering historical experience, current market conditions, including changes in investment returns and interest rates and expected future trends.

Accumulated and projected benefit obligations are expressed as the present value of future cash payments. We discount those cash payments based upon a yield curve developed from corporate bond yield information with maturities that correspond to the payment of benefits. Lower discount rates increase present values and subsequent year pension expense, while higher discount rates decrease present values and subsequent year pension expense. The construction of the yield curve is based upon yields of corporate bonds rated Aa quality. Target yields are developed from bonds at various maturity points and a curve is fitted to those targets. Spot rates (zero coupon bond yields) are developed from the yield curve and used to discount benefit payment amounts associated with each future year. The present value of plan benefits is calculated by applying the spot/

Table of Contents

discount rates to projected benefit cash flows. A single discount rate is then developed to produce the same present value. The cash flows from the yield curve were matched against our projected benefit payments in the pension plan, which have a duration of about 20 years. This yield curve supported the selection of a 4.17% discount rate for the projected benefit obligation at December 31, 2014 and for the 2015 pension expense. The same methodology was used to develop the 5.11% and 4.19% discount rates used to determine the projected benefit obligation for 2013 and 2012, respectively, and the pension expense for 2014 and 2013, respectively. A 25 basis point decrease in the discount rate assumption, with other assumptions held constant, would increase pension cost in the following year by \$4 million and would increase the pension benefit obligation by \$34 million.

Unrecognized actuarial gains and losses arise from several factors, including experience and assumption changes in the obligations and from the difference between expected returns and actual returns on plan assets. These unrecognized gains and losses are recorded in the pension plan obligation and accumulated other comprehensive income (loss) on the Consolidated Statements of Financial Position. These amounts are systematically recognized to net periodic pension expense in future periods, with gains decreasing and losses increasing future pension expense. If actuarial net gains or losses exceed 5% of the greater of the projected benefit obligation and the market-related value of plan assets, the excess is recognized through the net periodic pension expense equally over the estimated service period of the employee group, which is currently 14 years.

The expected long-term rate of return for the pension plan represents the average rate of return to be earned on plan assets over the period the benefits included in the benefit obligation are to be paid. The expected long-term rate of return is less susceptible to annual revisions, as there are typically no significant changes in the asset mix. To determine the expected long-term rate of return assumption, we utilized models based upon rigorous historical analysis and forward-looking views of the financial markets based upon key factors such as historical returns for the asset class' applicable indices, the correlations of the asset classes under various market conditions and consensus views on future real economic growth and inflation. The expected future return for each asset class is then combined by considering correlations between asset classes and the volatilities of each asset class to produce a reasonable range of asset return results within which our expected long-term rate of return assumption falls. A change of 25 basis points in the expected long-term rate of return assumption, with other assumptions held constant, would have an estimated \$1.3 million impact on net pension benefit cost in the following year, of which Indemnity's share would be approximately \$0.6 million.

We use a four year averaging method to determine the market-related value of plan assets, which is used to determine the expected return component of pension expense. Under this methodology, asset gains or losses that result from returns that differ from our long-term rate of return assumption are recognized in the market-related value of assets on a level basis over a four year period. The market-related asset experience during 2014 that related to the actual investment return being different from that assumed during the prior year was a gain of \$42 million. Recognition of this gain will be deferred and recognized over a four year period, consistent with the market-related asset value methodology. Once factored into the market-related asset value, these experience gains and losses will be amortized over a period of 14 years, which is the remaining service period of the employee group.

Estimates of fair values of the pension plan assets are obtained primarily from our trustee and custodian of our pension plan. Our Level 1 category includes a money market fund that is a mutual fund for which the fair value is determined using an exchange traded price provided by the trustee and custodian. Our Level 2 category includes commingled pools. Estimates of fair values for securities held by our commingled pools are obtained primarily from the trustee and custodian. The methodologies used by the trustee and custodian that support a financial instrument Level 2 classification include multiple verifiable, observable inputs including benchmark yields, reported trades, broker/dealer quotes, issuers spreads, two-sided markets, benchmark securities, bids, offers, and reference data. There were no Level 3 investments in 2014 or 2013.

We expect our net pension benefit costs to increase from \$26 million in 2014 to \$39 million in 2015. This increase is due to both the lower discount rate and the adoption of the newly issued mortality tables, partially offset by a change in other plan assumptions that were updated to reflect our most recent actual experience. Indemnity's share of the net pension benefit costs after reimbursements will increase from \$12 million in 2014 to approximately \$17 million in 2015.

The actuarial assumptions we used in determining our pension obligation may differ materially from actual results due to changing market and economic conditions, higher or lower withdrawal rates, or longer or shorter life spans of participants. While we believe that the assumptions used are appropriate, differences in actual experience or changes in assumptions may materially affect our financial position, results of operations, or cash flows. See Item 8. "Financial Statements and Supplementary Data - Note 15, Postretirement Benefits, of Notes to Consolidated Financial Statements" contained within this report for additional details on the pension plans.

Table of Contents

## RESULTS OF OPERATIONS

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

## Management Operations

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

(dollars in millions)	Indemnity Shareholder Interest Years ended December 31,					
	2014	% Change	2013	% Change	2012	
Management fee revenue, net	\$1,376	8.7 %	\$1,266	9.4 %	\$1,157	
Service agreement revenue	31	NM	31	NM	31	
Total revenue from management operations	1,407	8.5	1,297	9.2	1,188	
Cost of management operations	1,184	8.8	1,088	10.6	983	
Income from management operations – Indemnity <sup>(1)</sup>	\$223	6.5 %	\$209	2.1 %	\$205	
Gross margin	15.8	% (0.3 )pts.	16.1	% (1.2 )pts.	17.3	%

NM = not meaningful

(1) The Indemnity shareholder interest 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:

(dollars in millions)	Indemnity Shareholder Interest Years ended December 31,					
	2014	% Change	2013	% Change	2012	
Property and Casualty Group direct written premium	\$5,514	8.6 %	\$5,076	9.6 %	\$4,631	
Management fee rate	25	%	25	%	25	%
Management fee revenue, gross	1,379	8.6	1,269	9.6	1,157	
Change in allowance for management fee returned on cancelled policies <sup>(1)</sup>	(3 )	NM	(3 )	NM	0	
Management fee revenue, net of allowance	\$1,376	8.7 %	\$1,266	9.4 %	\$1,157	

NM = not meaningful

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

Management fee revenue increased \$110 million, or 8.7%, in 2014, compared to 2013. Direct written premium of the Property and Casualty Group increased 8.6% in 2014, compared to 2013, due to a 4.3% increase in policies in force and a 4.2% increase in the year-over-year average premium per policy for all lines of business. The year-over-year policy retention ratio was 90.3% at December 31, 2014, 90.6% at December 31, 2013, and 90.9% at December 31, 2012. See the “Property and Casualty Insurance Operations” segment that follows for a complete discussion of property and casualty direct written premium, which has a direct bearing on Indemnity’s management fee. The management fee rate was set at 25%, the maximum rate, for 2014, 2013 and 2012. The management fee rate for 2015 was set at 25% by our Board of Directors. Changes in the management fee rate can affect the Indemnity shareholder interest's revenue and net income from this segment significantly. See also, the “Transactions/Agreements between Indemnity and Noncontrolling Interest (Exchange), Board Oversight” section within this report.

#### 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

Table of Contents

charges are fixed dollar amounts per billed installment. Service agreement revenue totaled \$31 million in 2014, 2013 and 2012. The consistency in the service agreement revenue compared to the growth in policies in force reflects the continued shift in policies to the monthly direct debit payment plan, which does not incur service charges, and the no-fee single payment plan, which offers a premium discount. The shift to these plans is driven by the consumers' desire to avoid paying service charges and to take advantage of the discount in pricing offered for paid-in-full policies.

## Cost of management operations

(in millions)	Indemnity Shareholder Interest Years ended December 31,				
	2014	% Change	2013	% Change	2012
Commissions:					
Total commissions	\$783	10.3	% \$710	11.7	% \$635
Non-commission expense:					
Sales and advertising	\$60	2.1	\$59	6.2	\$55
Underwriting and policy processing	127	5.8	120	8.0	111
Information technology	121	12.5	108	4.8	103
Customer service	26	18.4	22	19.1	19
Administrative and other	67	(3.7)	69	15.4	60
Total non-commission expense	401	6.2	378	8.6	348
Total cost of management operations	\$1,184	8.8	% \$1,088	10.6	% \$983

Commissions – Commissions increased \$73 million in 2014 compared to 2013, and increased \$75 million in 2013 compared to 2012, primarily as a result of the 8.6% and 9.6% respective increases in direct written premiums of the Property and Casualty Group. Commission growth outpaced direct written premium growth in 2014 and 2013 primarily due to an increase in agent incentive costs related to profitable growth. Also impacting the increase in 2013 was an adjustment that reduced commission expense by \$6 million in 2012. This amount represented the reimbursement by the North Carolina Reinsurance Facility (NCRF) for commissions Indemnity paid to agents on the surcharges collected on behalf of the NCRF which was incorrectly recorded as a benefit to the Exchange in prior periods.

Non-commission expense – Non-commission expense increased \$23 million in 2014 compared to 2013. Information technology costs increased \$13 million, which included \$6 million of professional fees, \$4 million of personnel costs, and \$3 million of hardware and software costs. Underwriting and policy processing costs increased \$7 million due to the increased cost of underwriting reports, postage, and printing costs related to increased volume. Customer service costs increased \$4 million due to an increase of \$2 million in credit card processing fees and \$2 million in personnel costs. All other operating costs decreased \$1 million.

In 2013, compared to 2012, non-commission expense increased \$30 million. Sales and advertising costs increased \$4 million due to personnel costs. Underwriting and policy processing costs increased \$9 million due to increased personnel costs and the increased cost of underwriting reports and postage and printing costs. Information technology costs increased \$5 million, which included \$6 million of personnel costs, offset by a decrease of \$1 million in software, hardware, and maintenance costs. Customer service costs increased \$3 million due to an increase of \$2 million in credit card processing fees and \$1 million in personnel costs. Administrative and other costs increased \$9 million driven by increases in professional fees and personnel costs of \$5 million and \$4 million, respectively. Personnel costs in all expense categories were impacted by higher staffing levels, increased pension and medical costs, and increased estimates for incentive plan compensation costs related to growth and underwriting performance.



**Gross margin**

The gross margin in 2014 was 15.8%, compared to 16.1% in 2013 and 17.3% in 2012. Excluding the adjustment in 2012 that reduced commission expense by \$6 million (described above), the gross margin would have been 16.8% in 2012.

41

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Table of Contents

## Property and Casualty Insurance Operations

The Property and Casualty Group operates in 12 Midwestern, Mid-Atlantic, and Southeastern states and the District of Columbia and primarily writes private passenger automobile, homeowners, commercial multi-peril, commercial automobile, and workers compensation lines of insurance. A summary of the results of our property and casualty insurance operations is as follows:

(dollars in millions)	Property and Casualty Group Years ended December 31,					
	2014	% Change	2013	% Change	2012	
Premiums:						
Direct written premium	\$5,514	8.6 %	\$5,076	9.6 %	\$4,631	
Reinsurance premium – assumed and ceded	(27 )	13.4	(31 )	(9.3 )	(28 )	
Net written premium	5,487	8.8	5,045	9.6	4,603	
Change in unearned premium	(227 )	(1.1 )	(225 )	24.1	(181 )	
Net premiums earned	5,260	9.1	4,820	9.0	4,422	
Losses and loss expenses:						
Current accident year, excluding catastrophe losses	3,580	11.1	3,222	7.0	3,010	
Current accident year catastrophe losses	395	NM	162	NM	489	
Prior accident years, including prior year catastrophe losses	(116 )	NM	(19 )	NM	(115 )	
Losses and loss expenses	3,859	14.7	3,365	(0.5 )	3,384	
Policy acquisition and other underwriting expenses	1,502	8.4	1,387	7.9	1,284	
Total losses and expenses	5,361	12.8	4,752	1.8	4,668	
Underwriting (loss) income – Exchange <sup>(1)</sup>	\$(101 )	NM %	\$68	NM %	\$(246 )	
Loss and loss expense ratios:						
Current accident year loss ratio, excluding catastrophe losses	68.1	% 1.3 pts.	66.8	% (1.3 ) pts.	68.1	%
Current accident year catastrophe loss ratio	7.5	4.1	3.4	(7.6 )	11.0	
Prior accident year loss ratio, including prior year catastrophe losses	(2.2 )	(1.8 )	(0.4 )	2.2	(2.6 )	
Total loss and loss expense ratio	73.4	3.6	69.8	(6.7 )	76.5	
Policy acquisition and other underwriting expense ratio	28.5	(0.3 )	28.8	(0.3 )	29.1	
Combined ratio	101.9	% 3.3 pts.	98.6	% (7.0 ) pts.	105.6	%

NM = not meaningful

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

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

Premiums

Direct written premium – Direct written premium of the Property and Casualty Group increased 8.6% to \$5.5 billion in 2014, from \$5.1 billion in 2013, driven by an increase in policies in force and increases in average premium per policy. Year-over-year policies in force for all lines of business increased by 4.3% in 2014 as the result of continuing strong policyholder retention and an increase in new policies written, compared to 4.8% in 2013. The year-over-year average premium per policy for all lines of business increased 4.2% at December 31, 2014, compared to 4.5% at December 31, 2013.

Premiums generated from new business increased 5.8% to \$695 million in 2014, compared to 15.6%, or \$656 million, in 2013. Underlying the trend in new business premiums was a 2.9% increase in new business policies written in 2014, compared to 13.6% in 2013, while the year-over-year average premium per policy on new business increased 2.9% at December 31, 2014, compared to 1.8% at December 31, 2013.

Premiums generated from renewal business increased 9.0% to \$4.8 billion in 2014, compared to 8.8%, or \$4.4 billion, in 2013. Underlying the trend in renewal business premiums were increases in average premium per policy and steady policy retention ratios. The renewal business year-over-year average premium per policy increased 4.3% at December 31, 2014, compared to

Table of Contents

5.0% at December 31, 2013. The Property and Casualty Group's year-over-year policy retention ratio was 90.3% at December 31, 2014, 90.6% at December 31, 2013, and 90.9% at December 31, 2012.

The Property and Casualty Group implemented rate increases in 2014, 2013, and 2012 in order to meet loss cost expectations.

As the Property and Casualty Group writes policies with annual terms only, rate actions take 12 months to be fully recognized in written premium and 24 months to be fully recognized in earned premiums. Since rate changes are realized at renewal, it takes 12 months to implement a rate change to all policyholders and another 12 months to earn the increased or decreased premiums in full. As a result, certain rate actions approved in 2013 were reflected in 2014, and recent rate actions in 2014 will be reflected in 2015. The Property and Casualty Group continuously evaluates pricing and product offerings to meet consumer demands.

Personal lines – Total personal lines premiums written increased 7.9% to \$3.9 billion in 2014, from \$3.6 billion in 2013, driven by an increase of 4.3% in total personal lines policies in force and an increase of 3.5% in the total personal lines year-over-year average premium per policy.

New business premiums written on personal lines increased 6.0% in 2014, compared to 21.1% in 2013, driven by increases in new business policies written in the private passenger auto and other personal lines of business and average premium per policy. Personal lines new business policies written increased 3.0% in 2014, compared to 15.7% in 2013, while the year-over-year average premium per policy on personal lines new business increased 2.9% at December 31, 2014, compared to 4.7% at December 31, 2013.

Private passenger auto new business premiums written increased 7.3% in 2014, compared to 22.8% in 2013. New business policies written for private passenger auto increased 3.7% in 2014, compared to 19.5% in 2013, while the new business year-over-year average premium per policy for private passenger auto increased 3.6% at December 31, 2014, compared to 2.8% at December 31, 2013.

Homeowners new business premiums written increased 2.9% in 2014, compared to 18.4% in 2013. New business policies written for homeowners decreased 0.5% in 2014, compared to an increase of 11.7% in 2013. The new business year-over-year average premium per policy for homeowners increased 3.5% at December 31, 2014, compared to 6.0% at December 31, 2013.

Renewal premiums written on personal lines increased 8.2% in 2014, compared to 7.3% in 2013, driven by increases in average premium per policy and steady policy retention ratios. The year-over-year average premium per policy on personal lines renewal business increased 3.6% at December 31, 2014, compared to 3.8% at December 31, 2013. The personal lines year-over-year policy retention ratio was 90.9% at December 31, 2014, 91.2% at December 31, 2013, and 91.6% at December 31, 2012.

Private passenger auto renewal premiums written increased 6.3% in 2014, compared to 4.5% in 2013. The year-over-year average premium per policy on private passenger auto renewal business increased 2.0% at December 31, 2014, compared to 1.5% at December 31, 2013. The private passenger auto year-over-year policy retention ratio was 91.7% at December 31, 2014, and 92.1% at December 31, 2013 and 2012.

Homeowners renewal premiums written increased 11.2% in 2014, compared to 12.2% in 2013. The year-over-year average premium per policy on homeowners renewal business increased 6.7% at December 31, 2014, compared to 8.4% in 2013. The homeowners year-over-year policyholder retention ratio was 89.8% at December 31, 2014, 90.1% at December 31, 2013, and 90.9% at December 31, 2012.

Commercial lines – Total commercial lines premiums written increased 10.4%, to \$1.6 billion in 2014, from \$1.5 billion in 2013, driven by a 4.4% increase in total commercial lines policies in force and a 5.7% increase in the total commercial lines year-over-year average premium per policy.

New business premiums written on commercial lines increased 5.5% in 2014, compared to 6.3% in 2013, driven by increases in new business policies written seen across all major commercial lines of business and average premium per policy. Commercial lines new business policies written increased 2.2% in 2014, compared to 4.6% in 2013, while the year-over-year average premium per policy on commercial lines new business increased 3.2% at December 31, 2014, compared to 1.6% at December 31, 2013.

Renewal premiums for commercial lines increased 11.3% in 2014, compared to 12.9% in 2013, driven by increases in average premium per policy and steady policy retention ratios. The combined impact of these increases was seen primarily in the

## Table of Contents

commercial multi-peril line of business, and to a lesser extent in the commercial auto and workers compensation lines of business. The year-over-year average premium per policy on commercial lines renewal business increased 6.0% in 2014, compared to 7.2% in 2013. The year-over-year policy retention ratio for commercial lines was 86.5% at December 31, 2014, 86.7% at December 31, 2013, and 86.2% at December 31, 2012.

Future trends—premium revenue – We plan to continue our efforts to grow Property and Casualty Group premiums and improve our competitive position in the marketplace. Expanding the size of our agency force through a careful agency selection process and increased market penetration in our existing operating territories will contribute to future growth as existing and new agents build their books of business with the Property and Casualty Group. At December 31, 2014, we had nearly 2,200 agencies with over 11,000 licensed property and casualty representatives. The Property and Casualty Group began writing private passenger automobile, home insurance, and personal excess liability insurance in Kentucky in the fourth quarter of 2014.

Changes in premium levels attributable to the growth in policies in force directly affect the profitability of the Property and Casualty Group and have a direct bearing on Indemnity's management fee. Our continued focus on underwriting discipline and the maturing of our pricing sophistication models has contributed to the Property and Casualty Group's growth in new policies in force, steady policy retention ratios, and increased average premium per policy. The continued growth of our policy base is dependent upon the Property and Casualty Group's ability to retain existing policyholders and attract new policyholders. A lack of new policy growth or the inability to retain existing customers could have an adverse effect on the Property and Casualty Group's premium level growth, and consequently Indemnity's management fee.

Changes in premium levels attributable to rate changes also directly affect the profitability of the Property and Casualty Group and have a direct bearing on Indemnity's management fee. Pricing actions contemplated or taken by the Property and Casualty Group are subject to various regulatory requirements of the states in which our insurers operate. The pricing actions already implemented, or to be implemented, have an effect on the market competitiveness of our insurance products. Such pricing actions, and those of competitors, could affect the ability of our agents to retain and attract new business. We expect the Property and Casualty Group's pricing actions to result in a net increase in direct written premium in 2015, however, exposure reductions and/or changes in our mix of business as a result of economic conditions could impact the average premium written by the Property and Casualty Group, as customers may reduce coverages.

### Losses and loss expenses

Current accident year, excluding catastrophe losses – The current accident year loss and loss expense ratio for all lines of business, excluding catastrophe losses, was 68.1% in 2014, compared to 66.8% in 2013 and 68.1% in 2012. The personal lines loss and loss expense ratio related to the current accident year, excluding catastrophe losses, was 67.9% in 2014, compared to 67.3% in 2013 and 68.5% in 2012. The commercial lines loss and loss expense ratio related to the current accident year, excluding catastrophe losses, was 68.6% in 2014, compared to 65.7% in 2013 and 67.1% in 2012. The higher ratios for 2014 were driven primarily by a higher volume of non-catastrophe weather related claims resulting from more severe winter weather experienced in the first quarter and a few large commercial property claims, compared to 2013.

Current accident year catastrophe losses – Catastrophic events, destructive weather patterns, or changes in climate conditions are an inherent risk of the property and casualty insurance business and can have a material impact on our property and casualty insurance underwriting results. In addressing this risk, we employ what we believe are reasonable underwriting standards and monitor our exposure by geographic region. The Property and Casualty Group's definition of catastrophes includes those weather-related or other loss events that we consider significant to our geographic footprint which, individually or in the aggregate, may not reach the level of a national catastrophe as defined by the Property Claim Service ("PCS").

The Property and Casualty Group maintains property catastrophe reinsurance coverage from unaffiliated reinsurers to mitigate future potential catastrophe loss exposures and no longer participates in the voluntary assumed reinsurance business, which lowers the variability of the Property and Casualty Group's underwriting results. The property catastrophe reinsurance coverage during 2014 included a first treaty providing coverage of up to 30% of a loss of \$100 million in excess of the Property and Casualty Group's loss retention of \$300 million per occurrence, a second treaty providing coverage of up to 90% of a loss of \$500 million in excess of \$400 million, a third treaty providing coverage of up to 85% of a loss of \$200 million in excess of \$900 million, and a fourth treaty providing coverage of up to 100% of a loss of \$25 million in excess of \$1.1 billion. The property catastrophe reinsurance coverage that became effective for January 1, 2015 included a first property catastrophe reinsurance treaty providing coverage of up to 35% of a loss of \$100 million in excess of the Property and Casualty Group's loss retention of \$300 million per occurrence, a second treaty providing coverage of up to 90% of a loss of \$500 million in excess of \$400 million, a third treaty providing coverage of up to 86% of a loss of \$200 million in excess of \$900 million, and a fourth treaty providing coverage of up to 100% of a loss of \$25 million in excess of \$1.1 billion.

Table of Contents

While the Property and Casualty Group is exposed to terrorism losses in commercial lines, including workers compensation, these lines are afforded a limited backstop above insurer deductibles for foreign acts of terrorism under the federal Terrorism Risk Insurance Program Reauthorization and Extension Act of 2015 that continues through December 31, 2020. There is no federal assistance for personal lines terrorism losses. Although current models suggest the most likely occurrences would not have a material impact on the Property and Casualty Group, there is a chance that if future terrorism attacks occur, the Property and Casualty Group could incur large losses.

Catastrophe losses for the current accident year, as defined by the Property and Casualty Group, totaled \$395 million in 2014, \$162 million in 2013, and \$489 million in 2012, and contributed 7.5 points, 3.4 points and 11.0 points to the respective loss ratios. For 2014, catastrophe losses primarily resulted from many smaller events across our footprint and one large hail event in Pennsylvania.

