ERIE INDEMNITY CO
Form 10-Q
May 05, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT PERSUANT TO SECTION 13 OR 15(d) OF**

**THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2011**

Commission file number 0-24000

**ERIE INDEMNITY COMPANY**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| PENNSYLVANIA<br>(State or other jurisdiction of incorporation or organization) | 25-0466020<br>(I.R.S. Employer Identification No.) |
| 100 Erie Insurance Place, Erie, Pennsylvania<br>(Address of principal executive offices) | 16530<br>(Zip Code) |

(814) 870-2000
(Registrant s telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Yes X No ____

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

Yes X No ____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No ____

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

Large Accelerated Filer X    Accelerated Filer ____    Non-Accelerated Filer ____ (Do not check if a smaller reporting company)    Smaller Reporting Company ____

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

Yes ____ No X

The number of shares outstanding of the registrant s Class A Common Stock as of the latest practicable date, with no par value and a stated value of $0.0292 per share, was 49,395,315 at April 29, 2011.

The number of shares outstanding of the registrant s Class B Common Stock as of the latest practicable date, with no par value and a stated value of $70 per share, was 2,546 at April 29, 2011.

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**ERIE INDEMNITY COMPANY**

**CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

*(dollars in millions, except per share data)*

| | Three months ended March 31, 2011 | Three months ended March 31, 2010 |
|---|---|---|
| **Revenues** | | |
| Premiums earned | $ 1,030 | $ 978 |
| Net investment income | 105 | 104 |
| Net realized investment gains | 149 | 125 |
| Net impairment losses recognized in earnings | 0 | (2) |
| Equity in earnings of limited partnerships | 72 | 3 |
| Other income | 9 | 8 |
| Total revenues | 1,365 | 1,216 |
| **Benefits and expenses** | | |
| Insurance losses and loss expenses | 706 | 761 |
| Policy acquisition and underwriting expenses | 247 | 227 |
| Total benefits and expenses | 953 | 988 |
| **Income from operations before income taxes and noncontrolling interest** | 412 | 228 |
| Provision for income taxes | 138 | 66 |
| **Net income** | **$ 274** | **$ 162** |
| | | |
| **Less: Net income attributable to noncontrolling interest in consolidated entity - Exchange** | **230** | **115** |
| | | |
| **Net income attributable to Indemnity** | **$ 44** | **$ 47** |
| | | |
| **Earnings Per Share** | | |
| **Net income attributable to Indemnity per share** | | |
| Class A common stock basic | $ 0.88 | $ 0.92 |
| **Class A common stock diluted** | **$ 0.78** | **$ 0.82** |
| Class B common stock basic and diluted | $ 126.48 | $ 132.83 |
| | | |
| **Weighted average shares outstanding attributable to Indemnity Basic** | | |
| Class A common stock | 49,789,056 | 51,185,736 |
| Class B common stock | 2,546 | 2,546 |
| | | |
| **Weighted average shares outstanding attributable to Indemnity Diluted** | | |
| Class A common stock | 55,968,838 | 57,357,543 |
| Class B common stock | 2,546 | 2,546 |
| | | |
| **Dividends declared per share** | | |
| Class A common stock | $ 0.515 | $ 0.48 |
| Class B common stock | $ 77.25 | $ 72.00 |

See accompanying notes to Consolidated Financial Statements.