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

(in millions)	Property and Casualty Group		
	Years ended December 31,		
	2014	2013	2012
Direct business, including reserves for catastrophe losses and salvage and subrogation	\$(120 )	\$2	\$(92 )
Assumed reinsurance business	4	(13 )	(14 )
Ceded reinsurance business	0	(8 )	(9 )
Total prior year loss development	\$(116 )	\$(19 )	\$(115 )

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

Direct business, including reserves for catastrophe losses and salvage and subrogation – The following table presents the overall prior year loss development of direct reserves, including reserves for catastrophe losses and the effects of salvage and subrogation recoveries, for our personal and commercial lines' operations by accident year:

(in millions)	Property and Casualty Group		
	Years ended December 31,		
	2014	2013	2012
2013	\$(23 )	\$—	\$—
2012	(20 )	(11 )	—
2011	(25 )	2	(46 )
2010	(21 )	(2 )	(27 )
2009	(12 )	(1 )	(7 )
2008	(8 )	1	(6 )
2007	(6 )	(2 )	(5 )
2006	(12 )	0	(4 )
2005	1	(2 )	(3 )
2004 and prior	6	17	6
Total	\$(120 )	\$2	\$(92 )



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

The 2014 direct business favorable development, including reserves for catastrophe losses and salvage and subrogation recoveries, totaled \$120 million, improved the combined ratio by 2.3 points, and represented 3.2% of the net loss reserves at December 31, 2013. The most significant factors contributing to the 2014 favorable development were:

Favorable development of \$78 million related to better than expected severity trends in personal auto, commercial multi-peril, and workers compensation lines of business. Additionally, \$42 million of favorable development was due to changes on individual claims, primarily workers compensation massive injury lifetime medical claims, personal auto massive injury lifetime medical claims, and the settlement of one commercial multi-peril individual large claim.

## Table of Contents

The 2013 direct business adverse development, including reserves for catastrophe losses and salvage and subrogation recoveries, totaled \$2 million, contributing only 0.1 points to the combined ratio, and represented 0.1% of the net loss reserves at December 31, 2012. The most significant factors contributing to the 2013 adverse development were:

Adverse development of \$29 million related to the personal auto and workers compensation massive injury lifetime medical claims due to increased annual claims cost expectations. This was offset somewhat by favorable development of \$10 million due to the settlement of three massive injury lifetime medical claims. These primarily impacted accident years 2003 and prior.

Favorable development of \$22 million related to the personal auto line of business resulting from better than expected severity trends, offset somewhat by minor changes across all other lines of business, which impacted the 2012 accident year.

The 2012 direct business favorable development, including reserves for catastrophe losses and salvage and subrogation recoveries, totaled \$92 million, improved the combined ratio by 2.1 points, and represented 2.6% of the net loss reserves at December 31, 2011. The most significant factors contributing to the 2012 favorable development were:

Favorable development of \$54 million related to the homeowners line of business primarily resulting from improved claims frequency trends, which impacted the 2011 accident year, better than expected severity trends, which impacted the 2007 through 2011 accident years, and the closing of one large claim which impacted the 2010 accident year.

Favorable development of \$42 million related to the commercial multi-peril line of business primarily resulting from better than expected severity trends, which impacted the 2007 through 2011 accident years, and the closing of two large claims which impacted the 2006 through 2010 accident years.

Favorable development of \$11 million related to the commercial auto line of business primarily resulting from better than expected severity trends, which impacted the 2007 through 2011 accident years.

Adverse development of \$15 million related to the workers compensation line of business primarily resulting from increased severity trends, which impacted accident years 2000 through 2008.

Additional information on direct loss reserve development is provided in Item 1. "Business, Reserves for losses and loss expenses." The variability in reserve development over the ten year period illustrates the uncertainty of the loss reserving process. Conditions and trends that have affected reserve development in the past will not necessarily recur in the future. It is not appropriate to extrapolate future favorable or unfavorable reserve development based upon amounts experienced in prior years.

Assumed reinsurance – The Property and Casualty Group experienced adverse development on prior accident year loss reserves for its assumed involuntary reinsurance business totaling \$4 million in 2014, compared to favorable development of

\$13 million in 2013 and \$14 million in 2012. The adverse development in 2014 was primarily from the personal auto and workers compensation lines of business somewhat offset by favorable development in commercial auto. The favorable development in 2013 and 2012 was due to less than anticipated growth in involuntary reinsurance.

Ceded reinsurance – The Property and Casualty Group's ceded reinsurance reserve recoveries remained flat during 2014, compared to an increase of \$8 million in 2013 and an increase of \$9 million in 2012. An increase in ceded recoveries is reflected as favorable loss development as it represents an increase in recoveries resulting from adverse development on our direct loss reserves, while a decrease in ceded recoveries is reflected as adverse loss development as it represents a decrease in recoveries resulting from favorable development on our direct loss reserves. Ceded reinsurance reserves primarily relate to the pre-1986 automobile massive injury claims. In 2013, the increase in ceded recoveries was primarily due to adverse development related to the pre-1986 automobile massive injury claims and the commercial multi-peril and business catastrophe liability lines of business, offset somewhat by favorable

development in the workers compensation line of business. In 2012, the increase in ceded recoveries was primarily the result of adverse development related to the pre-1986 automobile massive injury claims.

Policy acquisition and other underwriting expenses – Our policy acquisition and other underwriting expense ratio decreased 0.3% points to 28.5% in 2014, from 28.8% in 2013, and decreased 0.3 points in 2013 from 29.1% in 2012. Additionally, 2012 included an adjustment of \$4 million which contributed 0.1 points to the combined ratio at December 31, 2012. This adjustment represents the reimbursement by the North Carolina Reinsurance Facility (NCRF) for commissions Indemnity paid to agents on the surcharges collected on behalf of the NCRF which was incorrectly recorded as a benefit to the Exchange in prior periods. The management fee rate was 25.0% in 2014, 2013 and 2012.

46

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Table of Contents

## Life Insurance Operations

EFL is a Pennsylvania-domiciled life insurance company which underwrites and sells individual and group life insurance policies and fixed annuities and operates in 11 states and the District of Columbia. EFL began writing life insurance and annuity products in Kentucky in the fourth quarter of 2014. A summary of the results of our life insurance operations is as follows:

(in millions)	Erie Family Life Insurance Company Years ended December 31,					
	2014	% Change	2013	% Change	2012	
Individual and group life premiums, gross	\$127	5.1	\$121	4.6	\$116	
Reinsurance premium – ceded	(41)	) NM	(41)	) 2.2	(43)	)
Individual and group life premiums, net	86	7.9	80	8.4	73	
Other revenue	1	NM	1	NM	1	
Total net policy revenue	87	7.9	81	8.0	74	
Net investment income	96	2.0	94	(1.0)	95	)
Net realized gains on investments	9	(45.9)	17	NM	9	
Impairment losses recognized in earnings	(1)	) NM	(1)	) NM	0	
Equity in earnings of limited partnerships	1	NM	1	NM	0	
Total revenues	192	NM	192	7.8	178	
Benefits and other changes in policy reserves	105	(1.6)	107	5.8	101	
Amortization of deferred policy acquisition costs	13	(12.9)	15	48.7	10	
Other operating expenses	25	10.1	22	6.7	21	
Total benefits and expenses	143	(1.0)	144	9.2	132	
Income before taxes – Exchange <sup>(1)</sup>	\$49	3.7	\$48	3.6	\$46	%

NM = not meaningful

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

## Policy revenue

Gross policy revenues increased 5.1% to \$127 million in 2014, compared to \$121 million in 2013, and \$116 million in 2012. EFL uses, and has used, a variety of reinsurance programs to reduce claims volatility and for other financial benefits. While the amount of risk that EFL retains can vary based upon the type of policy issued and the year it was issued, EFL generally does not retain more than \$1 million of risk on any individual life. Ceded reinsurance premiums totaled \$41 million in 2014 and 2013, and \$43 million in 2012.

Annuity and universal life premiums that are recorded as deposits totaled \$65 million, \$59 million, and \$58 million in 2014, 2013 and 2012, respectively, and therefore are not reflected in individual and group life premiums in the table above.

## Investment revenue

EFL's investment revenue decreased in 2014 due to a decrease in net realized gains on investments from the sale of bonds. Offsetting this decrease was a slight increase in net investment income from higher bond earnings primarily due to increased holdings. EFL's investment revenue increased in 2013 due to an increase in net realized gains on investments from the sale of bonds and a slight increase in equity in earnings of limited partnerships. Offsetting these increases was a slight decrease in net investment income due to lower investment yields and a slight increase in impairment losses recognized in earnings due to bond impairments. See the discussion of investments in the "Investment Operations" segment that follows for further information.

Benefits and expenses

In 2014, total benefits and expenses were impacted by a decrease in benefits and other changes in policy reserves, as a result of a decrease in interest on annuity deposits partially offset by a slight increase in death benefits. Amortization of deferred policy acquisition costs also decreased compared to 2013 as a result of the annual unlocking. In 2013, total benefits and expenses were primarily impacted by increases in benefits and other changes in policy reserves, as a result of increases in death benefits and future policy benefits, and the amortization of deferred policy acquisition costs, as a result of the annual unlocking, compared to 2012.

47

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Table of Contents

## Investment Operations

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

(in millions)	Erie Insurance Group				
	Years ended December 31,				
	2014	% Change	2013	% Change	2012
<b>Indemnity</b>					
Net investment income	\$16	10.0 %	\$15	(8.4 )%	\$16
Net realized gains on investments	1	11.8	1	(82.7 )	5
Net impairment losses recognized in earnings	0	NM	0	NM	0
Equity in earnings of limited partnerships	11	(49.6 )	22	51.2	15
Net revenue from investment operations – Indemnity	\$28	(23.8 )%	\$38	3.0 %	\$36
<b>Exchange</b>					
Net investment income	\$446	6.4 %	\$419	(3.1 )%	\$433
Net realized gains on investments	192	(75.0 )	770	86.4	413
Net impairment losses recognized in earnings	(4 )	(66.3 )	(13 )	NM	0
Equity in earnings of limited partnerships	102	(26.7 )	139	19.6	116
Net revenue from investment operations – Exchange <sup>(1)</sup>	\$736	(44.1 )%	\$1,315	36.8 %	\$962

NM = not meaningful

<sup>(1)</sup> The Exchange's investment results include net investment revenues from EFL's operations of \$105 million in 2014, \$111 million in 2013, and \$104 million in 2012.

## Net investment income

Net investment income primarily includes interest and dividends on our fixed maturity and equity security portfolios.

Indemnity's net investment income increased by \$1 million in 2014, compared to 2013, and decreased by \$1 million in 2013, compared to 2012, while net investment income for the Exchange increased by \$27 million and decreased by \$14 million during the same respective periods. The increase in net investment income for Indemnity in 2014 was due to higher invested balances and higher investment yields, while the decrease in 2013 was primarily due to lower average invested balances. The increase in net investment income for the Exchange in 2014 was due to an increase in invested balances partially offset by lower investment yields, while the decrease in 2013 was due to lower yields partially offset by an increase in invested balances.

## Net impairment losses recognized in earnings

Net impairment losses recognized in earnings for Indemnity were \$0.1 million in 2014, compared to \$0.4 million in 2013, and \$0.1 million in 2012. Impairment losses for the Exchange totaled \$4 million in 2014, compared to \$13 million in 2013, and \$0.1 million in 2012. The impairments for the Exchange in 2014 and 2013 were related to several securities in unrealized loss positions that we intended to sell prior to an expected recovery to our cost basis.



Table of Contents

## Net realized gains on investments

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

(in millions)	Erie Insurance Group		
	Years ended December 31,		
	2014	2013	2012
Indemnity			
Securities sold:			
Fixed maturities	\$0	\$1	\$0
Equity securities	1	0	0
Common stock equity securities	0	0	8
Common stock increases (decreases) in fair value <sup>(1)</sup>	0	0	(3
Total net realized gains – Indemnity <sup>(2)</sup>	\$1	\$1	\$5
Exchange			
Securities sold:			
Fixed maturities	\$17	\$6	\$58
Equity securities	14	(4	) 9
Common stock equity securities	231	271	125
Common stock (decreases) increases in fair value <sup>(1)</sup>	(70	) 497	221
Total net realized gains – Exchange <sup>(2)</sup> <sup>(3)</sup>	\$192	\$770	\$413

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

See Item 8. “Financial Statements and Supplementary Data – Note 7, Investments, of Notes to Consolidated Financial Statements” contained within this report for additional disclosures regarding net realized gains (losses) on investments.

(3) The Exchange’s results include net realized gains from EFL’s operations of \$9 million in 2014, \$17 million in 2013, and \$9 million in 2012.

Net realized gains and losses on investments include the changes in fair value of common stocks designated as trading securities, and gains and losses resulting from the actual sales of all security categories.

Indemnity generated net realized gains of \$1 million in both 2014 and 2013, compared to gains of \$5 million in 2012. The Exchange generated net realized gains of \$192 million in 2014, compared to gains of \$770 million in 2013 and \$413 million in 2012. Realized gains for Indemnity were primarily attributable to gains from sales of equity securities in 2014, and gains from sales of fixed maturity securities in 2013. Indemnity recorded no changes in fair value of common stocks in 2014 or 2013 due to the sale of its common stock portfolio classified as trading securities in the fourth quarter of 2012. In 2012, Indemnity's net realized gains were primarily due to the favorable performance and sale of its common stock portfolio. Realized gains for the Exchange in 2014 primarily reflected gains from sales of common stock partially offset by decreases in fair value of common stock. Realized gains for the Exchange in 2013 and 2012 were primarily due to increases in fair value and realized gains on the sale of common stock securities reflecting favorable market performance.

## Equity in earnings of limited partnerships

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

(in millions)	Erie Insurance Group		
	Years ended December 31,		
	2014	2013	2012



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Indemnity			
Private equity	\$4	\$6	\$7
Mezzanine debt	2	3	5
Real estate	5	13	3
Total equity in earnings of limited partnerships – Indemnity	\$11	\$22	\$15
Exchange			
Private equity	\$47	\$70	\$61
Mezzanine debt	19	22	32
Real estate	36	47	23
Total equity in earnings of limited partnerships – Exchange <sup>(1)</sup>	\$102	\$139	\$116

(1) The Exchange's results include equity in earnings of limited partnerships from EFL's operations of \$1 million in 2014 and 2013, and \$0.1 million in 2012.

Table of Contents

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

Limited partnership earnings tend to be cyclical based upon market conditions, the age of the partnership, and the nature of the investments. Generally, limited partnership earnings are recorded on a quarter lag from financial statements we receive from our general partners. As a consequence, earnings from limited partnerships reported at December 31, 2014 reflect investment valuation changes resulting from the financial markets and the economy for the twelve month period ending September 30, 2014.

Indemnity's equity in earnings of limited partnerships decreased by \$11 million in 2014, compared to 2013, and increased by \$7 million in 2013, compared to 2012, while earnings for the Exchange decreased by \$37 million and increased by \$23 million during the same respective periods. These changes in earnings for both Indemnity and the Exchange were the result of lower earnings from each investment sector in 2014, and primarily due to higher earnings from real estate investments in 2013.

Table of Contents

## FINANCIAL CONDITION

## Investments

We generate revenues from our fixed maturity, equity security and limited partnership investment portfolios to support our underwriting business. The Indemnity and Exchange portfolios are managed with the objective of maximizing after-tax returns on a risk-adjusted basis, while the EFL portfolio is managed to be closely aligned to its liabilities and to maintain a sufficient yield to meet profitability targets.

## Distribution of investments

(in millions)	Erie Insurance Group Carrying value at December 31,			
	2014	% to total	2013	% to total
Indemnity				
Fixed maturities	\$564	80 %	\$526	73 %
Equity securities:				
Preferred stock	12	2	25	3
Common stock	13	2	25	3
Limited partnerships:				
Private equity	52	7	62	9
Mezzanine debt	14	2	20	3
Real estate	47	7	64	9
Real estate mortgage loans	1	0	1	0
Total investments – Indemnity	\$703	100 %	\$723	100 %
Exchange				
Fixed maturities	\$9,007	65 %	\$8,162	62 %
Equity securities:				
Preferred stock	710	5	621	5
Common stock	3,363	24	3,400	26
Limited partnerships:				
Private equity	418	3	463	4
Mezzanine debt	170	1	172	1
Real estate	278	2	305	2
Life policy loans	18	0	17	0
Real estate mortgage loans	2	0	3	0
Total investments – Exchange	\$13,966	100 %	\$13,143	100 %
Total investments – Erie Insurance Group	\$14,669		\$13,866	

During 2014, Indemnity increased its investments in non-investment grade fixed maturities from less than 1% of total invested assets at December 31, 2013 to 9% of total invested assets at December 31, 2014. The increase during 2014 was primarily funded by cash flows from limited partnership distributions. The Exchange also increased its investment in non-investment grade fixed maturities during 2014 from 2% of total invested assets at December 31, 2013 to 5% of total invested assets at December 31, 2014. The increase during 2014 was primarily funded by cash flows from the sale of common stock and limited partnership distributions.

We continually review our investment portfolio to evaluate positions that might incur other-than-temporary declines in value. We record impairment writedowns on investments in instances where the fair value of the investment is substantially below cost, and we conclude that the decline in fair value is other-than-temporary, which includes

consideration for intent to sell.

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 our 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

51

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Table of Contents

entire amount of the impairment charges are included in earnings and no impairments are recorded in other comprehensive income. For available-for-sale equity securities, a charge is recorded in the Consolidated Statements of Operations for positions that have experienced other-than-temporary impairments. (See the “Investment Operations” section herein for further information.) We believe our 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 maturity portfolio that is of high quality and well diversified within each market sector. This investment strategy also achieves a balanced maturity schedule. Our fixed maturity portfolio is managed with the goal of achieving reasonable returns while limiting exposure to risk. Our municipal bond portfolio accounts for

\$231 million, or 41%, of the total fixed maturity portfolio for Indemnity and \$1.5 billion, or 16%, of the fixed maturity portfolio for the Exchange at December 31, 2014. The overall credit rating of the municipal portfolio without consideration of the underlying insurance is AA.

Fixed maturities classified as available-for-sale are carried at fair value with unrealized gains and losses, net of deferred taxes, included in shareholders’ equity. Indemnity’s net unrealized gains on fixed maturities, net of deferred taxes, amounted to

\$6 million at December 31, 2014, compared to \$5 million at December 31, 2013. At December 31, 2014, the Exchange had net unrealized gains on fixed maturities of \$303 million, compared to \$234 million at December 31, 2013.

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

(in millions)	Erie Insurance Group <sup>(1)</sup>					Non-investment grade	Fair value
	December 31, 2014						
Industry Sector	AAA	AA	A	BBB			
<b>Indemnity</b>							
Basic materials	\$0	\$0	\$3	\$3	\$ 4	\$10	
Communications	0	0	0	15	8	23	
Consumer	0	0	8	21	25	54	
Energy	0	0	0	5	6	11	
Financial	0	8	43	39	7	97	
Government-municipal	105	104	21	1	0	231	
Industrial	0	0	1	5	8	14	
Structured securities <sup>(2)</sup>	29	23	31	15	1	99	
Technology	0	0	0	0	4	4	
Utilities	0	0	13	7	1	21	
<b>Total – Indemnity</b>	<b>\$134</b>	<b>\$135</b>	<b>\$120</b>	<b>\$111</b>	<b>\$ 64</b>	<b>\$564</b>	
<b>Exchange</b>							
Basic materials	\$0	\$0	\$59	\$187	\$ 58	\$304	
Communications	0	0	252	337	96	685	
Consumer	0	35	383	723	196	1,337	
Diversified	0	0	14	0	2	16	
Energy	7	67	134	461	76	745	
Financial	1	138	1,004	1,713	165	3,021	
Foreign government	0	10	0	0	0	10	
Government-municipal	445	846	161	25	0	1,477	

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Government sponsored entity	0	4	0	0	0	4
Industrial	0	11	69	281	57	418
Structured securities <sup>(2)</sup>	42	122	32	25	0	221
Technology	0	34	62	92	22	210
U.S. Treasury	0	6	0	0	0	6
Utilities	0	3	164	359	27	553
Total – Exchange	\$495	\$1,276	\$2,334	\$4,203	\$ 699	\$9,007

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

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

Table of Contents

## Equity securities

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

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

(in millions)	Erie Insurance Group			
	Fair value at December 31, 2014		December 31, 2013	
Industry sector	Preferred stock	Common stock	Preferred stock	Common stock
Indemnity				
Communications	\$1	\$0	\$1	\$0
Diversified	0	0	3	0
Financial	7	0	16	0
Funds <sup>(1)</sup>	0	13	0	25
Utilities	4	0	5	0
Total – Indemnity	\$12	\$13	\$25	\$25
Exchange				
Basic materials	\$0	\$88	\$0	\$86
Communications	6	278	6	352
Consumer	16	980	6	968
Diversified	0	19	2	14
Energy	0	187	0	205
Financial	587	590	518	538
Funds <sup>(1)</sup>	0	435	0	479
Government sponsored entity	0	0	2	0
Industrial	0	456	0	457
Technology	1	268	0	240
Utilities	100	62	87	61
Total – Exchange	\$710	\$3,363	\$621	\$3,400

(1) Includes certain exchange traded funds with underlying holdings of fixed maturity securities totaling \$13 million for Indemnity and \$140 million for the Exchange at December 31, 2014, and \$25 million for Indemnity and \$198 million for the Exchange at December 31, 2013. These securities meet the criteria of a common stock under U.S. GAAP, and are included on the balance sheet as available-for-sale equity securities. Remaining common stock investments are classified as trading securities.

Equity securities classified as available-for-sale include preferred and certain common stock securities, and are carried at fair value on the Consolidated Statements of Financial Position with all changes in unrealized gains and losses reflected in other comprehensive income. The unrealized gain on equity securities classified as available-for-sale, net of deferred taxes, for Indemnity was \$0.6 million at December 31, 2014, compared to an unrealized loss of less than \$0.1 million at December 31, 2013. The net unrealized gain on equity securities classified as available-for-sale, net of deferred taxes, for the Exchange was \$40 million at December 31, 2014, compared to an unrealized gain of \$26 million at December 31, 2013.

Our common stocks classified as trading securities are measured at fair value with all increases or decreases in fair value reflected in the Consolidated Statements of Operations.

Limited partnerships

In 2014, investments in limited partnerships decreased for both Indemnity and the Exchange from the investment levels at December 31, 2013. Changes in partnership values are a function of contributions and distributions, adjusted for market value changes in the underlying investments. The decrease in limited partnership investments was due to net distributions received from the partnerships which were partially offset by increases in underlying asset values. Indemnity has made no new limited partnership commitments since 2006, and the balance of its limited partnership investments is expected to decline over time as additional distributions are received. The results from our limited partnerships are based upon financial statements received from our general partners, which are generally received on a quarter lag. As a result, the market values and earnings recorded at December 31, 2014 reflect the partnership activity experienced during the twelve month period ending September 30, 2014.

53

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Table of Contents

The components of limited partnership investments are as follows:

(in millions)	Erie Insurance Group	
	At December 31,	
	2014	2013
Indemnity		
Private equity	\$52	\$62
Mezzanine debt	14	20
Real estate	47	64
Total limited partnerships – Indemnity	\$113	\$146
Exchange		
Private equity	\$418	\$463
Mezzanine debt	170	172
Real estate	278	305
Total limited partnerships – Exchange	\$866	\$940

## Liabilities

## Property and casualty losses and loss expense reserves

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

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

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

(in millions)	Property and Casualty Group	
	At December 31,	
	2014	2013
Gross reserve liability <sup>(1)</sup> :		
Personal auto	\$1,245	\$1,217
Automobile massive injury	330	345
Homeowners	279	271
Workers compensation	636	604
Workers compensation massive injury	82	94
Commercial auto	388	371
Commercial multi-peril	630	587
All other direct lines of business	179	170
Assumed reinsurance	84	88
Gross reserves	3,853	3,747
Less: reinsurance recoverable	142	156
Net reserve liability – Exchange	\$3,711	\$3,591

(1) Loss reserves are set at estimated ultimate costs, except for workers compensation loss reserves which have been discounted using an interest rate of 2.5%. This discounting reduced unpaid losses and loss expenses by \$89 million and \$85 million at December 31, 2014 and 2013, respectively.

The reserves that have the greatest potential for variation are the massive injury lifetime medical claim reserves. The Property and Casualty Group is currently reserving for 245 claimants requiring lifetime medical care, of which 97 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 \$274 million at December 31, 2014, which is net of \$138 million of anticipated reinsurance recoverables, compared to \$291 million at December 31, 2013, which was net of

## Table of Contents

\$148 million of anticipated reinsurance recoverables. The pre-1986 automobile and workers compensation massive injury gross reserves both decreased at December 31, 2014, compared to December 31, 2013, primarily due to continued payments on the pre-1986 automobile massive injury claims and the settlement of two workers compensation massive injury claims, offset somewhat by the addition of two new workers compensation massive injury claims, respectively.

The estimation of ultimate liabilities for these claims is subject to significant judgment due to variations in medical cost inflation, claimant health, and mortality over time. It is anticipated that these massive injury lifetime medical claims will require payments over the next 30 to 40 years. Actual experience, however, may emerge in a manner that is different relative to the original assumptions, which could have a significant impact on our reserve estimates. A 100-basis point increase in the medical cost inflation assumption would result in an increase in the combined automobile and workers compensation massive injury gross reserves of \$84 million and a \$41 million increase in the reinsurance recoverable and the workers compensation discount, resulting in a \$43 million increase in the net reserve. Massive injury claims payments totaled \$12 million, \$15 million, and \$13 million in 2014, 2013 and 2012, respectively.

### Life insurance reserves

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

### Shareholders' Equity

#### Pension plan

The funded status of our postretirement benefit plans is recognized in the statement of financial position, with a corresponding adjustment to accumulated other comprehensive income, net of tax. At December 31, 2014, shareholders' equity decreased by \$60 million, net of tax, of which \$5 million represents amortization of the prior service cost and net actuarial loss and

\$65 million represents the current period actuarial loss. The 2014 actuarial loss was primarily due to the change in the discount rate assumption used to measure the future benefit obligations to 4.17% in 2014, from 5.11% in 2013. At December 31, 2013, shareholders' equity increased by \$81 million, net of tax, of which \$10 million represents amortization of the prior service cost and net actuarial loss and \$71 million represents the current period actuarial gain. The 2013 actuarial gain was primarily due to the change in the discount rate assumption used to measure the future benefit obligations to 5.11% in 2013, from 4.19% in 2012. Although Indemnity is the sponsor of these postretirement plans and records the funded status of these plans, the Exchange and EFL reimburse Indemnity for approximately 56% of the annual benefit expense of these plans, which represents pension benefits for Indemnity employees performing claims and EFL functions.

### IMPACT OF INFLATION

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

ratio, individual claim, and massive injury lifetime medical reserving methods. Inflation assumptions are implicitly derived through the selection of applicable loss development patterns for all other reserving methods. Occasionally, unusual aberrations in loss development patterns are caused by external and internal factors such as changes in claim reporting, settlement patterns, unusually large losses, process changes, legal or regulatory changes, and other influences. In these instances, analyses of alternate development factor selections are performed to evaluate the effect of these factors and actuarial judgment is applied to make appropriate assumptions needed to develop a best estimate of ultimate losses.

Table of Contents

## LIQUIDITY AND CAPITAL RESOURCES

## Sources and Uses of Cash

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

Volatility in the financial markets presents challenges to us as we do occasionally access our investment portfolio as a source of cash. Some of our fixed income investments, despite being publicly traded, are illiquid. Volatility in these markets could impair our ability to sell certain of our fixed income securities or cause such securities to sell at deep discounts. Additionally, our limited partnership investments are significantly less liquid. We believe we have sufficient liquidity to meet our needs from other sources even if market volatility persists throughout 2015.

## Cash flow activities – Erie Insurance Group

The following table provides condensed consolidated cash flow information for the years ended December 31:

(in millions)	Erie Insurance Group		
	2014	2013	2012
Net cash provided by operating activities	\$779	\$903	\$577
Net cash used in investing activities	(596)	) (759	) (85
Net cash used in financing activities	(121)	) (92	) (277
Net increase in cash	\$62	\$52	\$215

Net cash provided by operating activities totaled \$779 million in 2014, \$903 million in 2013, and \$577 million in 2012. Decreased cash from operating activities in 2014 was driven primarily by increases in losses and loss expense paid, commissions and bonuses paid to agents, and other underwriting and acquisition costs, combined with a decrease in limited partnership distributions received. Somewhat offsetting this decrease in cash provided was an increase in premiums collected by the Exchange, driven by the increase in premiums written, and an increase in net investment income received, combined with a decrease in income taxes paid, compared to 2013. The increase in 2013, compared to 2012, was primarily due to an increase in premiums collected by the Exchange driven by the increase in premiums written, a decrease in losses and loss expense paid, and a slight increase in limited partnership distributions received. Somewhat offsetting this increase in cash was an increase in income taxes and other underwriting and acquisition costs paid, and a slight decrease in net investment income received, compared to 2012.

At December 31, 2014, we recorded a net deferred tax asset of \$37 million related to Indemnity and a net deferred tax liability of \$490 million related to the Exchange. There was no deferred tax valuation allowance recorded at December 31, 2014. During calendar years 2014, 2013, and 2012, we received cash refunds of federal income taxes paid in prior tax periods of \$4 million, \$4 million, and \$49 million respectively.

Net cash used in investing activities totaled \$596 million in 2014, \$759 million in 2013, and \$85 million in 2012. Changes in investing activities in 2014 primarily included a decrease in certain fixed maturity purchases and increased cash generated from the sale of preferred stocks, offset somewhat by an increase in other preferred stock purchases combined with decreased cash generated from the sale, call and maturity of fixed income securities, compared to 2013. At December 31, 2014, we had contractual commitments to invest up to \$483 million related to our limited partnership investments to be funded as required by the partnerships' agreements. Of this amount, the total remaining commitment to fund limited partnerships that invest in private equity securities was \$151 million, mezzanine debt securities was \$165 million, and real estate activities was \$167 million. Changes in investing activities in 2013 primarily included an increase in certain fixed maturity purchases and decreased cash generated from the sale of common stocks, offset somewhat by a decrease in other common stock purchases, compared to 2012.

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

Table of Contents

## Cash flow activities – Indemnity

The following table is a summary of cash flows for Indemnity for the years ended December 31:

(in millions)	Indemnity Shareholder Interest			
	2014	2013	2012	
Net cash provided by operating activities	\$186	\$218	\$205	
Net cash (used in) provided by investing activities	(4	) (65	) 95	
Net cash used in financing activities	(139	) (116	) (299	)
Net increase in cash	\$43	\$37	\$1	

See Item 8. “Financial Statements and Supplementary Data - Note 22, Indemnity Supplemental Information, of Notes to Consolidated Financial Statements” contained within this report for more detail on Indemnity’s cash flows.

Net cash provided by Indemnity’s operating activities decreased to \$186 million in 2014, compared to \$218 million in 2013, and \$205 million in 2012. Decreased cash from operating activities in 2014 was primarily due to increases in commissions and bonuses paid to agents and general operating expenses combined with decreases in reimbursements collected from affiliates and limited partnership distributions. Somewhat offsetting this decrease in cash was an increase in management fee revenue received, compared to 2013. 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 \$749 million in 2014, compared to \$681 million in 2013, as a result of an increase in cash paid for scheduled commissions and bonus awards. Indemnity contributed \$23 million to its pension plan in 2014, compared to \$17 million in 2013. Additionally, Indemnity made a contribution to its pension plan for \$17 million in January 2015. Our funding policy is generally to contribute an amount equal to the greater of the target normal cost for the plan year or the amount necessary to fund the plan to 100% plus interest to the date the contribution is made. Indemnity is reimbursed approximately 56% of the net periodic benefit cost of the pension plan from its affiliates, which represents pension benefits for Indemnity employees performing claims and EFL functions. In 2013, increased cash from operating activities, compared to 2012, was primarily due to increases in management fee revenue and limited partnership distributions received. Offsetting this increase in cash were increases in cash paid for commissions to agents, general operating expenses, salaries and wages, and income taxes, combined with a slight decrease in net investment income received, compared to 2012.

At December 31, 2014, Indemnity recorded a net deferred tax asset of \$37 million. There was no deferred tax valuation allowance recorded at December 31, 2014. During calendar year 2014, Indemnity received cash refunds of federal income taxes paid in prior tax periods of \$1 million.

Net cash used in Indemnity’s investing activities totaled \$4 million in 2014 and \$65 million in 2013, compared to cash provided of \$95 million in 2012. Changes in Indemnity’s 2014 investing activities primarily included increased cash generated from fixed maturity and equity security sales, somewhat offset by decreased cash generated from fixed maturity calls combined with an increase in purchases of property, plant and equipment, compared to 2013. Also impacting Indemnity's future investing activities are limited partnership commitments, which totaled \$24 million at December 31, 2014, and will be funded as required by the partnerships’ agreements. Of this amount, the total remaining commitment to fund limited partnerships that invest in private equity securities was \$10 million, mezzanine debt securities was \$9 million, and real estate activities was \$5 million. Changes in Indemnity’s 2013 investing activities primarily included decreased cash generated from the sales of fixed maturities and common stocks, compared to 2012.

Net cash used in Indemnity’s financing activities totaled \$139 million in 2014, \$116 million in 2013, and \$299 million in 2012. The increase in cash used in financing activities for 2014 was driven by an increase in the cash outlay for dividends paid to shareholders, somewhat offset by a decrease in the cash outlay for share repurchases. Decreased cash used in financing activities in 2013 was driven by a decrease in dividends paid to shareholders, due to the

accelerated payment of the regular first quarter 2013 dividend into the fourth quarter of 2012 and a special one-time cash dividend, and a decrease in the cash outlay for share repurchases. Dividends paid to shareholders totaled \$119 million, \$84 million, and \$229 million in 2014, 2013 and 2012, respectively. Indemnity increased both its Class A and Class B shareholder regular quarterly dividends for 2014 and 2013. In 2012, in addition to the regular quarterly dividend declared in November, the Board also declared a special one-time cash dividend of \$2.00 on each Class A share and \$300.00 on each Class B share, totaling \$95 million. The payment of both the regular and special dividend was accelerated and paid in December 2012 due to the potential significant increases in tax rates on 2013 dividend income pending at the time of declaration. In 2013, the regular quarterly dividend was declared by the Board at its December meeting and paid in January of the following year. There are no regulatory restrictions on the payment of dividends to Indemnity's shareholders. Dividends have been approved at a 7.2% increase for 2015.



## Table of Contents

Indemnity repurchased 276,390 shares of its Class A nonvoting common stock in conjunction with its stock repurchase program at a total cost of \$19.5 million in 2014, based upon settlement date. In 2013, shares repurchased under this program totaled 441,024 at a total cost of \$31.9 million, compared to 986,439 shares at a total cost of \$70.2 million in 2012. In October 2011, our Board of Directors approved a continuation of the current stock repurchase program for a total of \$150 million with no time limitation. This repurchase authority includes, and is not in addition to, any unspent amounts remaining under the prior authorization. Indemnity had approximately \$18 million of repurchase authority remaining under this program at December 31, 2014, based upon trade date.

In 2014, we repurchased 64,398 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$4.9 million for the vesting of stock-based awards for executive management and an outside director, and for awards under our long-term incentive plan. These shares were delivered in January, May and June 2014, respectively. In 2013, we repurchased 3,477 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$255,454 to settle payments due to a retired executive under our long-term incentive plan. These shares were delivered to the plan participant in January 2013 and July 2013. In 2012, we also repurchased 1,803 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$129,849 to settle payments due to two retired senior vice presidents under our long-term incentive plan. These shares were delivered to the plan participants in January 2012 and June 2012, respectively.

### 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 \$92 million at December 31, 2014, 2) a \$100 million bank revolving line of credit held by Indemnity, and 3) liquidation of assets held in Indemnity's investment portfolio, including common stock, preferred stock, and investment grade bonds which totaled approximately \$411 million at December 31, 2014. Volatility in the financial markets could impair Indemnity's ability to sell certain of its fixed income securities or cause such securities to sell at deep discounts. Additionally, Indemnity has the ability to curtail or modify discretionary cash outlays such as those related to shareholder dividends and share repurchase activities.

As of December 31, 2014, Indemnity has access to a \$100 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on November 3, 2018. As of December 31, 2014, a total of \$98 million remains available under the facility due to \$2 million outstanding letters of credit, which reduce the availability for letters of credit to \$23 million. Indemnity had no borrowings outstanding on its line of credit as of December 31, 2014. Bonds with a fair value of

\$114 million were pledged as collateral on the line at December 31, 2014. These securities have no trading restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position. The bank requires compliance with certain covenants, which include leverage ratios. Indemnity was in compliance with its bank covenants at December 31, 2014.

### Exchange

Outside of the Exchange's normal operating and investing cash activities, future funding requirements could be met through:

1) the Exchange's cash and cash equivalents, which total approximately \$422 million at December 31, 2014, 2) a \$300 million bank revolving line of credit held by the Exchange, and 3) liquidation of assets held in the Exchange's investment portfolio, including common stock, preferred stock, and investment grade bonds which totaled approximately \$12.1 billion at December 31, 2014. Volatility in the financial markets could impair the Exchange's ability to sell certain of its fixed income securities or cause such securities to sell at deep discounts.

As of December 31, 2014, the Exchange has access to a \$300 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on October 25, 2018. As of December 31, 2014, a total of \$299 million remains available under the facility due to \$1 million outstanding letters of credit, which reduce the availability for letters of credit to \$24 million. The Exchange had no borrowings outstanding on its line of credit as of December 31, 2014.

Bonds with a fair value of

\$328 million were pledged as collateral on the line at December 31, 2014. These securities have no trading restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position. The bank requires compliance with certain covenants, which include statutory surplus and risk based capital ratios. The Exchange was in compliance with its bank covenants at December 31, 2014.

Indemnity has no rights to the assets, capital, or line of credit of the Exchange and, conversely, the Exchange has no rights to the assets, capital, or line of credit of Indemnity. We believe we have the funding sources available to us to support our cash flow requirements in 2015.

Table of Contents

## Contractual Obligations

Cash outflows for the Property and Casualty Group are variable as fluctuations in settlement dates for claims payments vary and cannot be predicted with absolute certainty. While volatility in claims payments could be significant, the cash flow requirements for claims have not historically had a significant effect on our liquidity. Based upon a historical 15 year average, approximately 35% of losses and loss expenses included in reserves for the Property and Casualty Group are settled within the first 12 months, and approximately 80% are settled within the first five years. Amounts that are paid after the first five years reflect long-tail lines such as workers compensation and auto bodily injury.

We have certain obligations and commitments to make future payments under various contracts. As of December 31, 2014, the aggregate obligations were as follows:

(in millions)	Erie Insurance Group				
	Payments due by period				
	Total	2015	2016- 2017	2018- 2019	2020 and thereafter
Fixed obligations:					
Indemnity:					
Limited partnership commitments <sup>(1)</sup>	\$24	\$24	\$0	\$0	\$0
Pension contribution <sup>(2)</sup>	17	17	0	0	0
Other commitments <sup>(3)</sup>	88	40	43	5	0
Operating leases – vehicles	16	5	8	3	0
Operating leases – real estate <sup>(4)</sup>	8	2	4	2	0
Operating leases – computer equipment	4	2	2	0	0
Total fixed contractual obligations – Indemnity	157	90	57	10	0
Noncontrolling interest:					
Limited partnership commitments <sup>(1)</sup>	459	199	74	146	40
Total fixed contractual obligations – Exchange	459	199	74	146	40
Total fixed contractual obligations – Erie Insurance Group	616	289	131	156	40
Gross property and casualty loss and loss expense reserves – Exchange	3,853	1,310	1,195	462	886
Life gross long-term liabilities <sup>(5)</sup>	4,866	172	334	332	4,028
Gross contractual obligations – Erie Insurance Group	\$9,335	\$1,771	\$1,660	\$950	\$4,954

Gross contractual obligations net of estimated reinsurance recoverables are as follows:

(in millions)	Erie Insurance Group				
	Payments due by period				
	Total	2015	2016- 2017	2018- 2019	2020 and thereafter
Gross contractual obligations – Erie Insurance Group	\$9,335	\$1,771	\$1,660	\$950	\$4,954
Estimated reinsurance recoverables – property and casualty <sup>(6)</sup>	142	7	11	10	114
Estimated reinsurance recoverables – life <sup>(6)</sup>	666	27	60	69	510
Net contractual obligations – Erie Insurance Group	\$8,527	\$1,737	\$1,589	\$871	\$4,330

(1) Limited partnership commitments will be funded as required for capital contributions at any time prior to the agreement expiration date. The commitment amounts are presented using the expiration date as the factor by which to age when the amounts are due. At December 31, 2014, Indemnity's total commitment to fund limited partnerships that invest in private equity securities was \$10 million, mezzanine debt was \$9 million, and real estate

activities was \$5 million. At December 31, 2014, the Exchange's total commitment to fund limited partnerships that invest in private equity securities was \$141 million, mezzanine debt was \$156 million, and real estate activities was \$162 million.

The pension contribution for 2015 was estimated in accordance with the Pension Protection Act of 2006.

Contributions anticipated in future years depend upon certain factors that cannot be reasonably predicted. Any contributions required in future years will be an amount equal to the greater of the target normal cost for the plan (2) year or the amount necessary to fund the plan to 100% plus interest to the date the contribution is made. The obligations for our unfunded benefit plans, including the Supplemental Employee Retirement Plan (SERP) for our executive and senior management, are not included in gross contractual obligations. The recorded accumulated benefit obligation for this plan at December 31, 2014, is \$10 million. We expect to have sufficient cash flows from operations to meet the future benefit payments as these become due.

- (3) Other commitments include various agreements for services, including such things as computer software, telephones, copiers, and maintenance.
- (4) Operating leases – real estate are for 18 of our 25 field offices that are operated in the states in which the Property and Casualty Group does business and two operating leases are for office space and a warehouse facility leased from unaffiliated parties.  
Life gross long-term liabilities represent estimated benefit payments from insurance policies and annuity contracts including claims currently payable. Actual obligations in any single year will vary based upon actual mortality, morbidity, lapse, and withdrawal experience. The sum of these obligations exceeds the liability on the Consolidated Statements of Financial Position of \$1.8 billion due to expected future premiums and investment income that, along with invested assets backing the liabilities, will be used to fund these obligations.
- (5) Life gross long-term liabilities represent estimated benefit payments from insurance policies and annuity contracts including claims currently payable. Actual obligations in any single year will vary based upon actual mortality, morbidity, lapse, and withdrawal experience. The sum of these obligations exceeds the liability on the Consolidated Statements of Financial Position of \$1.8 billion due to expected future premiums and investment income that, along with invested assets backing the liabilities, will be used to fund these obligations.
- (6) Reinsurance recoverables include estimated amounts from reinsurers on long-term liabilities subject to the credit worthiness of the reinsurer.

Table of Contents

## Off-Balance Sheet Arrangements

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

## Financial Ratings

Our property and casualty insurers are rated by rating agencies that provide insurance consumers with meaningful information on the financial strength of insurance entities. Higher ratings generally indicate financial stability and a strong ability to pay claims. The ratings are generally based upon factors relevant to policyholders and are not directed toward return to investors. The insurers of the Property and Casualty Group are currently rated by A.M. Best Company as follows:

Erie Insurance Exchange	A+
Erie Insurance Company	A+
Erie Insurance Property and Casualty Company	A+
Erie Insurance Company of New York	A+
Flagship City Insurance Company	A+
Erie Family Life Insurance Company	A

The outlook for all ratings is stable. According to A.M. Best, a “Superior” rating (A+), the second highest financial strength rating category, is assigned to those companies that, in A.M. Best’s opinion, have achieved superior overall performance when compared to the standards established by A.M. Best and have a superior ability to meet obligations to policyholders over the long term. Only 9.7% of insurance groups are rated A+ or higher, and we are included in that group. By virtue of its affiliation with the Property and Casualty Group, EFL is typically rated one level lower, or an “Excellent” rating (A), than our property and casualty insurance companies by A.M. Best Company. Financial strength ratings continue to be an important factor in evaluating the competitive position of insurance companies.

## Regulatory Risk-Based Capital

The standard set by the National Association of Insurance Commissioners (NAIC) for measuring the solvency of insurance companies, referred to as Risk-Based Capital (RBC), is a method of measuring the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The RBC formula is used by state insurance regulators as an early warning tool to identify, for the purpose of initiating regulatory action, insurance companies that potentially are inadequately capitalized. In addition, the formula defines minimum capital standards that will supplement the current system of low fixed minimum capital and surplus requirements on a state-by-state basis. At December 31, 2014, the members of the Property and Casualty Group and EFL had RBC levels substantially in excess of levels that would require regulatory action.

## Regulatory Restrictions on Surplus

The members of the Property and Casualty Group and EFL are subject to various regulatory restrictions that limit the maximum amount of dividends available to be paid without prior approval by insurance regulatory authorities. The Exchange’s property and casualty insurance subsidiaries have a maximum of \$35 million available for such dividends in 2015 without prior approval by the Pennsylvania Insurance Commissioner for Pennsylvania-domiciled subsidiaries and the New York Superintendent of Insurance for the New York domiciled subsidiary. No dividends were paid from the property and casualty insurance subsidiaries in 2014, 2013, or 2012.

The maximum dividend EFL could pay the Exchange in 2015 without prior approval is \$30 million. No dividends were paid by EFL in 2014, 2013 or 2012.

The Exchange is operated for the interest of its subscribers (policyholders) and any distributions it might declare would only be payable to them. The Exchange did not make any distributions to its subscribers (policyholders) in 2014, 2013, or 2012.

#### Enterprise Risk Management

The role of our Enterprise Risk Management ("ERM") function is to ensure that all significant risks are clearly identified, understood, proactively managed and consistently monitored to achieve strategic objectives for all stakeholders of the Erie Insurance Group. See Item 1A "Risk Factors" contained in this report for a list of risk factors related to the Erie Insurance Group.

## Table of Contents

As an insurance company, we are in the business of taking risks from our policyholders, managing these risks in a cost-effective manner and ensuring long term stability for policyholders as well as shareholders. Since risk is integral to our business, we strive to manage the multitude of risks we face in an optimal manner. Some risks can occur simultaneously or be correlated with other risks. Therefore an event or a series of events has the potential to impact multiple areas of our business and materially affect our operations, financial position or liquidity. As such, our ERM program takes a holistic view of risk and ensures implementation of risk responses to mitigate potential impacts across our entire group of companies.

Our ERM process is founded on a governance framework that includes oversight at multiple levels of our organization, including our Board of Directors and executive management. Accountability to identify, manage, and mitigate risk is embedded within all functions and areas of our business. We have defined risk tolerances to monitor and manage significant risks within acceptable levels. In addition to identifying, evaluating, prioritizing, monitoring, and mitigating significant risks, our ERM process includes extreme event analyses and scenario testing. Financial and catastrophe modeling enable us to quantify risk within our property and casualty insurance operations and investment portfolio. Model output is used to quantify the potential variability of future performance and the sufficiency of capital levels given our defined tolerance for risk. These models provide insight into capital management, allocation of capital by product lines, catastrophe exposure management, and reinsurance purchasing decisions. Additionally, ERM tools have been developed and modified to enhance our ability to assess project level risk and to provide senior management with pertinent risk information, enabling them to make better informed decisions.

Insurers are required to regularly conduct an Own Risk and Solvency Assessment (“ORSA”) starting in 2015. ORSA regulation requires insurance companies to document their risk management framework, assess individual material risks, and test group capital and solvency. This will allow regulators to form an enhanced view of an insurer’s ability to withstand stress.

## TRANSACTIONS / AGREEMENTS BETWEEN INDEMNITY AND NONCONTROLLING INTEREST (EXCHANGE)

### Board Oversight

Our Board of Directors has a broad oversight responsibility over our intercompany relationships within and among the Property and Casualty Group. As a consequence, our Board of Directors may be required to make decisions or take actions that may not be solely in the interest of our shareholders, such as setting the management fee rate paid by the Exchange to Indemnity and ratifying any other significant intercompany activity.

### Subscriber’s Agreement

Indemnity serves as attorney-in-fact for the policyholders at the Exchange, a reciprocal insurance exchange. Each applicant for insurance to a reciprocal insurance exchange signs a subscriber’s agreement that contains an appointment of an attorney-in-fact. Through the designation of attorney-in-fact, Indemnity is required to provide sales, underwriting, and policy issuance services to the policyholders of the Exchange, as discussed previously. Pursuant to the subscriber’s agreement, Indemnity earns a management fee for these services 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.