**ERIE INDEMNITY COMPANY**

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

*(dollars in millions, except per share data)*

| | March 31, 2011 (Unaudited) | December 31, 2010 |
|---|---|---|
| **Assets** | | |
| **Investments Indemnity** | | |
| Available-for-sale securities, at fair value: | | |
| Fixed maturities (amortized cost of $506 and $257, respectively) | $ 513 | $ 264 |
| Equity securities (cost of $18 and $20, respectively) | 22 | 24 |
| Trading securities, at fair value (cost of $23 and $21, respectively) | 29 | 28 |
| Limited partnerships (cost of $200 and $202, respectively) | 222 | 216 |
| Other invested assets | 1 | 1 |
| **Investments Exchange** | | |
| Available-for-sale securities, at fair value: | | |
| Fixed maturities (amortized cost of $6,857 and $6,863, respectively) | 7,254 | 7,279 |
| Equity securities (cost of $519 and $503, respectively) | 603 | 570 |
| Trading securities, at fair value (cost of $1,847 and $1,773, respectively) | 2,462 | 2,306 |
| Limited partnerships (cost of $1,097 and $1,083, respectively) | 1,153 | 1,108 |
| Other invested assets | 18 | 19 |
| **Total investments** | **12,277** | **11,815** |
| | | |
| Cash and cash equivalents (Exchange portion of $125 and $120, respectively) | 211 | 430 |
| Premiums receivable from policyholders (Exchange portion of $959 and $942, respectively) | 959 | 942 |
| Reinsurance recoverable (Exchange portion of $199 and $201, respectively) | 199 | 201 |
| Deferred acquisition costs (Exchange portion of $469 and $467, respectively) | 469 | 467 |
| Other assets (Exchange portion of $332 and $357, respectively) | 438 | 489 |
| **Total assets** | **$ 14,553** | **$ 14,344** |
| **Liabilities and shareholders equity** | | |
| **Liabilities** | | |
| **Indemnity liabilities** | | |
| Deferred income taxes | $ 14 | $ 26 |
| Other liabilities | 344 | 382 |
| **Exchange liabilities** | | |
| Losses and loss expense reserves | 3,559 | 3,584 |
| Life policy and deposit contract reserves | 1,615 | 1,603 |
| Unearned premiums | 2,093 | 2,082 |
| Deferred income taxes | 309 | 257 |
| Other liabilities | 68 | 76 |
| **Total liabilities** | **8,002** | **8,010** |
| | | |
| **Indemnity s shareholders equity** | | |
| Class A common stock, stated value $0.0292 per share; authorized 74,996,930 shares; 68,289,600 shares issued; 49,525,482 and 50,054,506 shares outstanding, respectively | 2 | 2 |
| Class B common stock, convertible at a rate of 2,400 Class A shares for one Class B share, stated value $70 per share; 2,546 shares authorized, issued and outstanding, respectively | 0 | 0 |
| Additional paid-in-capital | 16 | 8 |
| Accumulated other comprehensive loss | (63) | (53) |
| Retained earnings | 1,846 | 1,827 |
| Total contributed capital and retained earnings | 1,801 | 1,784 |
| Treasury stock, at cost, 18,764,118 and 18,235,094 shares, respectively | (908) | (872) |
| **Total Indemnity shareholders equity** | **893** | **912** |
| | | |
| **Noncontrolling interest in consolidated entity Exchange** | **5,658** | **5,422** |
| **Total equity** | **6,551** | **6,334** |
| **Total liabilities, shareholders equity and noncontrolling interest** | **$ 14,553** | **$ 14,344** |

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

**ERIE INDEMNITY COMPANY**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

*(in millions)*

| | Three months ended March 31, 2011 | 2010 |
|---|---|---|
| **Accumulated other comprehensive loss:** | | |
| Balance, beginning of period  Indemnity | $(53) | $(43) |
| | | |
| Gross unrealized holding (losses) gains on investments arising during period | (1) | 13 |
| Unrealized gains transferred to noncontrolling interest (See Note 1) | (13) | |
| Reclassification adjustment for gross gains included in net income | (1) | (4) |
| Unrealized (losses) gains on investments | (15) | 9 |
| Income tax benefit (expense) related to unrealized gains | 5 | (3) |
| Change in other comprehensive (loss) income, net of tax  Indemnity | (10) | 6 |
| | | |
| Balance, end of period  Indemnity | $(63) | $(37) |
| | | |
| | | |
| Change in other comprehensive (loss) income, net of tax  Indemnity | $(10) | $ 6 |
| Change in other comprehensive income, net of tax  Exchange | $ 6 | $ 45 |
| Change in other comprehensive (loss) income, net of tax  Erie Insurance Group | $ (4) | $ 51 |
| | | |
| **Comprehensive income:** | | |
| Net income  Erie Insurance Group | $274 | $162 |
| Change in other comprehensive (loss) income, net of tax  Erie Insurance Group | (4) | 51 |
| Unrealized gains transferred to noncontrolling interest, net of tax (See Note 1) | 9 | |
| Total comprehensive income  Erie Insurance Group | 279 | 213 |
| Less: Noncontrolling interest in consolidated entity  Exchange | 236 | 160 |
| **Total comprehensive income - Indemnity** | $ 43 | $ 53 |

See accompanying notes to Consolidated Financial Statements.