### Intercompany Agreements

#### Pooling

Members of the Property and Casualty Group participate in an intercompany reinsurance pooling agreement. Under the pooling agreement, all insurance business of the Property and Casualty Group is pooled in the Exchange. The Erie Insurance Company and Erie Insurance Company of New York share in the underwriting results of the reinsurance

pool through retrocession. Since 1995, the Board of Directors has set the allocation of the pooled underwriting results at 5.0% participation for Erie Insurance Company, 0.5% participation for Erie Insurance Company of New York, and 94.5% participation for the Exchange.

Service agreements

Indemnity makes certain payments on behalf of the Erie Insurance Group's related entities. These amounts are reimbursed to Indemnity on a cost basis in accordance with service agreements between Indemnity and the individual entities within the Erie Insurance Group. These reimbursements are settled on a monthly basis.



Table of Contents

## Leased property

The Exchange leases certain office space to Indemnity, including the home office and four field office facilities, with one field office owned by EFL. Rents are determined considering returns on invested capital and building operating and overhead costs. Rental costs of shared facilities are allocated based upon square footage occupied.

## Cost Allocation

The allocation of costs affects the financial condition of the Erie Insurance Group companies. Management's role is to determine that allocations are consistently made in accordance with the subscriber's agreements with the policyholders at the Exchange, intercompany service agreements, and applicable insurance laws and regulations. Allocation of costs under these various agreements requires judgment and interpretation, and such allocations are performed using a consistent methodology, which is intended to adhere to the terms and intentions of the underlying agreements.

## Intercompany Receivables of Indemnity

(in millions)	Indemnity Shareholder Interest								
	2014	Percent of Indemnity total assets		2013	Percent of Indemnity total assets		2012	Percent of Indemnity total assets	
Receivables from the Exchange and other affiliates (management fees, costs and reimbursements)	\$335	25.4	%	\$300	24.7	%	\$281	24.2	%
Note receivable from EFL	25	1.9		25	2.1		25	2.2	
Total intercompany receivables	\$360	27.3	%	\$325	26.8	%	\$306	26.4	%

Indemnity has significant receivables from the Exchange that result in a concentration of credit risk. These receivables include management fees due for services performed by Indemnity for the Exchange under the subscriber's agreement, and costs Indemnity pays on behalf of the Exchange. We periodically evaluate credit risks related to the receivables from the Exchange. Indemnity also pays certain costs for, and is reimbursed monthly by, EFL. The receivable from the Exchange for management fees and costs Indemnity pays on behalf of the Exchange is settled monthly.

## Surplus Notes

Indemnity holds a surplus note for \$25 million from EFL that is payable on demand on or after December 31, 2018; however, no principal or interest payments may be made without prior approval by the Pennsylvania Insurance Commissioner. Interest payments are scheduled to be paid semi-annually. Indemnity recognized interest income on the note of \$2 million in both 2014 and 2013.

The Exchange holds a surplus note for \$20 million from EFL that is payable on demand on or after December 31, 2025; however, no principal or interest payments may be made without prior approval by the Pennsylvania Insurance Commissioner. Interest payments are scheduled to be paid semi-annually. The Exchange recognized interest income on the note of \$1 million in both 2014 and 2013.

Table of Contents

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

## Market Risk

Market risk is the risk of loss arising from adverse changes in interest rates, credit spreads, equity prices, or foreign exchange rates, as well as other relevant market rate or price changes. The volatility and liquidity in the markets in which the underlying assets are traded directly influence market risk. The following is a discussion of our primary risk exposures, including interest rate risk, investment credit risk, concentration risk, liquidity risk, equity price risk, and foreign exchange rate risk, and how those exposures are currently managed as of December 31, 2014.

## Interest Rate Risk

We invest primarily in fixed maturity investments, which comprised 80% of invested assets for Indemnity and 65% of invested assets for the Exchange at December 31, 2014. The value of the fixed maturity portfolio is subject to interest rate risk. As market interest rates decrease, the value of the portfolio goes up with the opposite holding true in rising interest rate environments. We do not hedge our exposure to interest rate risk. A common measure of the interest sensitivity of fixed maturity assets is modified duration, a calculation that utilizes maturity, coupon rate, yield, and call terms to calculate an average age of the expected cash flows. The longer the duration, the more sensitive the asset is to market interest rate fluctuations. Duration is analyzed quarterly to ensure that it remains in the targeted range we established.

A sensitivity analysis is used to measure the potential loss in future earnings, fair values, or cash flows of market-sensitive instruments resulting from one or more selected hypothetical changes in interest rates and other market rates or prices over a selected period. In our sensitivity analysis model, a hypothetical change in market rates is selected that is expected to reflect reasonably possible changes in those rates. The following pro forma information is presented assuming a 100-basis point increase in interest rates at December 31 of each year and reflects the estimated effect on the fair value of our fixed maturity investment portfolio. We used the modified duration of our fixed maturity investment portfolio to model the pro forma effect of a change in interest rates at December 31, 2014 and 2013.

## Fixed maturities interest-rate sensitivity analysis

(dollars in millions)	Erie Insurance Group	
	At December 31,	
	2014	2013
Indemnity		
Fair value of fixed maturity portfolio	\$564	\$526
Fair value assuming 100-basis point rise in interest rates	\$550	\$508
Modified duration – Indemnity	3.6	3.6
Exchange		
Fair value of fixed maturity portfolio	\$9,007	\$8,162
Fair value assuming 100-basis point rise in interest rates	\$8,580	\$7,747
Modified duration – Exchange	5.2	5.3

While the fixed maturity portfolio is sensitive to interest rates, the future principal cash flows that will be received by contractual maturity date are presented below at December 31, 2014 and 2013. Actual cash flows may differ from those stated as a result of calls, prepayments, or defaults.

Contractual repayments of principal by maturity date  
(in millions)

Erie Insurance Group

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Fixed maturities:	December 31, 2014	
	Indemnity	Exchange
2015	\$62	\$450
2016	111	582
2017	62	890
2018	29	837
2019	33	861
Thereafter	233	4,704
Total <sup>(1)</sup>	\$530	\$8,324
Fair value	\$564	\$9,007

(1) These amounts exclude Indemnity's \$25 million surplus note due from EFL and the Exchange's \$20 million surplus note due from EFL.

63

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Table of Contents

(in millions)	Erie Insurance Group	
	December 31, 2013	
Fixed maturities:	Indemnity	Exchange
2014	\$ 101	\$ 370
2015	91	505
2016	112	694
2017	21	797
2018	12	900
Thereafter	158	4,380
Total <sup>(1)</sup>	\$ 495	\$ 7,646
Fair value	\$ 526	\$ 8,162

(1) These amounts exclude Indemnity's \$25 million surplus note due from EFL and the Exchange's \$20 million surplus note due from EFL.

**Investment Credit Risk**

Our objective is to earn competitive returns by investing in a diversified portfolio of securities. Our portfolios of fixed maturity securities, nonredeemable preferred stock, mortgage loans and, to a lesser extent, short-term investments are subject to credit risk. This risk is defined as the potential loss in fair value resulting from adverse changes in the borrower's ability to repay the debt. We manage this risk by performing upfront underwriting analysis and ongoing reviews of credit quality by position and for the fixed maturity portfolio in total. We do not hedge the credit risk inherent in our fixed maturity investments.

Generally, the fixed maturities in our portfolio are rated by external rating agencies. If not externally rated, we rate them internally on a basis consistent with that used by the rating agencies. We classify all fixed maturities as available-for-sale securities, allowing us to meet our liquidity needs and provide greater flexibility to appropriately respond to changes in market conditions.

The following table shows our fixed maturity investments by rating as of December 31, 2014:

(dollars in millions)	Erie Insurance Group <sup>(1)</sup>		
	Amortized cost	Fair value	Percent of total
Indemnity			
AAA, AA, A	\$ 378	\$ 389	69 %
BBB	110	111	20
Total investment grade	488	500	89
BB	15	15	2
B	40	38	7
CCC, CC, C	12	11	2
Total non-investment grade	67	64	11
Total – Indemnity	\$ 555	\$ 564	100 %
Exchange			
AAA, AA, A	\$ 3,857	\$ 4,105	45 %
BBB	3,977	4,203	47
Total investment grade	7,834	8,308	92
BB	362	370	4
B	259	250	3
CCC, CC, C	85	79	1

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Total non-investment grade	706	699	8	
Total – Exchange	\$8,540	\$9,007	100	%

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

Approximately 18% of Indemnity's and 2% of the Exchange's fixed income portfolios are invested in structured products. This includes mortgage-backed securities, collateralized debt and loan obligations, collateralized mortgage obligations, and asset-backed securities. The overall credit rating of the structured product portfolio is AA-.

## Table of Contents

Our municipal bond portfolio accounts for \$231 million, or 41% of the total fixed maturity portfolio for Indemnity, and \$1.5 billion, or 16% of the total fixed maturity portfolio for the Exchange. The overall credit rating of our municipal portfolio, without consideration of the underlying insurance, is AA.

Our limited partnership investment portfolio is exposed to credit risk, as well as price risk. Price risk is defined as the potential loss in estimated fair value resulting from an adverse change in prices. Our investments are directly affected by the impact of changes in these risk factors on the underlying investments held by our fund managers, which could vary significantly from fund to fund. We manage these risks by performing up-front due diligence on our fund managers, ongoing monitoring, and through the construction of a diversified portfolio.

Indemnity is also exposed to a concentration of credit risk with the Exchange. See the section, “Transactions / Agreements between Indemnity and Noncontrolling Interest (Exchange), Intercompany receivables of Indemnity” for further discussion of this risk.

### Concentration Risk

While our portfolio is well diversified within each market sector, there is an inherent risk of concentration in a particular industry or sector. We continually monitor our level of exposure to individual issuers as well as our allocation to each industry and market sector against internally established policies. See the “Financial Condition” section of Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained within this report for details of investment holdings by sector.

### Liquidity Risk

Periods of volatility in the financial markets can create conditions where fixed maturity investments, despite being publicly traded, can become illiquid. However, we actively manage the maturity profile of our fixed maturity portfolio such that scheduled repayments of principal occur on a regular basis. Additionally, there is no ready market for limited partnerships which increases the risk that these investments may not be converted to cash on favorable terms and on a timely basis.

### Equity Price Risk

Our portfolio of equity securities, which include common stock classified as available-for-sale and trading securities and non-redeemable preferred stock classified as available-for-sale, are carried on the Consolidated Statements of Financial Position at estimated fair value. Equity securities are exposed to the risk of potential loss in estimated fair value resulting from an adverse change in prices (“price risk”). We do not hedge our exposure to price risk inherent in our equity investments.

The majority of our equity security portfolio is invested in common stock. Our objective is to earn competitive relative returns by investing in a diverse portfolio of high-quality, liquid securities. Portfolio holdings are diversified across industries and among exchange-traded, small- to large-cap stocks. We measure the risk of our common stock investments designated as trading securities by comparing performance to benchmark returns such as the Standard & Poors (S&P) 500 Composite Index. Beta is a measure of a security’s systematic (non-diversifiable) risk, which is the percentage change in an individual security’s return for a 1% change in the return of the market.

At December 31, 2014, the weighted average Beta for our common stock holdings designated as trading securities was 1.00 for the Exchange. Based upon a hypothetical 20% reduction in the overall value of the stock market, the fair value of the common stock portfolio designated as trading securities would decrease by approximately \$645 million for the Exchange. At December 31, 2013, the weighted average Beta for our common stock holdings designated as trading securities was 1.03 for the Exchange. Based upon a hypothetical 20% reduction in the overall value of the stock market, the fair value of the common stock portfolio designated as trading securities would decrease by

approximately \$660 million for the Exchange.

Common stocks designated as available-for-sale securities represent investments in certain exchange traded funds with underlying holdings of fixed maturity securities. While the performance of the exchange traded funds closely tracks that of the underlying fixed maturity securities, these investments are reported as common stock based on U.S. GAAP requirements. The average effective duration of these investments as reported by the funds was 6.3 for Indemnity and 5.4 for the Exchange at December 31, 2014, compared to 4.4 for Indemnity and 4.5 for the Exchange at December 31, 2013.

Table of Contents

Foreign Exchange Rate Risk

This risk primarily arises from our foreign investments included in the Exchange's common stock and limited partnership portfolios. As of December 31, 2014, we had \$679 million and \$74 million in foreign currency denominated common stock and limited partnership investments, respectively, which represented 5.4% of Exchange's total invested assets. As of December 31, 2013, we had \$449 million and \$97 million in foreign currency denominated common stock and limited partnership investments, respectively, which represented 4.2% of Exchange's total invested assets. The principal currencies creating foreign exchange rate risk for us are the Pound Sterling and Euro, and to a lesser extent the Swiss Franc and Japanese Yen. We actively monitor the level of our exposure to non-U.S. dollar denominated investments, but do not hedge the foreign exchange rate risk inherent in these investments.

Based on the fair values of the Exchange's non-U.S. dollar denominated securities as of December 31, 2014 and 2013, a simultaneous 10% unfavorable change across each of the foreign exchange rates to which we are exposed would decrease the fair value of our foreign currency denominated investments by \$75 million and \$55 million, respectively.



Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of  
Erie Indemnity Company

We have audited the accompanying consolidated statements of financial position of Erie Indemnity Company as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, shareholders' equity and noncontrolling interest, and cash flows for each of the three years in the period ended December 31, 2014. Our audits also included the financial statement schedules listed in the Index at 15 (a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Erie Indemnity Company at December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Erie Indemnity Company's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission 2013 framework and our report dated February 26, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young

Philadelphia, PA  
February 26, 2015

Table of Contents

FERIE INDEMNITY COMPANY  
CONSOLIDATED STATEMENTS OF OPERATIONS  
Years ended December 31, 2014, 2013 and 2012  
(dollars in millions, except per share data)

	2014	2013	2012
Revenues			
Premiums earned	\$5,344	\$4,898	\$4,493
Net investment income	446	422	438
Net realized investment gains	193	771	418
Net impairment losses recognized in earnings	(4	) (13	) 0
Equity in earnings of limited partnerships	113	161	131
Other income	32	32	32
Total revenues	6,124	6,271	5,512
Benefits and expenses			
Insurance losses and loss expenses	3,958	3,467	3,480
Policy acquisition and underwriting expenses	1,336	1,237	1,133
Total benefits and expenses	5,294	4,704	4,613
Income from operations before income taxes and noncontrolling interest	830	1,567	899
Provision for income taxes	257	519	280
Net income	\$573	\$1,048	\$619
Less: Net income attributable to noncontrolling interest in consolidated entity – Exchange	405	885	459
Net income attributable to Indemnity	\$168	\$163	\$160
Earnings Per Share			
Net income attributable to Indemnity per share			
Class A common stock – basic	\$3.59	\$3.46	\$3.38
Class A common stock – diluted	\$3.18	\$3.08	\$2.99
Class B common stock – basic	\$539	\$520	\$505
Class B common stock – diluted	\$538	\$519	\$505
Weighted average shares outstanding attributable to Indemnity – Basic			
Class A common stock	46,247,876	46,660,651	47,357,836
Class B common stock	2,542	2,542	2,544
Weighted average shares outstanding attributable to Indemnity – Diluted			
Class A common stock	52,616,234	52,855,757	53,547,833
Class B common stock	2,542	2,542	2,544

See accompanying notes to Consolidated Financial Statements. See Note 18, "Indemnity Accumulated Other Comprehensive Loss," for amounts reclassified out of accumulated other comprehensive income (loss) into the Consolidated Statements of Operations. See Note 22, "Indemnity Supplemental Information," for supplemental statements of operations information.



Table of Contents

ERIE INDEMNITY COMPANY  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 Years ended December 31, 2014, 2013 and 2012  
 (in millions)

	2014	2013	2012	
Net income	\$573	\$1,048	\$619	
Other comprehensive (loss) income				
Change in unrealized holding gains (losses) on available-for-sale securities, net of tax (expense) benefit of \$(42), \$125, and \$(121), respectively	78	(232)	) 224	
Reclassification adjustment for gross (gains) losses included in net income, net of tax benefit (expense) of \$10, \$(3) and \$23, respectively	(18	) 7	(44	)
Postretirement plans, net of tax (benefit) expense of \$(31), \$44 and \$(17), respectively	(60	) 81	(30	)
Other comprehensive (loss) income	0	(144	) 150	
Comprehensive income	573	904	769	
Less: Comprehensive income attributable to noncontrolling interest in consolidated entity – Exchange	464	667	637	
Total comprehensive income – Indemnity	\$109	\$237	\$132	

See accompanying notes to Consolidated Financial Statements. See Note 18, "Indemnity Accumulated Other Comprehensive Loss," for supplemental statements of comprehensive income (loss) information.

Table of Contents

ERIE INDEMNITY COMPANY  
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

At December 31, 2014 and 2013

(dollars in millions, except per share data)

	2014	2013
Assets		
Investments – Indemnity		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of \$555 and \$518, respectively)	\$564	\$526
Equity securities (cost of \$24 and \$50, respectively)	25	50
Limited partnerships (cost of \$89 and \$123, respectively)	113	146
Other invested assets	1	1
Investments – Exchange		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of \$8,540 and \$7,801, respectively)	9,007	8,162
Equity securities (cost of \$788 and \$778 respectively)	850	819
Trading securities, at fair value (cost of \$2,289 and \$2,198, respectively)	3,223	3,202
Limited partnerships (cost of \$694 and \$790, respectively)	866	940
Other invested assets	20	20
Total investments	14,669	13,866
Cash and cash equivalents (Exchange portion of \$422 and \$403, respectively)	514	452
Premiums receivable from policyholders – Exchange	1,281	1,167
Reinsurance recoverable – Exchange	161	172
Deferred income taxes – Indemnity	37	2
Deferred acquisition costs – Exchange	595	566
Other assets (Exchange portion of \$374 and \$337, respectively)	501	451
Total assets	\$17,758	\$16,676
Liabilities and shareholders' equity		
Liabilities		
Indemnity liabilities		
Other liabilities	\$611	\$476
Exchange liabilities		
Losses and loss expense reserves	3,853	3,747
Life policy and deposit contract reserves	1,812	1,758
Unearned premiums	2,834	2,598
Deferred income taxes	490	450
Other liabilities	175	97
Total liabilities	9,775	9,126
Indemnity's shareholders' equity		
Class A common stock, stated value \$0.0292 per share; 74,996,930 shares authorized; 68,299,200 shares issued; 46,189,068 and 46,461,125 shares outstanding, respectively	2	2
Class B common stock, convertible at a rate of 2,400 Class A shares for one Class B share, stated value \$70 per share; 3,070 shares authorized; 2,542 shares issued and outstanding	0	0
Additional paid-in-capital	16	16

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Accumulated other comprehensive loss	(118	) (59	)
Retained earnings	1,949	1,902	
Total contributed capital and retained earnings	1,849	1,861	
Treasury stock, at cost; 22,110,132 and 21,838,075 shares held, respectively	(1,146	) (1,127	)
Total Indemnity shareholders' equity	703	734	
Noncontrolling interest in consolidated entity – Exchange	7,280	6,816	
Total equity	7,983	7,550	
Total liabilities, shareholders' equity, and noncontrolling interest	\$17,758	\$16,676	

See accompanying notes to Consolidated Financial Statements. See Note 22, “Indemnity Supplemental Information,” for supplemental consolidating statements of financial position information.

70

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Table of Contents

ERIE INDEMNITY COMPANY  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
AND NONCONTROLLING INTEREST

Years ended December 31, 2014, 2013 and 2012

(dollars in millions, except per share data)

	2014	2013	2012
Common stock			
Class A	\$2	\$2	\$2
Class B	0	0	0
Total common stock	2	2	2
Additional paid-in-capital			
Balance, end of year	16	16	16
Accumulated other comprehensive loss			
Balance, beginning of year	(59	) (133	) (105
Change in accumulated other comprehensive loss	(59	) 74	(28
Balance, end of year	(118	) (59	) (133
Retained earnings			
Balance, beginning of year	1,902	1,852	1,894
Net income attributable to Indemnity	168	163	160
Dividends declared – Class A (\$2.586, \$2.4125 and \$4.25 per share, respectively)	(120	) (112	) (200
Dividends declared – Class B (\$387.90, \$361.875 and \$637.50 per share, respectively)	(1	) (1	) (2
Balance, end of year	1,949	1,902	1,852
Treasury stock			
Balance, beginning of year	(1,127	) (1,095	) (1,026
Net purchase of treasury stock	(19	) (32	) (69
Balance, end of year	(1,146	) (1,127	) (1,095
Total Indemnity shareholders' equity	\$703	\$734	\$642
Noncontrolling interest in consolidated entity – Exchange			
Balance, beginning of year	\$6,816	\$6,149	\$5,512
Comprehensive income	464	667	637
Balance, end of year	7,280	6,816	6,149
Total equity	\$7,983	\$7,550	\$6,791

See accompanying notes to Consolidated Financial Statements.





Table of Contents

ERIE INDEMNITY COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years ended December 31, 2014, 2013 and 2012  
(in millions)

	2014	2013	2012
Cash flows from operating activities			
Premiums collected	\$5,466	\$5,026	\$4,594
Net investment income received	484	450	471
Limited partnership distributions	131	176	164
Service agreement fee received	31	31	31
Commissions and bonuses paid to agents	(749)	(681)	(617)
Losses paid	(3,217)	(2,742)	(2,818)
Loss expenses paid	(516)	(470)	(464)
Other underwriting and acquisition costs paid	(661)	(603)	(557)
Income taxes paid	(190)	(284)	(227)
Net cash provided by operating activities	779	903	577
Cash flows from investing activities			
Purchase of investments:			
Fixed maturities	(2,298)	(2,879)	(2,112)
Preferred stock	(445)	(136)	(172)
Common stock	(1,262)	(1,339)	(1,807)
Limited partnerships	(120)	(88)	(100)
Sales/maturities of investments:			
Fixed maturity sales	645	849	881
Fixed maturity calls/maturities	854	1,135	1,169
Preferred stock	398	115	154
Common stock	1,486	1,426	1,733
Sale of and returns on limited partnerships	197	198	201
Net purchase of property and equipment	(52)	(42)	(33)
Net collections on agent loans	2	3	1
Net distributions on life policy loans	(1)	(1)	0
Net cash used in investing activities	(596)	(759)	(85)
Cash flows from financing activities			
Annuity deposits and interest	85	89	92
Annuity surrenders and withdrawals	(88)	(82)	(83)
Universal life deposits and interest	34	27	23
Universal life surrenders	(13)	(10)	(10)
Purchase of treasury stock	(20)	(32)	(70)
Dividends paid to shareholders	(119)	(84)	(229)
Net cash used in financing activities	(121)	(92)	(277)
Net increase in cash and cash equivalents	62	52	215
Cash and cash equivalents, beginning of year	452	400	185
Cash and cash equivalents, end of year	\$514	\$452	\$400

See accompanying notes to Consolidated Financial Statements. See Note 20, "Supplementary Data on Cash Flows," and Note 22, "Indemnity Supplemental Information," for supplemental cash flow information.

Table of Contents

ERIE INDEMNITY COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Nature of Operations

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

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

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

The Exchange, together with its wholly owned subsidiaries, Erie Insurance Company (“EIC”), Erie Insurance Company of New York (“ENY”), Erie Insurance Property and Casualty Company (“EPC”), and Flagship City Insurance Company (“Flagship”), operate as a property and casualty insurer and are collectively referred to as the “Property and Casualty Group”. The Property and Casualty Group operates in 12 Midwestern, Mid-Atlantic, and Southeastern states and the District of Columbia and primarily writes private passenger auto (43%), homeowners (27%), commercial multi-peril (13%), commercial automobile (7%), and workers compensation (7%) lines of insurance based upon 2014 direct written premiums.

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

The Property & Casualty Group and EFL began writing private passenger automobile, home insurance, personal excess liability insurance, and life insurance and annuity products in Kentucky in the fourth quarter of 2014.

All property and casualty and life insurance operations are owned by the Exchange and Indemnity functions solely as the management company.

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

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

Note 2. Significant Accounting Policies

Basis of presentation

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

Use of estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## Table of Contents

### Principles of consolidation

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

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

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

All intercompany assets, liabilities, revenues, and expenses between Indemnity and the Exchange have been eliminated in the Consolidated Financial Statements.

### Adopted accounting standards

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU 2013-02 requires entities to present in either a single note or parenthetically on the face of the financial statements the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line affected by the reclassification. ASU 2013-02 was effective for reporting periods beginning after December 15, 2012. We adopted the guidance effective January 1, 2013 and disclose reclassifications from accumulated other comprehensive income and the impact on our consolidated financial statements in Note 18, "Indemnity Accumulated Other Comprehensive Loss".

### Recently issued accounting standards

In February 2015, the FASB issued ASU 2015-02, "Consolidation", which changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. ASU 2015-02 modifies the evaluation of whether limited partnerships are variable interest entities and the consolidation analysis of reporting entities that are involved in variable interest entities, particularly those that have fee arrangements and related party relationships. All legal entities are subject to reevaluation under this revised consolidation model. ASU 2015-02 is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. We are currently evaluating this new guidance and have not yet determined the impact that the adoption of this new consolidation model will have on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. ASU 2014-09 clarifies the

principles for recognizing revenue and provides a common revenue standard for GAAP. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Insurance contracts are not within the scope of this guidance. ASU 2014-09 is effective for interim and annual periods beginning after December 15, 2016. Early application is not permitted. We do not expect the adoption of ASU 2014-09 related to the management fee and service agreement revenue to have a material impact on our consolidated financial statements.

#### Investments

Available-for-sale securities – Fixed maturity, preferred stock, and common stock securities classified as available-for-sale are reported at fair value. Unrealized holding gains and losses, net of related tax effects, on available-for-sale securities are recorded directly to shareholders' equity as accumulated other comprehensive income (loss).

## Table of Contents

Common stock securities classified as available-for-sale represent certain exchange traded funds with underlying holdings of fixed maturity securities.

Realized gains and losses on sales of available-for-sale securities are recognized in income based upon the specific identification method. Interest and dividend income are recognized as earned.

Fixed income and redeemable preferred stock (debt securities) are evaluated monthly for other-than-temporary impairment loss. For debt securities that have experienced a decline in fair value and that we intend to sell, or for which it is more likely than not we will be required to sell the security before recovery of its amortized cost, an other-than-temporary impairment is deemed to have occurred, and is recognized in earnings.

Debt securities that have experienced a decline in fair value and that we do not intend to sell, and that we will not be required to sell before recovery, are evaluated to determine if the decline in fair value is other-than-temporary.

Some factors considered in this evaluation include:

- the extent and duration to which fair value is less than cost;
- historical operating performance and financial condition of the issuer;
- short and long-term prospects of the issuer and its industry based upon analysts' recommendations;
- specific events that occurred affecting the issuer, including a ratings downgrade;
- near term liquidity position of the issuer; and
- compliance with financial covenants.

If a decline is deemed to be other-than-temporary, an assessment is made to determine the amount of the total impairment related to a credit loss and that related to all other factors. Consideration is given to all available information relevant to the collectability of the security in this determination. If the entire amortized cost basis of the security will not be recovered, a credit loss exists. Currently, we have the intent to sell all of our securities that have been determined to have a credit-related impairment. As a result, the entire amount of any impairment would be recognized in earnings. If we had securities with credit impairments that we did not intend to sell, the non-credit portion of the impairment would be recorded in other comprehensive income.

Other-than-temporary impairment charges on non-redeemable preferred securities, hybrid securities with equity characteristics and common stock are included in earnings consistent with the treatment for equity securities.

Trading securities – Common stock securities classified as trading securities are reported at fair value. Unrealized holding gains and losses on trading securities are included in net realized gains (losses) in the Consolidated Statements of Operations. Realized gains and losses on sales of trading securities are recognized in income based upon the specific identification method. Dividend income is recognized as of the ex-dividend date.

Limited partnerships – Limited partnerships include U.S. and foreign private equity, mezzanine debt, and real estate investments. The majority of our limited partnership holdings are considered investment companies and are recorded using the equity method of accounting. For these limited partnerships the general partners record assets at fair value, including any other-than-temporary impairments of these individual investments. We also own some real estate limited partnerships that do not meet the criteria of an investment company. These partnerships prepare audited financial statements on a cost basis. We have elected to report these limited partnerships under the fair value option, which is based on the net asset value (NAV) from our partner's capital statement reflecting the general partner's estimate of fair value for the fund's underlying assets. Limited partnerships reported under the fair value option are disclosed in Note 6, "Fair Value" as other investments. Fair value provides consistency in the evaluation and financial reporting for these limited partnerships and limited partnerships accounted for under the equity method.

Because of the timing of the preparation and delivery of financial statements for limited partnership investments, the use of the most recently available financial statements provided by the general partners results in a quarter delay in the inclusion of the limited partnership results in our Consolidated Statements of Operations. Due to this delay, these financial statements do not yet reflect the market conditions experienced in the fourth quarter of 2014 for all partnerships other than the real estate limited partnerships that are reported under the fair value option.

Nearly all of the underlying investments in our limited partnerships are valued using a source other than quoted prices in active markets. The fair value amounts for our private equity and mezzanine debt partnerships are based upon the financial statements of the general partners, who use multiple methods to estimate fair value including the market approach, income approach or the cost approach. The market approach uses prices and other pertinent information from market-generated transactions involving

75

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## Table of Contents

identical or comparable assets or liabilities. Such valuation techniques often use market multiples derived from a set of comparables. The income approach uses valuation techniques to convert future cash flows or earnings to a single discounted present value amount. The measurement is based upon the value indicated by current market expectations on those future amounts. The cost approach is derived from the amount that is currently required to replace the service capacity of an asset. If information becomes available that would impair the cost of investments owned by the partnerships, then the general partner would adjust to the net realizable value. For real estate limited partnerships, the general partners record these at fair value based upon an independent appraisal or internal estimates of fair value.

While we perform various procedures in review of the general partners' valuations, we rely on the general partners' financial statements as the best available information to record our share of the partnership unrealized gains and losses resulting from valuation changes. Due to the limited market for these investments, there is a greater potential for market price variability.

Unrealized gains and losses for these investments are reflected in equity in earnings (losses) of limited partnerships in our Consolidated Statements of Operations in accordance with the equity method of accounting or the fair value option, as applicable. Cash contributions made to and distributions received from the partnerships are recorded in the period in which the transaction occurs.

Cash and cash equivalents – Short-term investments, consisting of cash, money market accounts and other short-term, highly liquid investments with a maturity of three months or less at the date of purchase, are considered cash and cash equivalents.

### Deferred acquisition costs

Costs that vary with and directly relate to the successful acquisition of new and renewal insurance and investment-type contracts are deferred. These costs are principally commissions, premium taxes and policy issuance expenses.

Property and casualty insurance – DAC is amortized as premiums are earned over the applicable policy term. Investment income is considered in determining the recoverability of DAC. If a premium deficiency exists, it would first be recognized by charging any unamortized acquisition costs to expense. If the premium deficiency were greater than unamortized acquisition costs, a liability would be accrued for the excess deficiency. There was no reduction in costs deferred in any periods presented. Profitability is analyzed annually to ensure recoverability.

Life insurance – DAC related to traditional life insurance products is amortized in proportion to premium revenues over the premium-paying period of related policies using assumptions about mortality, morbidity, lapse rates, expenses, and future yield on related investments established when the policy was issued. Amortization is adjusted each period to reflect policy lapse or termination rates as compared to anticipated experience. DAC related to universal life products and deferred annuities is amortized over the estimated lives of the contracts in proportion to actual and expected future gross profits, investment, mortality, expense margins, and surrender charges. Historical and anticipated investment returns, including realized gains and losses, are considered in determining the amortization of DAC.

Estimated gross profits are adjusted monthly to reflect actual experience to date and/or for the unlocking of underlying key assumptions based upon experience studies. DAC is periodically reviewed for recoverability. For traditional life products, if the benefit reserves plus anticipated future premiums and interest earnings for a line of business are less than the current estimate of future benefits and expenses (including any unamortized DAC), a charge to income is recorded for additional DAC amortization or for increased benefit reserves. For universal life and deferred annuities, if the current present value of future expected gross profits is less than the unamortized DAC, a charge to income is recorded for additional DAC amortization.

#### Deferred taxes

Deferred tax assets and liabilities are recorded for temporary differences between the tax basis of assets and liabilities and the reported amounts in the consolidated financial statements, using the statutory tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date under the law. Valuation allowances on deferred tax assets are estimated based upon our assessment of the realizability of such amounts.

#### Property and casualty unpaid losses and loss expenses

Unpaid losses and loss expenses include estimates for claims that have been reported and those that have been incurred but not reported, as well as estimates of all expenses associated with processing and settling these claims, less estimates of anticipated salvage and subrogation recoveries. Unpaid loss and loss expense reserves are set at ultimate cost, except for workers compensation loss reserves, which have been discounted using an interest rate of 2.5%. Estimating the ultimate cost of future losses and loss expenses is an uncertain and complex process. This estimation process is based upon the assumption that past developments are an appropriate indicator of future events, and involves a variety of actuarial techniques that analyze

## Table of Contents

experience, trends, and other relevant factors. The uncertainties involved with the reserving process include internal factors, such as changes in claims handling procedures, as well as external factors, such as economic trends and changes in the concepts of legal liability and damage awards. Accordingly, final loss settlements may vary from the present estimates, particularly when those payments may not occur until well into the future.

We regularly review the adequacy of our estimated loss and loss expense reserves by line of business. Adjustments to previously established reserves are reflected in the operating results of the period in which the adjustment is determined to be necessary. Such adjustments could possibly be significant, reflecting any variety of new and adverse or favorable trends.

### Life insurance reserves

The liability for future benefits of life insurance contracts is the present value of such benefits less the present value of future net premiums. Life insurance and income-paying annuity future policy benefit reserves are computed primarily by the net level premium method with assumptions as to mortality, withdrawal, lapses, and investment yields. Traditional life insurance products are subject to loss recognition testing. The adequacy of the related reserves is verified as part of loss recognition testing. Loss recognition is necessary when the sum of the reserve and the present value of projected policy cash flows is less than unamortized DAC.

Deferred annuity future benefit reserves are established at accumulated account values without reduction for surrender charges. These account values are credited with varying interest rates determined at the discretion of EFL subject to certain minimums.

### Agent bonus estimates

Agent bonuses are based upon an individual agency's property and casualty underwriting profitability and also include a component for growth in agency property and casualty premiums if the agency's underwriting profitability targets for our book of business are met. The estimate for agent bonuses, which are based upon the performance over 36 months, is modeled on a monthly basis using actual underwriting data by agency for the prior two years combined with the current year-to-date actual data.

At December 31 of each year, we use actual data available and record an accrual based upon the expected payment amount. These costs are included in the policy acquisition and underwriting expenses in the Consolidated Statements of Operations.

### Recognition of premium revenues and losses

Property and casualty insurance – Insurance premiums written are earned over the terms of the policies on a pro-rata basis. Premiums receivable from policyholders represent premiums written but not yet collected. Premiums receivable are reported net of an allowance for uncollectible premiums. Unearned premiums represent that portion of premiums written which is applicable to the unexpired terms of policies in force. Losses and loss expenses are recorded as incurred.

Life insurance – Premiums on traditional life insurance products are recognized as revenue when due. Reserves for future policy benefits are established when premiums are earned. Premiums received for annuity and universal life products are reported as deposits and included in liabilities. For universal life products, revenue is recognized when amounts are assessed against the policyholder's account for mortality coverage and contract expenses. The primary source of revenue on annuity deposits is derived from the interest earned by EFL, which is reflected in net investment income.

### Reinsurance

Property and casualty insurance – Property and casualty assumed and ceded reinsurance premiums are earned over the terms of the reinsurance contracts. Premiums ceded to other companies are reported as a reduction of premium income. Reinsurance contracts do not relieve the Property and Casualty Group from its obligations to policyholders.

Life insurance – Reinsurance premiums, commissions, and expense reimbursements on reinsurance ceded on life insurance policies are accounted for on a basis consistent with those used in accounting for the underlying reinsured policies. Expense reimbursements received in connection with new reinsurance ceded have been accounted for as a reduction of the related policy acquisition costs. Amounts recoverable from reinsurers for future policy benefits are estimated in a manner consistent with the assumptions used for the underlying policy benefits. Amounts recoverable for incurred claims, future policy benefits, and expense reimbursements are recorded as assets. Reinsurance contracts do not relieve EFL from its obligations to policyholders.

#### Recognition of management fee revenue

Indemnity earns management fees from the Exchange for providing sales, underwriting, and policy issuance services. Pursuant to the subscriber's agreements with the policyholders at the Exchange, Indemnity may retain up to 25% of all premiums written or assumed by the Exchange. 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 arrangement. The Property and Casualty Group issues policies with annual terms

Table of Contents

only. Management fees are recorded as revenue upon policy issuance or renewal, as substantially all of the services required to be performed by us 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. Management fee revenue is eliminated upon consolidation.

Recognition of service agreement revenue

Included in service agreement revenue are service charges Indemnity collects from policyholders for providing multiple payment plans on policies written by the Property and Casualty Group. Service charges, which are flat dollar charges for each installment billed beyond the first installment, are recognized as revenue when bills are rendered to the policyholder. Service agreement revenue also includes late payment and policy reinstatement fees. Service agreement revenue is included in other income in the Consolidated Statements of Operations.

78

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Table of Contents

## Note 3. Indemnity Earnings Per Share

Class A and Class B basic earnings per share and Class B diluted earnings per share are calculated under the two-class method. The two-class method allocates earnings to each class of stock based upon its dividend rights. Class B shares are convertible into Class A shares at a conversion ratio of 2,400 to 1. See Note 17, "Indemnity Capital Stock."

Class A diluted earnings per share are calculated under the if-converted method, which reflects the conversion of Class B shares to Class A shares. Diluted earnings per share calculations include the dilutive effect of assumed issuance of stock-based awards under compensation plans using the treasury stock method. See Note 16, "Incentive and Deferred Compensation Plans."

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

(dollars in millions, except per share data)	Indemnity Shareholder Interest								
	For the years ended December 31,								
	2014			2013			2012		
	Allocated net income (numerator)	Weighted shares (denominator)	Per-share amount	Allocated net income (numerator)	Weighted shares (denominator)	Per-share amount	Allocated net income (numerator)	Weighted shares (denominator)	Per-share amount
<b>Class A – Basic EPS:</b>									
Income available to Class A stockholders	\$ 167	46,247,876	\$ 3.59	\$ 162	46,660,651	\$ 3.46	\$ 159	47,357,836	\$ 3.38
Dilutive effect of stock-based awards	0	267,558	—	0	94,306	—	0	84,397	—
Assumed conversion of Class B shares	1	6,100,800	—	1	6,100,800	—	1	6,105,600	—
<b>Class A – Diluted EPS:</b>									
Income available to Class A stockholders on Class A equivalent shares	\$ 168	52,616,234	\$ 3.18	\$ 163	52,855,757	\$ 3.08	\$ 160	53,547,833	\$ 2.99
<b>Class B – Basic EPS:</b>									
Income available to Class B stockholders	\$ 1	2,542	\$ 539	\$ 1	2,542	\$ 520	\$ 1	2,544	\$ 505
<b>Class B – Diluted EPS:</b>									

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Income available to Class B stockholders	\$ 1	2,542	\$ 538	\$ 1	2,542	\$ 519	\$ 1	2,544	\$ 505
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79

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Table of Contents

Note 4. Variable Interest Entity

Erie Insurance Exchange

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

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

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

All property and casualty and life insurance operations are owned by the Exchange, and Indemnity functions solely as the management company.

Indemnity has not provided financial or other support to the Exchange for any of the reporting periods presented. At December 31, 2014, there are no explicit or implicit arrangements that would require Indemnity to provide future financial support to the Exchange. Indemnity is not liable if the Exchange was to be in violation of its debt covenants or was unable to meet its obligation for unfunded commitments to limited partnerships.



## Table of Contents

### Note 5. Segment Information

Our reportable segments include management operations, property and casualty insurance operations, life insurance operations, and investment operations. Accounting policies for segments are the same as those described in the summary of significant accounting policies (see Note 2, "Significant Accounting Policies"). Assets are not allocated to the segments, but rather, are reviewed in total for purposes of decision-making. No single customer or agent provides 10% or more of revenues.

#### Management operations

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

The year ended December 31, 2012 includes an adjustment that reduced commission expense by \$6 million. This amount represents the reimbursement by the North Carolina Reinsurance Facility (NCRF) for commissions Indemnity paid to agents on the surcharges collected on behalf of the NCRF which was incorrectly recorded as a benefit to the Exchange in prior periods.

#### Property and casualty insurance operations

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

#### Life insurance operations

Our life insurance operations segment includes traditional and universal life insurance products and fixed annuities marketed to individuals using the same independent agency force utilized by our property and casualty insurance operations. We evaluate profitability of the life insurance segment principally based upon segment net income, including investments, which for segment purposes are reflected in the investment operations segment. At the same time, we recognize that investment-related income is integral to the evaluation of the life insurance segment because of the long duration of life products. In 2014, investment activities on life insurance-related assets generated revenues of \$105 million, resulting in EFL reporting income before income taxes of \$49 million, before intercompany eliminations. In 2013, investment activities on life insurance-related assets generated revenues of \$111 million,

resulting in EFL reporting income before income taxes of \$48 million, before intercompany eliminations. In 2012, investment activities on life insurance-related assets generated revenues of \$104 million, resulting in EFL reporting income before income taxes of \$46 million, before intercompany eliminations.

#### Investment operations

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

Table of Contents

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

(in millions)	Erie Insurance Group Year ended December 31, 2014					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		\$5,260	\$86		\$(2 )	\$ 5,344
Net investment income				\$462	(16 )	446
Net realized investment gains				193		193
Net impairment losses recognized in earnings				(4 )		(4 )
Equity in earnings of limited partnerships				113		113
Management fee revenue	\$1,376				(1,376 )	—
Service agreement and other revenue	31		1			32
Total revenues	1,407	5,260	87	764	(1,394 )	6,124
Cost of management operations	1,184				(1,184 )	—
Insurance losses and loss expenses		3,859	105		(6 )	3,958
Policy acquisition and underwriting expenses		1,502	38		(204 )	1,336
Total benefits and expenses	1,184	5,361	143	—	(1,394 )	5,294
Income (loss) before income taxes	223	(101 )	(56 )	764	—	830
Provision for income taxes	78	(35 )	(20 )	234	—	257
Net income (loss)	\$145	\$(66 )	\$(36 )	\$530	\$—	\$ 573

(in millions)	Erie Insurance Group Year ended December 31, 2013					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		\$4,820	\$80		\$(2 )	\$ 4,898
Net investment income				\$434	(12 )	422
Net realized investment gains				771		771
Net impairment losses recognized in earnings				(13 )		(13 )
Equity in earnings of limited partnerships				161		161
Management fee revenue	\$1,266				(1,266 )	—
Service agreement and other revenue	31		1			32
Total revenues	1,297	4,820	81	1,353	(1,280 )	6,271
Cost of management operations	1,088				(1,088 )	—
Insurance losses and loss expenses		3,365	107		(5 )	3,467

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Policy acquisition and underwriting expenses		1,387	37		(187	) 1,237
Total benefits and expenses	1,088	4,752	144	—	(1,280	) 4,704
Income (loss) before income taxes	209	68	(63	) 1,353	—	1,567
Provision for income taxes	73	24	(22	) 444	—	519
Net income (loss)	\$136	\$44	\$(41	) \$909	\$—	\$ 1,048

82

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Table of Contents

Erie Insurance Group						
Year ended December 31, 2012						
(in millions)	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		\$4,422	\$73		\$(2 )	\$ 4,493
Net investment income				\$449	(11 )	438
Net realized investment gains				418		418
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				131		131
Management fee revenue	\$1,157				(1,157 )	—
Service agreement and other revenue	31		1			32
Total revenues	1,188	4,422	74	998	(1,170 )	5,512
Cost of management operations	983				(983 )	—
Insurance losses and loss expenses		3,384	101		(5 )	3,480
Policy acquisition and underwriting expenses		1,284	31		(182 )	1,133
Total benefits and expenses	983	4,668	132	—	(1,170 )	4,613
Income (loss) before income taxes	205	(246 )	(58 )	998	—	899
Provision for income taxes	72	(86 )	(20 )	314	—	280
Net income (loss)	\$133	\$(160 )	\$(38 )	\$684	\$—	\$ 619

Table of Contents

Note 6. Fair Value

Our available-for-sale and trading securities are recorded at fair value, which is the price that would be received to sell the asset in an orderly transaction between willing market participants as of the measurement date.

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

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

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

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

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

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

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

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

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



Table of Contents

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

Erie Insurance Group December 31, 2014 Fair value measurements using:					
(in millions)	Total	Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3	
<b>Indemnity</b>					
Available-for-sale securities:					
States & political subdivisions	\$231	\$0	\$231	\$0	
Corporate debt securities	234	0	234	0	
Residential mortgage-backed securities	8	0	8	0	
Commercial mortgage-backed securities	51	0	51	0	
Collateralized debt obligations	33	0	33	0	
Other debt securities	7	0	7	0	
Total fixed maturities	564	0	564	0	
Nonredeemable preferred stock	12	2	10	0	
Common stock	13	13	0	0	
Total available-for-sale securities	589	15	574	0	
Other investments <sup>(1)</sup>	8	0	0	8	
Total – Indemnity	\$597	\$15	\$574	\$8	
<b>Exchange</b>					
Available-for-sale securities:					
U.S. treasury	\$6	\$0	\$6	\$0	
Government sponsored enterprises	4	0	4	0	
States & political subdivisions	1,477	0	1,477	0	
Foreign government securities	10	0	10	0	
Corporate debt securities	7,289	0	7,202	87	
Residential mortgage-backed securities	111	0	111	0	
Commercial mortgage-backed securities	30	0	30	0	
Collateralized debt obligations	11	0	11	0	
Other debt securities	69	0	57	12	
Total fixed maturities	9,007	0	8,908	99	
Nonredeemable preferred stock	710	328	381	1	
Common stock	140	140	0	0	
Total available-for-sale securities	9,857	468	9,289	100	
Trading securities:					
Common stock	3,223	3,208	0	15	
Total trading securities	3,223	3,208	0	15	
Other investments <sup>(1)</sup>	71	0	0	71	
Total – Exchange	\$13,151	\$3,676	\$9,289	\$186	
Total – Erie Insurance Group	\$13,748	\$3,691	\$9,863	\$194	
% of total assets at fair value	100.0	% 26.9	% 71.7	% 1.4	%



(1) Other investments measured at fair value represent four real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option. These investments can never be redeemed with the funds. Instead, distributions are received when liquidation of the underlying assets of the funds occur. It is estimated that the underlying assets will generally be liquidated between 5 and 10 years from the inception of the funds. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner. Fair value is based on our proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to our balance sheet date. These values are then analyzed to determine if the NAV represents fair value at our balance sheet date, with adjustment being made where appropriate. We consider observable market data and perform a review validating the appropriateness of the NAV at each balance sheet date. It is likely that all of the investments will be redeemed at a future date for an amount different than the NAV of our ownership interest in partners' capital as of December 31, 2014. During the year ended December 31, 2014, Indemnity made no contributions and received distributions totaling \$12.9 million, and the Exchange made no contributions and received distributions totaling \$41.5 million for these investments. As of December 31, 2014, the amount of unfunded commitments related to the investments was \$0.6 million for Indemnity and \$1.7 million for the Exchange.