**ERIE INDEMNITY COMPANY**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

*(in millions)*

| | Three months ended March 31, | |
|---|---|---|
| | 2011 | 2010 |
| **Cash flows from operating activities** | | |
| Premiums collected | $1,023 | $ 965 |
| Net investment income received | 97 | 99 |
| Limited partnership distributions | 32 | 18 |
| Service agreement fee received | 8 | 8 |
| Commissions and bonuses paid to agents | (178) | (169) |
| Losses paid | (598) | (622) |
| Loss expenses paid | (109) | (106) |
| Other underwriting and acquisition costs paid | (162) | (159) |
| Income taxes paid | (21) | (7) |
| **Net cash provided by operating activities** | **92** | **27** |
| | | |
| **Cash flows from investing activities** | | |
| Purchase of investments: | | |
| Fixed maturities | (752) | (525) |
| Preferred stock | (35) | (67) |
| Common stock | (421) | (249) |
| Limited partnerships | (29) | (30) |
| Sales/maturities of investments: | | |
| Fixed maturity sales | 277 | 233 |
| Fixed maturity calls/maturities | 247 | 315 |
| Preferred stock | 25 | 29 |
| Common stock | 400 | 251 |
| Sale of and returns on limited partnerships | 26 | 3 |
| Disposal (purchase) of property and equipment | 7 | (9) |
| Net collections on agent loans | 1 | 0 |
| **Net cash used in investing activities** | **(254)** | **(49)** |
| | | |
| **Cash flows from financing activities** | | |
| Annuity and supplementary contract deposits and interest | 22 | 33 |
| Annuity and supplementary contract surrenders and withdrawals | (21) | (18) |
| Universal life deposits and interest | 12 | 11 |
| Universal life surrenders | (8) | (8) |
| Purchase of treasury stock | (36) | (3) |
| Dividends paid to shareholders | (26) | (25) |
| **Net cash used in financing activities** | **(57)** | **(10)** |
| | | |
| Net decrease in cash and cash equivalents | (219) | (32) |
| Cash and cash equivalents at beginning of period | 430 | 234 |
| **Cash and cash equivalents at end of period** | **$ 211** | **$ 202** |

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

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

**Note 1. Nature of Operations**

Erie Indemnity Company ( Indemnity ) is a publicly held Pennsylvania business corporation that since 1925 has been the managing attorney-in-fact for the subscribers (policyholders) at the Erie Insurance Exchange ( Exchange ). 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), appointing 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, which are assumed by the Exchange under an intercompany pooling arrangement.

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

On December 31, 2010, Indemnity sold all of the outstanding capital stock of its wholly owned property and casualty subsidiaries to the Exchange. All property and casualty and life insurance operations are owned by the Exchange, and Indemnity will continue to function as the management company.

Erie Family Life Insurance Company ( EFL ) is an affiliated life insurance company that underwrites and sells individual and group life insurance policies and fixed annuities. On March 31, 2011, Indemnity sold its 21.6% ownership interest in EFL to the Exchange for 95% of EFL s GAAP book value per share as of this date. Because Indemnity and the Exchange are deemed to be under common control, there was no gain or loss resulting from this sale.

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 benefit of the subscribers (policyholders).

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 Erie Insurance Group ( we, us, our ).

**Note 2. Significant Accounting Policies**

Basis of presentation and principles of consolidation

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

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods have been included. Operating results for the three month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The accompanying consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on February 24, 2011.

*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 benefit 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 Statements of Financial Position.

Adopted accounting pronouncements

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

Pending accounting pronouncements

In October 2010, the FASB issued ASU 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. This guidance modifies the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal insurance contracts. The amendments in this update specify that the costs are limited to incremental direct costs that result directly from successful contract transactions and would not have been incurred by the insurance entity had the contract transactions not occurred. These costs must be directly related to underwriting, policy issuance and processing, medical and inspection and sales force contract selling. The amendments also specify that advertising costs only should be included as deferred acquisition costs if the direct-response advertising criteria are met. ASU 2010-26 is effective for interim and annual reporting periods beginning after December 15, 2011 with either prospective or retrospective adoption permitted. Although we have not performed a detailed analysis, the adoption method and impact of this update on the Company s financial position, cash flows, or results of operations is expected to be immaterial.

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**Note 3. Earnings Per Share**

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

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

| *(dollars in millions, except share data)* | Indemnity Earnings Per Share Calculation Three months ended March 31, 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Allocated net income (numerator) | Weighted shares (denominator) | Per-share amount | Allocated net income (numerator) | Weighted shares (denominator) | Per-share amount |
| **Class A Basic EPS:** | | | | | | |
| Income available to Class A stockholders | $44 | 49,789,056 | $ 0.88 | $47 | 51,185,736 | $ 0.92 |
| Dilutive effect of stock awards | 0 | 69,382 | | 0 | 61,407 | |
| Assumed conversion of Class B shares | 0 | 6,110,400 | | 0 | 6,110,400 | |
| **Class A Diluted EPS:** | | | | | | |
| Income available to Class A stockholders on Class A equivalent shares | $44 | 55,968,838 | $ 0.78 | $47 | 57,357,543 | $ 0.82 |
| **Class B Basic and diluted EPS:** | | | | | | |
| Income available to Class B stockholders | $ 0 | 2,546 | $126.48 | $ 0 | 2,546 | $132.83 |

Included in the diluted earnings per share calculations for the first quarters of 2011 and 2010, respectively, were 6,400 and 11,200 shares of stock-based awards not yet vested, 60,329 and 47,296 shares of awards vested related to our outside directors stock compensation plan, and 2,653 and 2,911 shares of awards not yet vested related to our outside directors stock compensation plan.