Table of Contents

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

(in millions)	Erie Insurance Group December 31, 2013 Fair value measurements using:				
	Total	Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3	
<b>Indemnity</b>					
Available-for-sale securities:					
States & political subdivisions	\$243	\$0	\$243	\$0	
Corporate debt securities	282	0	281	1	
Collateralized debt obligations	1	0	0	1	
Total fixed maturities	526	0	524	2	
Nonredeemable preferred stock	25	2	23	0	
Common stock	25	25	0	0	
Total available-for-sale securities	576	27	547	2	
Other investments <sup>(1)</sup>	18	0	0	18	
Total – Indemnity	\$594	\$27	\$547	\$20	
<b>Exchange</b>					
Available-for-sale securities:					
U.S. government & agencies	\$172	\$0	\$172	\$0	
States & political subdivisions	1,470	0	1,470	0	
Foreign government securities	15	0	15	0	
Corporate debt securities	6,211	0	6,185	26	
Residential mortgage-backed securities	156	0	156	0	
Commercial mortgage-backed securities	47	0	47	0	
Collateralized debt obligations	16	0	11	5	
Other debt securities	75	0	75	0	
Total fixed maturities	8,162	0	8,131	31	
Nonredeemable preferred stock	621	242	379	0	
Common stock	198	198	0	0	
Total available-for-sale securities	8,981	440	8,510	31	
Trading securities:					
Common stock	3,202	3,187	0	15	
Total trading securities	3,202	3,187	0	15	
Other investments <sup>(1)</sup>	98	0	0	98	
Total – Exchange	\$12,281	\$3,627	\$8,510	\$144	
Total – Erie Insurance Group	\$12,875	\$3,654	\$9,057	\$164	
% of total assets at fair value	100.0	% 28.4	% 70.3	% 1.3	%

(1) Other investments measured at fair value represent four real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option. These investments can never be redeemed with the funds. Instead, distributions are received when liquidation of the underlying assets of the funds

occur. It is estimated that the underlying assets will generally be liquidated between 5 and 10 years from the inception of the funds. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner. Fair value is based on our proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to our balance sheet date. These values are then analyzed to determine if the NAV represents fair value at our balance sheet date, with adjustment being made where appropriate. We consider observable market data and perform a review validating the appropriateness of the NAV at each balance sheet date. It is likely that all of the investments will be redeemed at a future date for an amount different than the NAV of our ownership interest in partners' capital as of December 31, 2013. During the year ended December 31, 2013, Indemnity made no contributions and received distributions totaling \$2.4 million, and the Exchange made no contributions and received distributions totaling \$21.7 million for these investments. As of December 31, 2013, the amount of unfunded commitments related to the investments was \$1.5 million for Indemnity and \$4.5 million for the Exchange.

Table of Contents

## Level 3 Assets –Year-to-Date Change:

(in millions)	Erie Insurance Group						Ending balance at December 31, 2014
	Beginning balance at December 31, 2013	Included in earnings <sup>(1)</sup>	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3	
<b>Indemnity</b>							
Available-for-sale securities:							
Corporate debt securities	\$1	\$0	\$0	\$0	\$0	\$(1)	\$0
Commercial mortgage-backed securities	0	0	0	3	0	(3)	0
Collateralized debt obligations	1	0	0	0	(1)	0	0
Total fixed maturities	2	0	0	3	(1)	(4)	0
Total available-for-sale securities	2	0	0	3	(1)	(4)	0
Other investments	18	2	0	0	(12)	0	8
Total Level 3 assets – Indemnity	\$20	\$2	\$0	\$3	\$(13)	\$(4)	\$8
<b>Exchange</b>							
Available-for-sale securities:							
Corporate debt securities	\$26	\$0	\$(1)	\$46	\$(6)	\$22	\$87
Collateralized debt obligations	5	1	(1)	0	(3)	(2)	0
Other debt securities	0	0	0	0	0	12	12
Total fixed maturities	31	1	(2)	46	(9)	32	99
Nonredeemable preferred stock	0	0	0	1	0	0	1
Total available-for-sale securities	31	1	(2)	47	(9)	32	100
Trading securities:							
Common stock	15	0	0	0	0	0	15
Total trading securities	15	0	0	0	0	0	15
Other investments	98	14	0	0	(41)	0	71
Total Level 3 assets – Exchange	\$144	\$15	\$(2)	\$47	\$(50)	\$32	\$186
Total Level 3 assets – Erie Insurance Group	\$164	\$17	\$(2)	\$50	\$(63)	\$28	\$194

(1) These amounts are reported in the Consolidated Statements of Operations. There was \$1 million included in net realized investment gains (losses) and \$16 million included in equity in earnings of limited partnerships for the year ended December 31, 2014 on Level 3 securities.

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

For Indemnity, there were no transfers between Level 1 and Level 2, or from Level 2 to Level 3, for the year ended December 31, 2014. Level 3 to Level 2 transfers totaled \$4 million related to two fixed maturity holdings due to the use of observable market data to determine the fair value at December 31, 2014.

For the Exchange, Level 1 to Level 2 transfers totaled \$36 million and Level 2 to Level 1 transfers totaled \$25 million due to trading activity levels related to four preferred stock holdings and three preferred stock holdings, respectively,

for the year ended December 31, 2014. Level 2 to Level 3 transfers totaled \$56 million for nine fixed maturity holdings and one preferred stock holding due to the use of unobservable inputs to determine the fair value. Level 3 to Level 2 transfers totaled \$24 million for three fixed maturity holdings and one preferred stock holding due to the use of observable market data to determine the fair value at December 31, 2014.

Table of Contents

## Level 3 Assets – Year-to-Date Change:

(in millions)	Erie Insurance Group				Purchases	Sales	Transfers in and (out) of Level 3	Ending balance at December 31, 2013
	Beginning balance at December 31, 2012	Included in earnings ( <sup>1</sup> )	Included in other comprehensive income					
Indemnity								
Available-for-sale securities:								
Corporate debt securities	\$1	\$0	\$0	\$0	\$0	\$0	\$0	\$1
Collateralized debt obligations	3	0	0	0	(2)	0	0	1
Total fixed maturities	4	0	0	0	(2)	0	0	2
Total available-for-sale securities	4	0	0	0	(2)	0	0	2
Other investments	19	1	0	0	(2)	0	0	18
Total Level 3 assets – Indemnity	\$23	\$1	\$0	\$0	\$(4)	\$0	\$0	\$20
Exchange								
Available-for-sale securities:								
Corporate debt securities	\$43	\$0	\$0	\$1	\$(3)	\$(15)		\$26
Commercial mortgage-backed securities	0	0	0	0	(1)	1		0
Collateralized debt obligations	16	3	1	0	(16)	1		5
Total fixed maturities	59	3	1	1	(20)	(13)		31
Nonredeemable preferred stock	0	2	(1)	4	(10)	5		0
Total available-for-sale securities	59	5	0	5	(30)	(8)		31
Trading securities:								
Common stock	15	1	0	4	(5)	0		15
Total trading securities	15	1	0	4	(5)	0		15
Other investments	109	11	0	0	(22)	0		98
Total Level 3 assets – Exchange	\$183	\$17	\$0	\$9	\$(57)	\$(8)		\$144
Total Level 3 assets – Erie Insurance Group	\$206	\$18	\$0	\$9	\$(61)	\$(8)		\$164

(1) These amounts are reported in the Consolidated Statements of Operations. There was \$6 million included in net realized investment gains (losses) and \$12 million included in equity in earnings of limited partnerships for the year ended December 31, 2013 on Level 3 securities.

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

For the Exchange, Level 1 to Level 2 transfers totaled \$6 million and Level 2 to Level 1 transfers totaled \$51 million due to trading activity levels related to one preferred stock holding and five preferred stock holdings, respectively, for the year ended December 31, 2013. Level 2 to Level 3 transfers totaled \$39 million related to seven fixed maturity holdings and one preferred stock holding, and Level 3 to Level 2 transfers totaled \$47 million for six fixed maturity holdings. These transfers in and out of Level 3 were primarily the result of using non-binding and binding broker quotes, respectively, to determine the fair value at December 31, 2013.



Table of Contents

When a non-binding broker quote was the only input available, it was classified within Level 3. The unobservable inputs are not reasonably available to us and therefore have not been included in the tables below. These investments totaled \$92 million for the Exchange at December 31, 2014, and \$1 million for Indemnity and \$21 million for the Exchange at December 31, 2013.

Other investments represent certain limited partnerships that are recorded at fair value based upon net asset value (NAV) provided by the general partner. Due to the nature of these investments, the NAV was classified within Level 3. The unobservable inputs are not reasonably available to us and therefore have not been included in the tables below. These investments totaled \$8 million for Indemnity and \$71 million for the Exchange at December 31, 2014, and \$18 million for Indemnity and \$98 million for the Exchange at December 31, 2013.

## Quantitative and Qualitative Disclosures about Unobservable Inputs

(dollars in millions)	Erie Insurance Group December 31, 2014		Unobservable input	Range	Weighted average
	Fair value	Valuation techniques			
Exchange					
Corporate debt securities <sup>(1)</sup>	\$7	Market approach	Comparable transaction EBITDA multiples	8.0x	8.0x
			Comparable security yield	6%	6%
Nonredeemable preferred stock <sup>(2)</sup>	1	Market approach	Held at cost		
Common stock <sup>(1)</sup>	15	Market approach	Comparable transaction EBITDA multiples	8.0x	8.0x
			Discount for lack of marketability	10%	10%
(dollars in millions)	December 31, 2013		Unobservable input	Range	Weighted average
Indemnity	Fair value	Valuation techniques			
Collateralized debt obligations <sup>(3)</sup>	\$1	Income approach	Projected maturity date	Mar 2014 - Nov 2014	
			Repayment at maturity	13 - 100%	79%
			Discount rate	7.5 - 15%	9%
Exchange					
Corporate debt securities <sup>(1)</sup>	8	Market approach	Comparable transaction EBITDA multiples	8.0 - 11.9x	8.0x
			Comparable security yield	6%	6%
Collateralized debt obligations <sup>(3)</sup>	2	Income approach	Projected maturity date	Mar 2014 - Oct 2035	
			Repayment at maturity	13 - 100%	80%
			Discount rate	7.5 - 18%	10%



Common stock <sup>(1)</sup>	15	Market approach	Comparable transaction EBITDA multiples	8.0 - 11.9x	8.0x
			Discount for lack of marketability	5 - 30%	7.5%

Common stock investments and Corporate debt securities – The unobservable inputs used in the fair value measurement of direct private equity common stock investments and certain corporate debt securities are comparable private transaction earnings before interest, taxes, depreciation, and amortization (“EBITDA”) multiples, the average EBITDA multiple for comparable publicly traded companies and the amount of discount applied to the price due to the illiquidity of the securities being valued. Significant changes in any of those inputs in isolation could result in a significantly higher or lower fair value measurement.

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

Collateralized-debt-obligation securities – The unobservable inputs used in the fair value measurement of certain collateralized-debt-obligation securities are the repayment at maturity of underlying collateral available to pay note holders, the projected maturity of the underlying security, and a discount rate appropriate for the security. Significant changes in any of those inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, a change in the assumption used for the performance of the underlying collateral is accompanied by an opposite change in the maturity and a directionally opposite change in the discount rate used to value the security.

Table of Contents

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

(in millions)	Erie Insurance Group December 31, 2014			
	Total	Level 1	Level 2	Level 3
Indemnity				
Fixed maturities:				
Priced via pricing services	\$564	\$0	\$564	\$0
Total fixed maturities	564	0	564	0
Nonredeemable preferred stock:				
Priced via pricing services	12	2	10	0
Total nonredeemable preferred stock	12	2	10	0
Common stock:				
Priced via pricing services	13	13	0	0
Total common stock	13	13	0	0
Other investments:				
Priced via unobservable inputs <sup>(2)</sup>	8	0	0	8
Total other investments	8	0	0	8
Total – Indemnity	\$597	\$15	\$574	\$8
Exchange				
Fixed maturities:				
Priced via pricing services	\$8,897	\$0	\$8,897	\$0
Priced via market comparables/broker quotes <sup>(1)</sup>	103	0	11	92
Priced via internal modeling	7	0	0	7
Total fixed maturities	9,007	0	8,908	99
Nonredeemable preferred stock:				
Priced via pricing services	709	328	381	0
Priced via internal modeling	1	0	0	1
Total nonredeemable preferred stock	710	328	381	1
Common stock:				
Priced via pricing services	3,348	3,348	0	0
Priced via internal modeling	15	0	0	15
Total common stock	3,363	3,348	0	15
Other investments:				
Priced via unobservable inputs <sup>(2)</sup>	71	0	0	71
Total other investments	71	0	0	71
Total – Exchange	\$13,151	\$3,676	\$9,289	\$186
Total – Erie Insurance Group	\$13,748	\$3,691	\$9,863	\$194

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

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

There were no assets measured at fair value on a nonrecurring basis during the year ended December 31, 2014.



Table of Contents

## Note 7. Investments

## Available-for-sale securities

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

(in millions)	Erie Insurance Group December 31, 2014			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Indemnity				
Available-for-sale securities:				
States & political subdivisions	\$219	\$12	\$0	\$231
Corporate debt securities	236	1	3	234
Residential mortgage-backed securities	8	0	0	8
Commercial mortgage-backed securities	52	0	1	51
Collateralized debt obligations	33	0	0	33
Other debt securities	7	0	0	7
Total fixed maturities	555	13	4	564
Nonredeemable preferred stock	11	1	0	12
Common stock	13	0	0	13
Total available-for-sale securities – Indemnity	\$579	\$14	\$4	\$589
Exchange				
Available-for-sale securities:				
U.S. treasury	\$6	\$0	\$0	\$6
Government sponsored enterprises	3	1	0	4
States & political subdivisions	1,394	84	1	1,477
Foreign government securities	10	0	0	10
Corporate debt securities	6,918	405	34	7,289
Residential mortgage-backed securities	109	3	1	111
Commercial mortgage-backed securities	28	2	0	30
Collateralized debt obligations	6	5	0	11
Other debt securities	66	3	0	69
Total fixed maturities	8,540	503	36	9,007
Nonredeemable preferred stock	650	64	4	710
Common stock	138	3	1	140
Total available-for-sale securities – Exchange	\$9,328	\$570	\$41	\$9,857
Total available-for-sale securities – Erie Insurance Group	\$9,907	\$584	\$45	\$10,446

Table of Contents

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

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

The amortized cost and estimated fair value of fixed maturities at December 31, 2014, are shown below by remaining contractual term to maturity. Mortgage-backed securities are allocated based upon 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 December 31, 2014	
	Amortized cost	Estimated fair value
Indemnity		
Due in one year or less	\$63	\$63
Due after one year through five years	241	241
Due after five years through ten years	144	148
Due after ten years	107	112
Total fixed maturities – Indemnity	\$555	\$564

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Exchange		
Due in one year or less	\$450	\$457
Due after one year through five years	3,240	3,409
Due after five years through ten years	3,327	3,482
Due after ten years	1,523	1,659
Total fixed maturities – Exchange	\$8,540	\$9,007
Total fixed maturities – Erie Insurance Group	\$9,095	\$9,571

92

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Table of Contents

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

(dollars in millions)	Erie Insurance Group December 31, 2014						
	Less than 12 months		12 months or longer		Total		No. of holdings
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	
Indemnity							
Available-for-sale securities:							
States & political subdivisions	\$6	\$0	\$2	\$0	\$8	\$0	4
Corporate debt securities	121	3	0	0	121	3	250
Residential mortgage-backed securities	6	0	0	0	6	0	4
Commercial mortgage-backed securities	41	1	0	0	41	1	24
Collateralized debt obligations	21	0	0	0	21	0	9
Other debt securities	7	0	0	0	7	0	3
Total fixed maturities – Indemnity	202	4	2	0	204	4	294
Common stock	0	0	13	0	13	0	1
Total available-for-sale securities – Indemnity	\$202	\$4	\$15	\$0	\$217	\$4	295
Quality breakdown of fixed maturities:							
Investment grade	\$146	\$1	\$2	\$0	\$148	\$1	58
Non-investment grade	56	3	0	0	56	3	236
Total fixed maturities – Indemnity	\$202	\$4	\$2	\$0	\$204	\$4	294
Exchange							
Available-for-sale securities:							
U.S. treasury	\$1	\$0	\$0	\$0	\$1	\$0	2
States & political subdivisions	47	0	47	1	94	1	24
Corporate debt securities	980	29	181	5	1,161	34	656
Residential mortgage-backed securities	6	0	27	1	33	1	8
Commercial mortgage-backed securities	1	0	0	0	1	0	1
Other debt securities	13	0	7	0	20	0	4
Total fixed maturities – Exchange	1,048	29	262	7	1,310	36	695
Nonredeemable preferred stock	86	3	25	1	111	4	16
Common stock	0	0	73	1	73	1	2
Total available-for-sale securities – Exchange	\$1,134	\$32	\$360	\$9	\$1,494	\$41	713
Quality breakdown of fixed maturities:							
Investment grade	\$606	\$10	\$253	\$5	\$859	\$15	172
Non-investment grade	442	19	9	2	451	21	523
Total fixed maturities – Exchange	\$1,048	\$29	\$262	\$7	\$1,310	\$36	695

The above securities for Indemnity and the Exchange have been evaluated and determined to be temporary impairments for which we expect to recover our entire principal plus interest. The primary components of this analysis include a general review of market conditions and financial performance of the issuer along with the extent and duration at which fair value is less than cost. Any securities that we intend to sell or will more likely than not be required to sell before recovery are included in other-than-temporary impairments with the impairment charges recognized in earnings.





Table of Contents

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

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

The above securities for Indemnity and the Exchange have been evaluated and determined to be temporary impairments for which we expect to recover our entire principal plus interest. The primary components of this analysis include a general review of market conditions and financial performance of the issuer along with the extent and duration at which fair value is less than cost. Any securities that we intend to sell or will more likely than not be required to sell before recovery are included in other-than-temporary impairments with the impairment charges recognized in earnings.



Table of Contents

## Net investment income

Interest and dividend income are recognized as earned and recorded to net investment income. Investment income, net of expenses, was generated from the following portfolios:

(in millions)	Erie Insurance Group		
	Years ended December 31,		
	2014	2013	2012
Indemnity			
Fixed maturities	\$ 14	\$ 12	\$ 13
Equity securities	2	2	3
Cash equivalents and other	1	2	1
Total investment income	17	16	17
Less: investment expenses	1	1	1
Investment income, net of expenses – Indemnity	\$ 16	\$ 15	\$ 16
Exchange			
Fixed maturities	\$ 354	\$ 334	\$ 350
Equity securities	115	105	102
Cash equivalents and other	1	2	2
Total investment income	470	441	454
Less: investment expenses	40	34	32
Investment income, net of expenses – Exchange	\$ 430	\$ 407	\$ 422
Investment income, net of expenses – Erie Insurance Group	\$ 446	\$ 422	\$ 438

Table of Contents

## Realized investment gains (losses)

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

(in millions)	Erie Insurance Group		
	Years ended December 31,		
	2014	2013	2012
Indemnity			
Available-for-sale securities:			
Fixed maturities:			
Gross realized gains	\$0	\$1	\$0
Gross realized losses	0	0	0
Net realized gains	0	1	0
Equity securities:			
Gross realized gains	1	0	0
Gross realized losses	0	0	0
Net realized gains	1	0	0
Trading securities:			
Common stock:			
Gross realized gains	0	0	9
Gross realized losses	0	0	(1 )
Increases (decreases) in fair value <sup>(1)</sup>	0	0	(3 )
Net realized gains	0	0	5
Net realized investment gains – Indemnity	\$1	\$1	\$5
Exchange			
Available-for-sale securities:			
Fixed maturities:			
Gross realized gains	\$25	\$37	\$78
Gross realized losses	(8 )	(31 )	(20 )
Net realized gains	17	6	58
Equity securities:			
Gross realized gains	17	7	17
Gross realized losses	(3 )	(11 )	(8 )
Net realized gains (losses)	14	(4 )	9
Trading securities:			
Common stock:			
Gross realized gains	291	307	213
Gross realized losses	(60 )	(36 )	(88 )
(Decreases) increases in fair value <sup>(1)</sup>	(70 )	497	221
Net realized gains	161	768	346
Net realized investment gains – Exchange	\$192	\$770	\$413
Net realized investment gains – Erie Insurance Group	\$193	\$771	\$418

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



Table of Contents

## Net impairment losses

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

(in millions)	Erie Insurance Group		
	Years ended December 31		
	2014	2013	2012
Indemnity			
Fixed maturities	\$0	\$0	\$0
Equity securities	0	0	0
Total other-than-temporary impairments	0	0	0
Portion recognized in other comprehensive income	0	0	0
Net impairment losses recognized in earnings – Indemnity	\$0	\$0	\$0
Exchange			
Fixed maturities	\$(4 )	\$(5 )	\$0
Equity securities	0	(8 )	0
Total other-than-temporary impairments	(4 )	(13 )	0
Portion recognized in other comprehensive income	0	0	0
Net impairment losses recognized in earnings – Exchange	\$(4 )	\$(13 )	\$0
Net impairment losses recognized in earnings – Erie Insurance Group	\$(4 )	\$(13 )	\$0

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. See also Note 2, “Significant Accounting Policies.”

## Limited partnerships

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

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

(in millions)	Erie Insurance Group		
	Years ended December 31		
	2014	2013	2012
Indemnity			
Equity in earnings of limited partnerships accounted for under the equity method	\$9	\$21	\$13
Change in fair value of limited partnerships accounted for under the fair value option	2	1	2
Equity in earnings of limited partnerships – Indemnity	\$11	\$22	\$15
Exchange			
Equity in earnings of limited partnerships accounted for under the equity method	\$88	\$128	\$105

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Change in fair value of limited partnerships accounted for under the fair value option	14	11	11
Equity in earnings of limited partnerships – Exchange	\$102	\$139	\$116
Equity in earnings of limited partnerships – Erie Insurance Group	\$113	\$161	\$131

97

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Table of Contents

We have provided summarized financial information in the following tables for the years ended December 31, 2014 and 2013. Amounts provided in the tables are presented using the latest available financial statements received from the partnerships for the respective periods. Limited partnership financial information has been presented based upon the investment percentage in the partnerships for the Erie Insurance Group consistent with how we evaluate these investments.

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

(dollars in millions)	Erie Insurance Group As of and for the year ended December 31, 2014			
	Number of partnerships	Asset recorded	Income (loss) recognized due to valuation adjustments by the partnerships	Income (loss) recorded
Investment percentage in limited partnerships				
Indemnity				
Private equity:				
Less than 10%	24	\$34	\$(7 )	\$7
Greater than or equal to 10% but less than 50%	3	18	3	1
Greater than 50%	0	0	0	0
Total private equity	27	52	(4 )	8
Mezzanine debt:				
Less than 10%	11	10	0	2
Greater than or equal to 10% but less than 50%	3	4	0	0
Greater than 50%	1	0	0	0
Total mezzanine debt	15	14	0	2
Real estate:				
Less than 10%	11	36	5	(2 )
Greater than or equal to 10% but less than 50%	3	4	1	0
Greater than 50%	2	7	0	1
Total real estate	16	47	6	(1 )
Total limited partnerships – Indemnity	58	\$113	\$2	\$9
Exchange				
Private equity:				
Less than 10%	42	\$344	\$(12 )	\$43
Greater than or equal to 10% but less than 50%	3	74	13	3
Greater than 50%	0	0	0	0
Total private equity	45	418	1	46
Mezzanine debt:				
Less than 10%	21	120	0	16
Greater than or equal to 10% but less than 50%	4	23	(3 )	3
Greater than 50%	3	27	0	3
Total mezzanine debt	28	170	(3 )	22
Real estate:				
Less than 10%	22	207	18	7



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Greater than or equal to 10% but less than 50%	5	44	6	2
Greater than 50%	2	27	(17	) 20
Total real estate	29	278	7	29
Total limited partnerships – Exchange	102	\$866	\$5	\$97
Total limited partnerships – Erie Insurance Group		\$979	\$7	\$106

Per the limited partnership financial statements, total partnership assets were \$45 billion and total partnership liabilities were \$4 billion at December 31, 2014 (as recorded in the September 30, 2014 limited partnership financial statements). For the twelve month period comparable to that presented in the preceding table (fourth quarter of 2013 and first three quarters of 2014), total partnership valuation adjustment losses were \$1 billion and total partnership net income was \$7 billion.

Table of Contents

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

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

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

See also Note 19, "Commitments and Contingencies," for investment commitments related to limited partnerships.

Table of Contents

## Note 8. Capitalized Software Development Costs

We capitalize computer software costs developed or obtained for internal use. Capitalized costs include internal and external labor and overhead. Capitalization ceases and amortization begins no later than the point at which a computer software project is complete and ready for its intended use. Capitalized software costs are amortized over the estimated useful life of the software.

The following table outlines the total capitalized software development costs subject to amortization and the related amortization expense:

(in millions)	Indemnity Shareholder Interest		
	Years ended December 31,		
	2014	2013	2012
Gross carrying amount	\$68	\$58	\$54
Accumulated amortization	(25	) (18	) (11
Net carrying amount	\$43	\$40	\$43
Amortization expense	\$7	\$7	\$6

Included in the gross carrying amount above are costs not yet subject to amortization of \$11 million, \$9 million and \$7 million in 2014, 2013 and 2012, respectively.

The following table outlines the estimated future amortization expense related to capitalized software development costs as of December 31, 2014:

(in millions)	Indemnity Shareholder Interest
Year ending	Estimated
December 31,	amortization expense
2015	\$8
2016	8
2017	7
2018	4
2019	2

The Exchange had capitalized software development costs in-process of \$4 million at December 31, 2014, not yet subject to amortization.

## Note 9. Bank Line of Credit

As of December 31, 2014, Indemnity has access to a \$100 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on November 3, 2018. As of December 31, 2014, a total of \$98 million remains available under the facility due to \$2 million outstanding letters of credit, which reduce the availability for letters of credit to \$23 million. Indemnity had no borrowings outstanding on its line of credit as of December 31, 2014. Bonds with a fair value of \$114 million were pledged as collateral on the line at December 31, 2014.

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As of December 31, 2014, the Exchange has access to a \$300 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on October 25, 2018. As of December 31, 2014, a total of \$299 million remains available under the facility due to \$1 million outstanding letters of credit, which reduce the availability for letters of credit to \$24 million. The Exchange had no borrowings outstanding on its line of credit as of December 31, 2014. Bonds with a fair value of \$328 million were pledged as collateral on the line at December 31, 2014.

Both lines have securities pledged as collateral that have no trading restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position as of December 31, 2014. The banks require compliance with certain covenants, which include leverage ratios for Indemnity's line of credit and statutory surplus and risk based capital ratios for the Exchange's line of credit. We are in compliance with all covenants at December 31, 2014.

100

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Table of Contents

## Note 10. Income Taxes

The provision for income taxes consists of the following for the years ended December 31:

(in millions)	Erie Insurance Group		
	2014	2013	2012
Indemnity			
Current income tax expense	\$87	\$89	\$84
Deferred income tax benefit	(4	) (5	) (3
Provision for income taxes – Indemnity	83	84	81
Exchange			
Current income tax expense	166	232	78
Deferred income tax expense	8	203	121
Provision for income taxes – Exchange	174	435	199
Provision for income taxes – Erie Insurance Group	\$257	\$519	\$280

The deferred income tax expense in 2013 and 2012 was primarily driven by unrealized gains on investments.

A reconciliation of the provision for income taxes, with amounts determined by applying the statutory federal income tax rates to pre-tax income, is as follows for the years ended December 31:

(in millions)	Erie Insurance Group		
	2014	2013	2012
Indemnity			
Income tax at statutory rates	\$88	\$86	\$84
Other, net	(5	) (2	) (3
Provision for income taxes – Indemnity	83	84	81
Exchange			
Income tax at statutory rates	202	462	230
Tax-exempt interest	(13	) (13	) (13
Dividends received deduction	(15	) (14	) (14
Other, net	0	0	(4
Provision for income taxes – Exchange	174	435	199
Provision for income taxes – Erie Insurance Group	\$257	\$519	\$280

Table of Contents

Temporary differences and carry-forwards, which give rise to consolidated deferred tax assets and liabilities, are as follows for the years ended December 31:

(in millions)	Erie Insurance Group		
	2014	2013	
Indemnity			
Deferred tax assets:			
Other employee benefits	\$18	\$14	
Pension and other postretirement benefits	55	24	
Other	4	3	
Total deferred tax assets	77	41	
Deferred tax liabilities:			
Unrealized gains on investments	4	3	
Limited partnerships	11	11	
Depreciation	17	17	
Prepaid expenses	8	7	
Other	0	1	
Total deferred tax liabilities	40	39	
Net deferred income tax asset – Indemnity	\$37	\$2	
Exchange			
Deferred tax assets:			
Loss reserve discount	\$55	\$63	
Unearned premiums	214	197	
Write-downs of impaired securities	8	18	
Other	25	19	
Total deferred tax assets	302	297	
Deferred tax liabilities:			
Deferred policy acquisition costs	191	185	
Unrealized gains on investments	510	489	
Limited partnerships	67	61	
Other	24	12	
Total deferred tax liabilities	792	747	
Net deferred income tax liability – Exchange	\$(490	) \$(450	)
Net deferred income tax liability – Erie Insurance Group	\$(453	) \$(448	)

Neither the Indemnity nor the Exchange had a valuation allowance recorded at December 31, 2014 or December 31, 2013. The IRS has examined our tax filings through tax year ended 2009 and is currently examining our federal income tax returns for 2010, 2011 and 2012.

Indemnity is the attorney-in-fact for the subscribers (policyholders) at the Exchange, a reciprocal insurance exchange. In that capacity, Indemnity provides all services and facilities necessary to conduct the Exchange's insurance business. Indemnity and the Exchange together constitute a single insurance business. Indemnity is not subject to state corporate income or franchise taxes in states where the Exchange conducts its business and the states collect premium tax in lieu of corporate income or franchise tax, as a result of the Exchange's remittance of premium taxes in those states.





Table of Contents

## Note 11. Deferred Policy Acquisition Costs

The following table summarizes the components of the Property and Casualty Group's and EFL's deferred policy acquisition costs assets for the years ended December 31:

(in millions)	Erie Insurance Group	
	2014	2013
Property and Casualty Group		
Deferred policy acquisition costs asset, beginning of year	\$402	\$364
Capitalized deferred policy acquisition costs	874	801
Amortized deferred policy acquisition costs	(836	) (763
Deferred policy acquisition costs asset, end of year – Property and Casualty Group	\$440	\$402
Erie Family Life Insurance Company		
Deferred policy acquisition costs asset, beginning of year	\$164	\$140
Capitalized deferred policy acquisition costs	18	15
Amortized deferred policy acquisition costs	(13	) (15
Change in shadow deferred policy acquisition costs	(14	) 24
Deferred policy acquisition costs asset, end of year – EFL	\$155	\$164
Deferred policy acquisition costs asset, end of year – Erie Insurance Group	\$595	\$566

## Note 12. Property and Casualty Unpaid Losses and Loss Expenses

The following table provides a reconciliation of our property and casualty beginning and ending loss and loss expense reserve balances for the years ended December 31:

(in millions)	Property and Casualty Group		
	2014	2013	2012
Losses and loss expense reserves, beginning of year – Gross	\$3,747	\$3,598	\$3,499
Less: reinsurance recoverable, beginning of year	156	154	151
Losses and loss expense reserves, beginning of year – Net	3,591	3,444	3,348
Incurring losses and loss expenses related to:			
Current accident year	3,969	3,379	3,494
Prior accident years	(116	) (19	) (115
Total incurred losses and loss expenses	3,853	3,360	3,379
Paid losses and loss expenses related to:			
Current accident year	2,513	2,007	2,166
Prior accident years	1,220	1,206	1,117
Total paid losses and loss expenses	3,733	3,213	3,283
Losses and loss expense reserves, end of year – Net	3,711	3,591	3,444
Add: reinsurance recoverable, end of year	142	156	154
Losses and loss expense reserves, end of year – Gross	\$3,853	\$3,747	\$3,598

Loss reserves are set at ultimate cost, except for workers compensation loss reserves, which have been discounted using an interest rate of 2.5% for all periods presented. This discounting reduced unpaid losses and loss expenses by \$89 million,

\$85 million and \$85 million at December 31, 2014, 2013 and 2012, respectively. The reserves for losses and loss expenses are reported net of receivables for salvage and subrogation, which totaled \$171 million, \$149 million and

\$150 million at December 31, 2014, 2013 and 2012, respectively.

In 2014, the favorable development on prior accident year direct loss reserves was primarily related to better than expected severity trends in personal auto, commercial multi-peril, and workers compensation lines of business combined with changes on individual claims, primarily workers compensation massive injury lifetime medical claims, personal auto massive injury lifetime medical claims, and the settlement of a commercial multi-peril individual large claim. Favorable development on prior accident year loss reserves was minimal in 2013. In 2012, the favorable development on prior accident year direct loss reserves was primarily the result of improved claims frequency and severity trends combined with the closing of several large claims in our homeowners, commercial multi-peril, and commercial auto lines of business, offset somewhat by adverse development in our workers compensation line of business as a result of increased severity trends.

103

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Table of Contents

## Note 13. Life Policy and Deposit Contract Reserves

The following table provides the components of our life policy and deposit contract liability balances for the years ended December 31:

(in millions)	Erie Family Life Insurance Company		
	2014	2013	2012
Deferred annuities	\$1,145	\$1,135	\$1,136
Ordinary/traditional life	374	343	313
Universal life	283	260	242
Other	10	20	17
Life policy and deposit contract reserves	\$1,812	\$1,758	\$1,708

The reinsurance credit related to life policy and deposit contract reserves was \$146 million, \$134 million and \$122 million at December 31, 2014, 2013 and 2012 respectively, and is presented in other assets in the Consolidated Statements of Financial Position.

## Note 14. Reinsurance

Members of the Property and Casualty Group participate in an intercompany reinsurance pooling agreement. Under the pooling agreement, all insurance business of the Property and Casualty Group is pooled in the Exchange. EIC and ENY share in the underwriting results of the reinsurance pool through retrocession. Since 1995, the Board of Directors has set the allocation of the pooled underwriting results at 5.0% participation for EIC, 0.5% participation for ENY, and 94.5% participation for the Exchange. The purpose of the pooling agreement is to spread the risks of the members of the Property and Casualty Group collectively across the different lines of business and geographic regions in which each operates. This agreement may be terminated by any party as of the end of any calendar year by providing not less than 365 days advance written notice. Intercompany pooling accounts are settled in cash within 30 days after the end of each quarterly accounting period.

Reinsurance contracts do not relieve the Property and Casualty Group or EFL from the primary obligations to policyholders. A contingent liability exists with respect to reinsurance recoverables in the event reinsurers are unable to meet their obligations under the reinsurance agreements.

The Property and Casualty Group maintains several property catastrophe reinsurance treaties with nonaffiliated reinsurers to mitigate future potential catastrophe loss exposures. During 2014, a first treaty provided coverage of up to 30% of a loss of \$100 million in excess of the Property and Casualty Group's loss retention of \$300 million per occurrence, a second treaty provided coverage of up to 90% of a loss of \$500 million in excess of \$400 million, a third treaty provided coverage of up to 85% of a loss of \$200 million in excess of \$900 million, and a fourth treaty provided coverage of up to 100% of a loss of \$25 million in excess of \$1.1 billion. The property catastrophe reinsurance treaties that became effective for January 1, 2015 included a first property catastrophe reinsurance treaty providing coverage of up to 35% of a loss of \$100 million in excess of the Property and Casualty Group's loss retention of \$300 million per occurrence, a second treaty providing coverage of up to 90% of a loss of \$500 million in excess of \$400 million, a third treaty providing coverage of up to 86% of a loss of \$200 million in excess of \$900 million, and a fourth treaty providing coverage of up to 100% of a loss of \$25 million in excess of \$1.1 billion. There have been no losses subject to these treaties.

In addition to the property catastrophe treaties, the Property and Casualty Group also cedes certain individual lines of business to unaffiliated reinsurers and cedes certain individual risks on a facultative basis. The Property and Casualty Group maintains several 100% quota share agreements with A.M. Best A++ rated Hartford Steam Boiler Inspection and Insurance Company. These agreements cede 100% of the covered insurance risk relating to the reinsured portions of the equipment breakdown, employment practices liability, and identity recovery lines of business. During 2014, the Property and Casualty Group ceded a total of \$24 million in premium to Hartford Steam Boiler. The cessions for 2013 and 2012 were \$21 million and \$17 million respectively.

EFL maintains several reinsurance treaties with nonaffiliated life reinsurance companies in order to reduce claims volatility. EFL had direct life insurance in force totaling \$47 billion and \$45 billion at December 31, 2014 and 2013, respectively. Of these amounts, EFL ceded \$21 billion of life insurance in force at December 31, 2014 and 2013. The largest amount of in force life insurance ceded to one reinsurer totaled \$10 billion at December 31, 2014 and 2013.

Table of Contents

The following tables summarize the direct insurance and reinsurance for our property and casualty and life insurance activities, respectively, for the years ended December 31:

(in millions)

	Erie Insurance Group		
	2014	2013	2012
Property and casualty insurance:			
Premiums written:			
Direct	\$5,514	\$5,076	\$4,631
Assumed	30	26	21
Ceded	(57	) (57	) (49
Premiums written, net	5,487	5,045	4,603
Premiums earned:			
Direct	5,286	4,850	4,449
Assumed	30	24	21
Ceded	(56	) (54	) (48
Premiums earned, net	5,260	4,820	4,422
Insurance losses and loss expenses:			
Direct	3,834	3,366	3,382
Assumed	25	7	10
Ceded	(6	) (13	) (13
Insurance losses and loss expenses, net	\$3,853	\$3,360	\$3,379
Life insurance:			
Premiums earned:			
Direct	\$125	\$119	\$113
Ceded	(41	) (41	) (42
Premiums earned, net	84	78	71
Insurance losses and loss expenses:			
Direct	120	124	120
Ceded	(15	) (17	) (19
Insurance losses and loss expenses, net	\$105	\$107	\$101
Total:			
Premiums earned:			
Property and casualty	\$5,260	\$4,820	\$4,422
Life	84	78	71
Premiums earned, net	5,344	4,898	4,493
Insurance losses and loss expenses:			
Property and casualty	3,853	3,360	3,379
Life	105	107	101
Insurance losses and loss expenses, net	\$3,958	\$3,467	\$3,480

105

Table of Contents

## Note 15. Postretirement Benefits

## Pension plans

Our pension plans consist of a noncontributory defined benefit pension plan covering substantially all employees and an unfunded supplemental employee retirement plan ("SERP") for certain members of executive and senior management of the Erie Insurance Group. The pension plans provide benefits to covered individuals satisfying certain age and service requirements. The defined benefit pension plan and SERP each provide benefits through a final average earnings formula.

Although Indemnity is the sponsor of these postretirement plans and records the funded status of these plans, the Exchange and EFL reimburse Indemnity for approximately 56% of the annual benefit expense of these plans, which represents pension benefits for Indemnity employees performing claims and EFL functions. For our funded pension plan, amounts are settled in cash for the portion of pension costs allocated to the Exchange and EFL, respectively. For our unfunded plans, we pay the obligations when due and amounts are settled in cash between entities when there is a payout.

Prior to 2003, the employee pension plan purchased annuities from EFL for certain plan participants that were receiving benefit payments under the pension plan. These are nonparticipating annuity contracts under which EFL has unconditionally contracted to provide specified benefits to beneficiaries; however, the pension plan remains the primary obligor to the beneficiaries. A contingent liability of \$25 million at December 31, 2014, exists in the event EFL does not honor the annuity contracts.

## Cost of pension plans

Pension plan cost includes the following components:

(in millions)	Erie Insurance Group		
	2014	2013	2012
Service cost for benefits earned	\$23	\$27	\$21
Interest cost on benefit obligation	28	26	24
Expected return on plan assets	(32)	(31)	(27)
Prior service cost amortization	1	1	1
Net actuarial loss amortization	6	15	11
Pension plan cost <sup>(1)</sup>	\$26	\$38	\$30

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

## Actuarial assumptions

The following table describes the assumptions at December 31 used to measure the year-end obligations and the net periodic benefit costs for the subsequent year:

	Erie Insurance Group			
	2014	2013	2012	2011
Employee pension plan:				
Discount rate	4.17	% 5.11	% 4.19	% 4.99
Expected return on assets	7.00	7.50	7.50	8.00
Compensation increases <sup>(1)</sup>	3.32	4.15	4.15	4.15
SERP:				

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Discount rate – pre-retirement/post-retirement	4.17/3.67	5.11/4.61	4.19/3.69	4.99/4.49
Rate of compensation increase	5.00	6.00	6.00	6.00

(1) The rate of compensation increase for the employee plan is age-graded. An equivalent single compensation increase rate of 3.32% in 2014 and 4.15% in 2013 and 2012 would produce similar results.

The economic assumptions that have the most impact on the postretirement benefits expense are the discount rate and the long-term rate of return on plan assets. The discount rate assumption used to determine the benefit obligation for 2014 was based upon a yield curve developed from corporate bond yield information. The same methodology was employed to develop the discount rates used to determine the benefit obligation for 2013 and 2012.

Table of Contents

The pension plan's expected long-term rate of return represents the average rate of return to be earned on plan assets over the period the benefits included in the benefit obligation are to be paid. To determine the expected long-term rate of return assumption, we utilized models based upon rigorous historical analysis and forward-looking views of the financial markets based upon key factors such as historical returns for the asset class' applicable indices, the correlations of the asset classes under various market conditions and consensus views on future real economic growth and inflation. The expected future return for each asset class is then combined by considering correlations between asset classes and the volatilities of each asset class to produce a reasonable range of asset return results within which our expected long-term rate of return assumption falls.

Projected benefit obligations increased \$180 million at December 31, 2014 compared to December 31, 2013. The largest factor driving the increase was the change in the discount rate. Also contributing to this increase was the adoption of the newly issued mortality tables, which was partially offset by the decrease related to other plan assumptions that were updated to reflect our most recent actual experience.

## Funding policy/funded status

Our funding policy is generally to contribute an amount equal to the greater of the target normal cost for the plan year or the amount necessary to fund the plan to 100% plus interest to the date the contribution is made. Employer contributions of

\$17 million were made to the defined benefit pension plan in January 2015. The following table sets forth the funded status of the pension plans and the amounts recognized in the Consolidated Statements of Financial Position at December 31:

(in millions)	Erie Insurance Group	
	2014	2013
Funded status at end of year, included in Indemnity Other Liabilities	\$ (189 )	\$ (95 )
Pension liabilities – due within one year	\$ 0	\$ (1 )
Pension liabilities – due after one year	(189 )	(94 )
Net amount recognized	\$ (189 )	\$ (95 )

## Benefit obligations

Benefit obligations are described in the following tables. Accumulated and projected benefit obligations represent the obligations of a pension plan for past service as of the measurement date. The accumulated benefit obligation is the present value of pension benefits earned as of the measurement date based on employee service and compensation prior to that date. It differs from the projected benefit obligation in that the accumulated benefit obligation includes no assumptions to reflect expected future compensation. The following table sets forth a reconciliation of beginning and ending balances of the projected benefit obligation, as well as the accumulated benefit obligation at December 31:

(in millions)	Erie Insurance Group	
	2014	2013
Projected benefit obligation, beginning of year	\$ 557	\$ 612
Service cost for benefits earned	23	27
Interest cost on benefit obligation	28	26
Plan amendments	0	1
Actuarial loss (gain)	140	(98 )
Benefits paid	(11 )	(11 )
Projected benefit obligation, end of year	\$ 737	\$ 557
Accumulated benefit obligation, end of year	\$ 583	\$ 425



The following table describes plans with assets less than accumulated benefit obligation at December 31:

(in millions)	Erie Insurance Group	
	2014	2013
Projected benefit obligation	\$737	\$557
Accumulated benefit obligation	583	425
Plan assets	548	462

Both the defined benefit pension plan and the SERP had accumulated benefit obligations in excess of plan assets at December 31, 2014. The SERP had an accumulated benefit obligation in excess of plan assets at December 31, 2013.

107

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Table of Contents

## Pension assets

The following table sets forth a reconciliation of beginning and ending balances of the fair value of plan assets at December 31:

(in millions)	Erie Insurance Group	
	2014	2013
Fair value of plan assets, beginning of year	\$462	\$411
Actual gain on plan assets	73	43
Employer contributions	24	19
Benefits paid	(11	) (11
Fair value of plan assets, end of year	\$548	\$462

## Accumulated other comprehensive income

Net actuarial loss and prior service cost included in accumulated other comprehensive income that were not yet recognized as components of net benefit costs were as follows:

(in millions)	Erie Insurance Group	
	2014	2013
Net actuarial loss	\$187	\$95
Prior service cost	5	6
Net amount not yet recognized	\$192	\$101

The estimated net actuarial loss and prior service cost for the pension plans that will be amortized from accumulated other comprehensive income into pension cost during 2015 is \$13 million and \$1 million, respectively.

## Other comprehensive income

Amounts recognized in other comprehensive income for pension plans:

(in millions)	Erie Insurance Group	
	2014	2013
Net actuarial loss (gain) arising during the year	\$98	\$(110)
Amortization of net actuarial loss	(6	) (15
Amortization of prior service cost	(1	) (1
Amendments	0	(1) 1
Total recognized in other comprehensive income	\$91	\$(125)

(1) The charges recognized as amendments were the result of factoring in the prior service cost for four new plan participants in 2014.

(2) The charges recognized as amendments were the result of factoring in the prior service cost for four new plan participants in 2013.

## Asset allocation

The employee pension plan utilizes a return seeking and a liability asset matching allocation strategy. It is based upon the understanding that 1) equity investments are expected to outperform debt investments over the long-term, 2) the

potential volatility of short-term returns from equities is acceptable in exchange for the larger expected long-term returns, and 3) a portfolio structured across investment styles and markets (both domestic and foreign) reduces volatility. As a result, the employee pension plan's investment portfolio utilizes a broadly diversified asset allocation across domestic and foreign equity and debt markets. The investment portfolio is composed of commingled pools that are dedicated exclusively to the management of employee benefit plan assets.

Table of Contents

The target and actual asset allocations for the portfolio are as follows for the years ended December 31:

Asset allocation:	Erie Insurance Group		Actual asset allocation 2014	Actual asset allocation 2013
	Target asset allocation 2014	Target asset allocation 2013		
Equity securities:				
U.S. equity securities	35	% <sup>(1)</sup> 35	% 37	% 36
Non-U.S. equity securities	20	(2) 20	19	20
Total equity securities	55	55	56	56
Debt securities	44	(3) 44	43	43
Other	1	(4) 1	1	1
Total	100	% 100	% 100	% 100

U.S. equity securities – 22% seek to achieve excess returns relative to the Russell 2000 Index, while 30% seek to (1) achieve excess returns relative to the S&P 500. The remaining 48% of the allocation to U.S. equity securities are comprised of equity index funds that track the S&P 500.

Non-U.S. equity securities – 11% are allocated to international small cap investments, while another 11% are (2) allocated to international emerging market investments. The remaining 78% of the Non-U.S. equity securities are allocated to investments seeking to achieve excess returns relative to an international market index.

Debt securities – 44% are allocated to long U.S. Treasury Strips, 44% are allocated to U.S. corporate bonds with an (3) emphasis on long duration bonds rated A or better, while the remaining 12% are allocated to floating rate high income leverage loans.

(4) Institutional money market fund.

The following tables represent the fair value measurements for the pension plan assets by major category and level of input:

(in millions)	Erie Insurance Group At December 31, 2014			
	Total	Quoted prices in active markets for identical assets Level 1	Significant observable inputs Level 2	Significant unobservable inputs Level 3
Equity securities:				
U.S. equity securities	\$202	\$0	\$202	\$0
Non-U.S. equity securities	106	0	106	0
Total equity securities	308	0	308	0
Debt securities	237	0	237	0
Other	3	3	0	0
Total	\$548	\$3	\$545	\$0

Erie Insurance Group  
At December 31, 2013

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(in millions)	Fair value measurements of plan assets using:			
	Total	Quoted prices in active markets for identical assets Level 1	Significant observable inputs Level 2	Significant unobservable inputs Level 3
Equity securities:				
U.S. equity securities	\$165	\$0	\$165	\$0
Non-U.S. equity securities	94	0	94	0
Total equity securities	259	0	259	0
Debt securities	199	0	199	0
Other	4	4	0	0
Total	\$462	\$4	\$458	\$0

Estimates of fair values of the pension plan assets are obtained primarily from our trustee and custodian of our pension plan. Our Level 1 category includes a money market fund that is a mutual fund for which the fair value is determined using an exchange traded price provided by the trustee and custodian. Our Level 2 category includes commingled pools. Estimates of

Table of Contents

fair values for securities held by our commingled pools are obtained primarily from the trustee and custodian. The methodologies used by the trustee and custodian that support a financial instrument Level 2 classification include multiple verifiable, observable inputs including benchmark yields, reported trades, broker/dealer quotes, issuers spreads, two-sided markets, benchmark securities, bids, offers, and reference data.