**Note 4. Variable Interest Entity**

<u>Exchange</u>

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. Indemnity earns management fee revenues from the Exchange for the services it provides as attorney-in-fact. Indemnity s management fee revenues are based on all premiums written or assumed by the Exchange. Indemnity s Board of Directors determines the management fee rate to be paid by the Exchange to Indemnity. This rate cannot exceed 25% of the direct and affiliated assumed written premiums of the Exchange, as defined by the subscriber s agreement signed by each policyholder. Management fee revenues and management fee expenses are eliminated upon consolidation.

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.

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

Indemnity has not provided financial or other support to the Exchange for the reporting periods presented. At March 31, 2011, there are no explicit or implicit arrangements that would require Indemnity to provide future financial support to the Exchange. Indemnity is not liable if the Exchange was to be in violation of its debt covenants or was unable to meet its obligation for unfunded commitments to limited partnerships.

**Note 5. Segment Information**

Our reportable segments include management operations, property and casualty insurance operations, life insurance operations and investment operations. Accounting policies for segments are the same as those described in the summary of significant accounting policies. See Item 8. Financial Statements and Supplementary Data, Note 2, Significant Accounting Policies, in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on February 24, 2011. Assets are not allocated to the segments but rather are reviewed in total for purposes of decision-making. No single customer or agent provides 10% or more of revenues.

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

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

Our life insurance operations segment includes traditional and universal life insurance products and fixed annuities marketed to individuals using the same independent agency force utilized by our property and casualty operations. We evaluate profitability of the life insurance segment principally based on segment net income, including investments, which for segment purposes are reflected in the investment operations segment. At the same time, we recognize that investment-related income is integral to the evaluation of the life insurance segment because of the long duration of life products. Through March 31, 2011, investment activities on life insurance-related assets generated revenues of $27 million resulting in EFL reporting income before income taxes of $13 million, before intercompany eliminations. Through March 31, 2010, investment activities on life insurance-related assets generated revenues of $27 million resulting in EFL reporting income before income taxes of $10 million, before intercompany eliminations.

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

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

| | Erie Insurance Group For the three months ended March 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| *(in millions)* | Management operations | Property and casualty insurance operations | Life insurance operations | Investment operations | Eliminations | Consolidated |
| Premiums earned/life policy revenue | | $1,014 | $ 16 | | | $1,030 |
| Net investment income | | | | $108 | $ (3) | 105 |
| Net realized investment gains | | | | 149 | | 149 |
| Net impairment losses recognized in earnings | | | | 0 | | 0 |
| Equity in earnings of limited partnerships | | | | 72 | | 72 |
| Management fee revenue | $251 | | | | (251) | |
| Service agreement and other revenue | 8 | | 1 | | | 9 |
| Total revenues | 259 | 1,014 | 17 | 329 | (254) | 1,365 |
| Cost of management operations | 211 | | | | (211) | |
| Insurance losses and loss expenses | | 683 | 24 | | (1) | 706 |
| Policy acquisition and underwriting expenses | | 282 | 7 | | (42) | 247 |
| Total benefits and expenses | 211 | 965 | 31 | | (254) | 953 |
| Income (loss) before income taxes | 48 | 49 | (14) | 329 | | 412 |
| Provision (benefit) for income taxes | 17 | 17 | (5) | 109 | | 138 |
| Net income (loss) | $ 31 | $ 32 | $ (9) | $220 | $ | $ 274 |