## Estimated future benefit payments

The following table sets forth amounts of benefits expected to be paid over the next 10 years from our pension and other postretirement plans as of December 31:

(in millions)	Erie Insurance Group
Year ending	Expected future
December 31,	benefit payments
2015	\$13
2016	14
2017	16
2018	19
2019	21
2020 - 2024	150

## Retiree health benefit plan

The retiree health benefit plan was terminated in 2006. We continue to provide retiree health benefits only to employees who met certain age and service requirements on or before July 1, 2010. The accumulated benefit obligation and net periodic benefit cost of this plan were not material to our consolidated financial statements.

## Employee savings plan

All full-time and regular part-time employees are eligible to participate in a traditional qualified 401(k) or a Roth 401(k) savings plan. We match 100% of the participant contributions up to 3% of compensation and 50% of participant contributions over 3% and up to 5% of compensation. Matching contributions paid to the plan were \$11 million in 2014,

\$10 million in 2013, and \$9 million in 2012. Employees are permitted to invest the employer-matching contributions in our Class A common stock. Employees, other than executive and senior officers, may sell the shares at any time without restriction; sales by executive and senior officers are subject to restrictions imposed by our insider trading policies and the federal securities laws. The plan acquires shares in the open market necessary to meet the obligations of the plan. Plan participants held 0.2 million shares of our Class A common stock at December 31, 2014 and 2013.

Table of Contents

Note 16. Incentive and Deferred Compensation Plans

Annual incentive plan

Our annual incentive plan is a bonus plan that pays cash to our executive and senior vice presidents annually. The cash awards are based on attainment of corporate and individual performance measures, which can include various financial measures. The plan includes a funding qualifier which considers Indemnity's financial results, based on operating income, before a payout can be made to plan participants. If the funding qualifier is met, plan participants are eligible to receive the incentive based upon specific performance measures. The measures are established at the beginning of each year by the Executive Compensation and Development Committee of our Board of Directors ("ECDC"), with ultimate approval by the full Board of Directors. For 2014 and 2013, the performance measures primarily included the Property and Casualty Group's direct written premium and statutory combined ratio.

Long-term incentive plan

Our long-term incentive plan ("LTIP") is a performance based incentive plan designed to reward executive and senior vice presidents who can have a significant impact on our long-term performance and to further align the interests of such employees with those of our shareholders. The LTIP permits grants of performance shares or units, to be satisfied with shares of our Class A common stock or cash payment as determined by the ECDC. The ECDC determines the form of the award to be granted at the beginning of each performance period, which is generally a three-year period. The number of shares of the Company's common stock authorized for grant under the LTIP is 1.5 million shares, with no one person able to receive more than 250,000 shares or the equivalent of \$5 million during any one performance period. We repurchase our Class A common stock on the open market to settle plan awards. We do not issue new shares of common stock to settle plan awards. LTIP awards are considered vested at the end of each applicable performance period.

The LTIP provides the recipient the right to earn performance shares or units based on the level of achievement of performance goals as defined by us. Performance measures and a peer group of property and casualty companies to be used for comparison are determined by the ECDC. The performance measures for the 2014, 2013 and 2012 awards were the reported combined ratio, growth in direct written premiums and return on invested assets over a three-year performance period as compared to the results of the peer group over the same period. Because the award is based upon a comparison to results of a peer group over a three-year period, the award accrual is based upon estimates of probable results for the remaining performance period. This estimate is subject to variability if our results or the results of the peer group are substantially different than the results we project.

The fair value of LTIP awards is measured at each reporting date at the current share price of our Class A common stock. A liability is recorded and compensation expense is recognized ratably over the performance period.

At December 31, 2014, the plan awards for the 2012-2014 performance period were fully vested. Distributions will be made in 2015 once peer group financial information becomes available. The estimated plan award based upon the peer group information as of September 30, 2014 is \$9 million. At December 31, 2013, the awards for the 2011-2013 period were fully vested. The average share price on the date the shares were delivered to plan participants for the 2011-2013 performance period was \$75.36. The plan award of 54,371 shares of Class A common stock with a market value of approximately \$4 million was paid in June 2014. At December 31, 2012, the awards for the 2010-2012 performance period were fully vested and the related cash award of \$5 million was paid in May 2013.

Earned compensation costs are allocated to related entities and reimbursed to Indemnity in cash once the payout is made. The total compensation cost charged to operations related to these LTIP awards was \$13 million in 2014, \$8 million in 2013, and \$5 million in 2012. The related tax benefits recognized in income were \$4 million in 2014, \$3 million in 2013, and \$2 million in 2012.

At December 31, 2014, there was \$11 million of total unrecognized compensation cost for non-vested LTIP awards related to open performance periods. Unrecognized compensation is expected to be recognized over a period of two years.

Equity compensation plan

Effective April 17, 2013, our Board of Directors approved an equity compensation plan (“ECP”) designed to reward key employees, as determined by the ECDC or the chief executive officer, who can have a significant impact on our long-term performance and to further align the interests of such employees with those of our shareholders. The ECP permits grants of restricted shares, restricted share units and other share based awards, to be satisfied with shares of our Class A common stock or cash. The ECDC determines the form of the award to be granted at the beginning of each performance period. The number of shares of Indemnity’s Class A common stock authorized for grant under the ECP is 100,000 shares, with no one person able to

111

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Table of Contents

receive more than 5,000 shares in a calendar year. Share awards are settled through the repurchase of our Class A common stock on the open market. We do not issue new shares of common stock to satisfy plan awards. Restricted share awards may be entitled to receive dividends payable during the performance period, or, if subject to performance goals, to receive dividend equivalents payable upon vesting. Dividend equivalents may provide for the crediting of interest or hypothetical reinvestment experience payable after expiration of the performance period. Vesting conditions are determined at the time the award is granted and may include continuation of employment for a specific period, satisfaction of performance goals and the defined performance period, and the satisfaction of any other terms and conditions as determined to be appropriate. The plan is to remain in effect until December 31, 2022, unless earlier amended or terminated by our Board of Directors. In 2014, 8,750 restricted stock units were granted under the plan. The total compensation charged to operations related to these ECP awards was \$0.3 million in 2014. Unrecognized compensation expense of \$1 million is expected to be recognized over a period of four years. There were no awards granted during 2013.

## Deferred compensation plans

Our deferred compensation plans are arrangements for our executive and senior vice presidents and outside directors that allows participants to elect to defer receipt of a portion of their compensation until a later date. Employer 401(k) matching contributions that are in excess of the annual contribution or compensation limits are also credited to the participant accounts for those who elected to defer receipt of some portion of their base salary. The deferred compensation plan for our outside directors allows participants to defer receipt of a portion of their director and meeting fees until a later date. Employees or outside directors participating in the respective plans select hypothetical investment funds for their deferrals which are credited with the hypothetical returns generated.

The following summarizes the incentive and deferred compensation plans for the years ended December 31:

(in millions)	Erie Insurance Group		
	2014	2013	2012
Awards, employer match, and hypothetical earnings by plan:			
Annual incentive plan awards	\$6	\$8	\$5
Long-term incentive plan awards	13	8	5
Deferred compensation plans, employer match, and hypothetical earnings	3	2	1
Total plan awards and earnings	22	18	11
Total plan awards paid	(15 )	(10 )	(8 )
Compensation deferred under the plans	0	0	0
Distributions from the deferred compensation plans	(1 )	(1 )	(1 )
Gross incentive plan and deferred compensation liabilities at end of period	\$39	\$33	\$26

## Stock compensation plan for outside directors

We have a stock compensation plan for our outside directors to further align the interests of directors with those of our shareholders that provides for a portion of the directors' annual compensation in shares of our Class A common stock. Each director vests in the grant 25% every three months over the course of a year. Dividends paid by us are reinvested into each directors' account as additional share credits which vest immediately. Upon ending board service, directors are paid shares of our Class A common stock equal to the number of share credits in their deferred stock account. Our practice is to repurchase shares of our Class A common stock in the open market to satisfy these awards. We do not issue new shares of common stock to directors. The annual charge related to these awards totaled \$2 million, \$1 million and \$0.5 million in 2014, 2013 and 2012, respectively.



Table of Contents

Note 17. Indemnity Capital Stock

Class A and B common stock

We have two classes of common stock: Class A which has a dividend preference and Class B which has voting power and a conversion right. Each share of Class A common stock outstanding at the time of the declaration of any dividend upon shares of Class B common stock shall be entitled to a dividend payable at the same time, at the same record date, and in an amount at least equal to 2/3 of 1.0% of any dividend declared on each share of Class B common stock. We may declare and pay a dividend in respect to Class A common stock without any requirement that any dividend be declared and paid in respect to Class B common stock. Sole shareholder voting power is vested in Class B common stock except insofar as any applicable law shall permit Class A common shareholders to vote as a class in regards to any changes in the rights, preferences, and privileges attaching to Class A common stock. Holders of Class B shares may, at their option, convert their shares into Class A shares at the rate of 2,400 Class A shares per Class B share. There were no shares of Class B common stock converted into Class A common stock in 2014 and 2013. In 2012, four shares of Class B common stock were converted into Class A common stock. There is no provision for conversion of Class A shares to Class B shares, and, Class B shares surrendered for conversion cannot be reissued.

Stock repurchases

A stock repurchase program was authorized for our outstanding Class A nonvoting common stock beginning January 1, 2004. Treasury shares are recorded in the Consolidated Statements of Financial Position at total cost based upon trade date. Shares repurchased under this program, based upon trade date, totaled 272,057 at a total cost of \$19.2 million during 2014, and 431,556 shares at a total cost of \$31.2 million during 2013. 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. We had approximately \$18 million of repurchase authority remaining under this program at December 31, 2014, based upon trade date.

In 2014, we repurchased 64,398 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$4.9 million. Of this amount, we repurchased 2,800 shares of our outstanding Class A nonvoting common stock at a total cost of \$201,411, or \$71.93 per share, for the vesting of stock-based awards for executive management. These shares were delivered to executive management in January 2014. In May 2014, we repurchased 7,227 shares of our outstanding Class A nonvoting common stock at a total cost of \$552,503, or \$76.45 per share, for the vesting of stock-based awards for a former outside director. These shares were delivered in May 2014. In May and June 2014, we repurchased 54,371 shares of our outstanding Class A nonvoting common stock at a total cost of \$4,143,544, or \$76.21 per share, for the vesting of stock-based awards in conjunction with our long-term incentive plan. These shares were delivered to plan participants in June 2014.

In 2013, we also repurchased 3,477 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$255,454. Of this amount, 444 and 3,033 shares were purchased in January 2013 and July 2013, respectively, for \$30,927, or \$69.65 per share, and \$224,527, or \$74.03 per share, respectively, to settle payments due to a retired executive under our long-term incentive plan. These shares were delivered to the plan participant in January 2013 and July 2013.

Table of Contents

## Note 18. Indemnity Accumulated Other Comprehensive Loss

Changes in Indemnity's accumulated other comprehensive loss by component attributable to the Indemnity shareholder interest is presented as follows for the year ended December 31:

(in millions)	Indemnity Shareholder Interest		Total
	Unrealized holding gains (losses) on available-for-sale securities	Postretirement plans	
Balance at December 31, 2012	\$13	\$(146)	\$(133)
Other comprehensive (loss) income before reclassifications, net of tax	(6)	71	65
Amounts reclassified from accumulated other comprehensive income (loss), net of tax <sup>(1)</sup>	(1)	10	9
Net current period other comprehensive (loss) income, net of tax	(7)	81	74
Balance at December 31, 2013	\$6	\$(65)	\$(59)
Other comprehensive income (loss) before reclassifications, net of tax	2	(65)	(63)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax <sup>(1)</sup>	(1)	5	4
Net current period other comprehensive income (loss), net of tax	1	(60)	(59)
Balance at December 31, 2014	\$7	\$(125)	\$(118)

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

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

(in millions)	Erie Insurance Group Amounts reclassified from accumulated other comprehensive income (loss) <sup>(1)</sup>	
	2014	2013
Unrealized holding gains (losses) on available-for-sale securities:		
Net realized investment gains	\$32	\$3
Net impairment losses recognized in earnings	(4)	(13)
Income (loss) from operations before income taxes and noncontrolling interest	28	(10)
Provision for income taxes	10	(3)
Net income (loss)	18	(7)
Less: Net income (loss) attributable to noncontrolling interest in consolidated entity – Exchange	17	(8)
Net income attributable to Indemnity	\$1	\$1
Amortization of postretirement plan items <sup>(2)</sup> :		
Prior service cost	\$(1)	\$(1)
Net actuarial loss	(6)	(15)
Loss from operations before income taxes and noncontrolling interest	(7)	(16)

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Provision for income taxes	(2	)	(6	)
Net loss	(5	)	(10	)
Less: Net loss attributable to noncontrolling interest in consolidated entity – Exchange	—		—	
Net loss attributable to Indemnity	\$(5	)	\$(10	)
Net loss attributable to Indemnity	\$(4	)	\$(9	)

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

(2) Components of accumulated other comprehensive income (loss) related to postretirement plan items are included in the computation of pension plan cost. See Note 15, "Postretirement Benefits," for additional details.

Table of Contents

Note 19. Commitments and Contingencies

Indemnity has contractual commitments to invest up to \$24 million related to its limited partnership investments at December 31, 2014. These commitments are split between private equity securities of \$10 million, mezzanine debt securities of \$9 million, and real estate activities of \$5 million. These commitments will be funded as required by the limited partnership agreements.

The Exchange, including EFL, has contractual commitments to invest up to \$459 million related to its limited partnership investments at December 31, 2014. These commitments are split between private equity securities of \$141 million, mezzanine debt securities of \$156 million, and real estate activities of \$162 million. These commitments will be funded as required by the limited partnership agreements.

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

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

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

In August 2012, we were notified that we would be subject to an audit of our compliance with the unclaimed property laws of a number of jurisdictions both within and outside our operating territory. The audit commenced in April 2013 and is ongoing. We continue to cooperate with the auditors, responding to several requests for information and supplying data runs, as requested. Additionally, EFL has been named in a lawsuit filed by the State Treasurer of West Virginia. The Complaint alleges that EFL has failed to comply with the West Virginia Uniform Unclaimed Property Act. EFL filed a motion to dismiss and a favorable decision was rendered in December 2013 with the Court dismissing the Complaint with prejudice. The State Treasurer appealed the dismissal of the lawsuit in January 2014. Briefing was completed in the fall of 2014. Oral argument before the West Virginia Supreme Court is scheduled for April 8, 2015.

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

Table of Contents

## Note 20. Supplementary Data on Cash Flows

## Indirect method of cash flows

A reconciliation of net income to net cash provided by operating activities as presented in the Consolidated Statements of Cash Flows is as follows for the years ended December 31:

(in millions)	Erie Insurance Group		
	2014	2013	2012
Cash flows from operating activities:			
Net income	\$573	\$1,048	\$619
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	23	21	17
Amortization of deferred policy acquisition costs	849	778	715
Deferred income tax expense	4	198	118
Realized gains and impairments on investments	(189)	(758)	(418)
Equity in earnings of limited partnerships	(113)	(161)	(131)
Net amortization of bond premium	49	36	28
Increase in deferred compensation	6	8	2
Limited partnership distributions	131	176	164
Increase in receivables, reinsurance recoverables and reserve credits	(159)	(112)	(166)
(Increase) decrease in prepaid expenses	(2)	24	63
Increase in deferred policy acquisition costs	(892)	(816)	(743)
Increase (decrease) in accounts payable and accrued expenses	98	18	(28)
Increase in accrued commissions and agent bonuses	35	28	20
Increase in loss reserves	106	148	99
Increase in future life policy benefits and claims reserves	24	34	31
Increase in unearned premiums	236	233	187
Net cash provided by operating activities	\$779	\$903	\$577

## Note 21. Statutory Information

Accounting principles used to prepare statutory financial statements differ from those used to prepare financial statements under GAAP. Prescribed statutory accounting practices (“SAP”) include state laws, regulations, and general administration rules, as well as a variety of publications from the National Association of Insurance Commissioners (“NAIC”). The statutory financial statements of the Exchange and its subsidiaries, EIC, EPC, Flagship, and EFL, are prepared in accordance with accounting practices prescribed and permitted by the Pennsylvania Insurance Department. ENY prepares its statutory financial statements in accordance with accounting practices prescribed by the New York Insurance Department.

Financial statements prepared under statutory accounting principles focus on the solvency of the insurer and generally provide a more conservative approach than under GAAP. Differences between SAP and GAAP include the valuation of investments, deferred policy acquisition cost assets, the actuarial assumptions used in life reserves, deferred tax assets, and unearned subscriber fees.

Statutory net income and capital and surplus of the Exchange and its subsidiaries as determined in accordance with SAP prescribed or permitted by insurance regulatory authorities are as follows:

SAP Net Income (Loss)	SAP Capital and Surplus
Years ended December 31,	At December 31,



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Exchange and its subsidiaries (in millions)	2014	2013	2012	2014	2013
Property and casualty insurance operations:					
Erie Insurance Exchange	\$353	\$479	\$311	\$6,817	\$6,467
Erie Insurance Company	12	17	14	312	294
Erie Insurance Company of New York	0	1	(1	) 28	22
Erie Insurance Property & Casualty Company	0	0	0	12	12
Flagship City Insurance Company	0	0	0	12	12
Life insurance operations:					
Erie Family Life Insurance Company	10	15	25	303	291

116

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Table of Contents

The minimum statutory capital and surplus requirements under Pennsylvania and New York law for the Exchange's property and casualty insurance subsidiaries amounts to \$12 million. The Exchange's property and casualty insurance subsidiaries' total statutory capital and surplus significantly exceed these minimum requirements, totaling \$364 million at December 31, 2014. The risk-based capital levels of all members of the Property and Casualty Group and EFL significantly exceed the minimum requirements. Cash and securities with a carrying value of \$15 million were deposited by the property and casualty and life entities with regulatory authorities under statutory requirements at December 31, 2014.

As prescribed by the Insurance Department of the Commonwealth of Pennsylvania, the Exchange records unearned subscriber fees (fees to the attorney-in-fact) as deductions from unearned premium reserve and charges current operations on a pro-rata basis over the periods covered by the policies. The Pennsylvania-domiciled members of the Property and Casualty Group discount workers compensation loss reserves on a non-tabular basis as prescribed by the Insurance Department of the Commonwealth of Pennsylvania. The Exchange's NAIC prepared statutory surplus, excluding the impact of the Pennsylvania prescribed practices, would have been \$6.2 billion at December 31, 2014. EIC's NAIC prepared statutory surplus, excluding the impact of the Pennsylvania prescribed practices, would have been \$307 million at December 31, 2014. EPC and Flagship record the discounting of workers compensation loss reserves on a direct basis, however, after application of the intercompany pooling arrangement, there is no impact on these financial statements.

The amount of dividends that can be paid to the Exchange without the prior approval by the Pennsylvania Insurance Commissioner by EIC, EPC, and Flagship, the Exchange's Pennsylvania-domiciled property and casualty insurance subsidiaries, is limited to not more than the greater of: (a) 10% of statutory surplus as reported in the last annual statement, or (b) net income as reported in the last annual statement. The amount of dividends that EIC's New York-domiciled property and casualty subsidiary, ENY, can pay without the prior approval by the New York Superintendent of Insurance is limited to the lesser of: (a) 10% of statutory surplus as reported in the last annual statement, or (b) 100% of adjusted net investment income during such period. In 2015, the maximum dividend payout that the Exchange could receive from its property and casualty insurance subsidiaries would be \$35 million. No dividends were paid by these property and casualty insurance subsidiaries in 2014, 2013 or 2012.

The amount of dividends that can be paid to the Exchange without the prior approval by the Pennsylvania Insurance Commissioner by EFL, a Pennsylvania-domiciled life insurer, is limited by statute to the greater of: (a) 10% of statutory surplus as shown in the last annual statement on file with the commissioner, or (b) net income as reported in the last annual statement, but shall not include pro-rata distribution of any class of the insurer's own securities. Accordingly, the maximum dividend payout that the Exchange could receive in 2015 without prior Pennsylvania Commissioner approval is \$30 million. There were no dividends paid to the Exchange in 2014, 2013 or 2012.

Table of Contents

## Note 22. Indemnity Supplemental Information

## Consolidating Statement of Financial Position

(in millions)	Erie Insurance Group At December 31, 2014			
	Indemnity shareholder interest	Exchange noncontrolling interest	Reclassifications and eliminations	Erie Insurance Group
Assets				
Investments				
Available-for-sale securities, at fair value:				
Fixed maturities	\$564	\$ 9,007	\$—	\$9,571
Equity securities	25	850	—	875
Trading securities, at fair value	—	3,223	—	3,223
Limited partnerships	113	866	—	979
Other invested assets	1	20	—	21
Total investments	703	13,966	—	14,669
Cash and cash equivalents	92	422	—	514
Premiums receivable from policyholders	—	1,281	—	1,281
Reinsurance recoverable	—	161	—	161
Deferred income tax asset	37	0	—	37
Deferred acquisition costs	—	595	—	595
Other assets	127	374	—	501
Receivables from the Exchange and other affiliates	335	—	(335	) —
Note receivable from EFL	25	—	(25	) —
Total assets	\$1,319	\$ 16,799	\$(360	) \$17,758
Liabilities				
Losses and loss expense reserves	\$—	\$ 3,853	\$—	\$3,853
Life policy and deposit contract reserves	—	1,812	—	1,812
Unearned premiums	—	2,834	—	2,834
Deferred income tax liability	—	490	—	490
Other liabilities	616	530	(360	) 786
Total liabilities	616	9,519	(360	) 9,775
Shareholders' equity and noncontrolling interest				
Total Indemnity shareholders' equity	703	—	—	703
Noncontrolling interest in consolidated entity – Exchange	—	7,280	—	7,280
Total equity	703	7,280	—	7,983
Total liabilities, shareholders' equity, and noncontrolling interest	\$1,319	\$ 16,799	\$(360	) \$17,758

Table of Contents

## Consolidating Statement of Financial Position

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

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

Management fees and expense allocation amounts due from the Exchange were \$331 million and \$296 million at December 31, 2014 and 2013, respectively. The receivable from EFL for expense allocations and interest on the surplus note totaled \$4 million at December 31, 2014 and 2013.

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. Indemnity recognized interest income on the note of \$2 million in 2014 and 2013.

Table of Contents

## Income attributable to Indemnity shareholder interest

(in millions)	Indemnity Shareholder Interest		
	Years ended December 31,		
	2014	2013	2012
Management operations:			
Management fee revenue, net	\$1,376	\$1,266	\$1,157
Service agreement revenue	31	31	31
Total revenue from management operations	1,407	1,297	1,188
Cost of management operations	1,184	1,088	983
Income from management operations before taxes	223	209	205
Investment operations:			
Net investment income	16	15	16
Net realized gains on investments	1	1	5
Net impairment losses recognized in earnings	0	0	0
Equity in earnings of limited partnerships	11	22	15
Income from investment operations before taxes	28	38	36
Income from operations before income taxes	251	247	241
Provision for income taxes	83	84	81
Net income attributable to Indemnity	\$168	\$163	\$160

Expense allocations – All claims handling services for the Exchange are performed by Indemnity employees who are entirely dedicated to claims related activities. All costs associated with these employees are reimbursed to Indemnity from the Exchange’s revenues in accordance with the subscriber’s agreement. Indemnity is reimbursed by EFL from its revenues for all costs associated with employees who perform life insurance related operating activities for EFL in accordance with its service agreement with Indemnity. Common overhead expenses included in the expenses paid by Indemnity are allocated based upon appropriate utilization statistics (employee count, square footage, vehicle count, project hours, etc.) specifically measured to accomplish proportional allocations. Executive compensation is allocated based upon each executive’s primary responsibilities (management services, property and casualty claims operations, EFL operations, and investment operations). We believe the methods used to allocate common overhead expenses among the affiliated entities are reasonable.

Cash settlements for payments on the account of the Exchange totaled \$378 million, \$351 million and \$343 million in 2014, 2013 and 2012, respectively, and \$37 million, \$32 million and \$30 million in 2014, 2013 and 2012, respectively, for EFL. These reimbursements are settled on a monthly basis.

Office leases – Indemnity leases certain o