| | Erie Insurance Group For the three months ended March 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| *(in millions)* | Management operations | Property and casualty insurance operations | Life insurance operations | Investment operations | Eliminations | Consolidated |
| Premiums earned/life policy revenue | | $ 962 | $ 16 | | | $ 978 |
| Net investment income | | | | $107 | $ (3) | 104 |
| Net realized investment gains | | | | 125 | | 125 |
| Net impairment losses recognized in earnings | | | | (2) | | (2) |
| Equity in earnings of limited partnerships | | | | 3 | | 3 |
| Management fee revenue | $237 | | | | (237) | |
| Service agreement and other revenue | 8 | | 0 | | | 8 |
| Total revenues | 245 | 962 | 16 | 233 | (240) | 1,216 |
| Cost of management operations | 192 | | | | (192) | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Insurance losses and loss expenses | | 738 | 24 | | (1) | 761 |
| Policy acquisition and underwriting expenses | | 265 | 9 | | (47) | 227 |
| Total benefits and expenses | 192 | 1,003 | 33 | | (240) | 988 |
| Income (loss) before income taxes | 53 | (41) | (17) | 233 | | 228 |
| Provision (benefit) for income taxes | 18 | (14) | (6) | 68 | | 66 |
| Net income (loss) | $ 35 | $ (27) | $ (11) | $165 | $ | $ 162 |

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

**Note 6. Fair Value**

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

Valuation techniques used to derive the fair value of our available-for-sale and trading securities are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources.

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

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

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

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

The following table represents the fair value measurements on a recurring basis for our consolidated available-for-sale and trading securities by asset class and level of input at March 31, 2011:

| | Erie Insurance Group<br>March 31, 2011<br>Fair value measurements using: | | | |
|---|---|---|---|---|
| *(in millions)* | Total | Quoted prices in active markets for identical assets Level 1 | Significant observable inputs Level 2 | Significant unobservable inputs Level 3 |
| **Indemnity** | | | | |
| Available-for-sale securities: | | | | |
| Fixed maturities: | | | | |
| U.S. treasuries and government agencies | $ 10 | $ 0 | $ 10 | $0 |
| U.S. government sponsored enterprises | 9 | 0 | 9 | 0 |
| Municipal securities | 222 | 0 | 222 | 0 |
| U.S. corporate debt non-financial | 78 | 0 | 78 | 0 |
| U.S. corporate debt financial | 107 | 0 | 107 | 0 |
| Foreign corporate debt non-financial | 21 | 0 | 21 | 0 |

| | | | | |
|---|---|---|---|---|
| Foreign corporate debt financial | 30 | 0 | 30 | 0 |
| Structured securities: | | | | |
| Asset-backed securities auto loans | 12 | 0 | 12 | 0 |
| Collateralized debt obligations | 4 | 0 | 0 | 4 |
| Commercial mortgage-backed | 20 | 0 | 20 | 0 |
| Total fixed maturities | 513 | 0 | 509 | 4 |
| Equity securities: | | | | |
| U.S. nonredeemable preferred securities: | | | | |
| Financial | 9 | 5 | 4 | 0 |
| Non-financial | 12 | 6 | 6 | 0 |
| Foreign nonredeemable preferred securities: | | | | |
| Non-financial | 1 | 0 | 1 | 0 |
| Total equity securities | 22 | 11 | 11 | 0 |
| Total available-for-sale securities | 535 | 11 | 520 | 4 |
| Trading securities: | | | | |
| Common stock | 29 | 29 | 0 | 0 |
| Total trading securities | 29 | 29 | 0 | 0 |
| Total Indemnity | $564 | $40 | $520 | $4 |

| | | Erie Insurance Group March 31, 2011 Fair value measurements using: | | |
|---|---|---|---|---|
| *(in millions)* | Total | Quoted prices in active markets for identical assets Level 1 | Significant observable inputs Level 2 | Significant unobservable inputs Level 3 |
| **Exchange** | | | | |
| Available-for-sale securities: | | | | |
| Fixed maturities: | | | | |
| U.S. treasuries and government agencies | $ 11 | $ 11 | $ 0 | $ 0 |
| U.S. government sponsored enterprises | 70 | 0 | 70 | 0 |
| Foreign government | 21 | 0 | 21 | 0 |
| Municipal securities | 1,436 | 0 | 1,432 | 4 |
| U.S. corporate debt non-financial | 2,452 | 6 | 2,437 | 9 |
| U.S. corporate debt financial | 1,934 | 6 | 1,926 | 2 |
| Foreign corporate debt non-financial | 530 | 0 | 530 | 0 |
| Foreign corporate debt financial | 365 | 0 | 365 | 0 |
| Structured securities: | | | | |
| Asset-backed securities auto loans | 36 | 0 | 36 | 0 |
| Asset-backed securities other | 14 | 0 | 9 | 5 |
| Collateralized debt obligations | 71 | 0 | 41 | 30 |
| Commercial mortgage-backed | 81 | 0 | 81 | 0 |
| Residential mortgage-backed: | | | | |
| Government sponsored enterprises | 216 | 0 | 216 | 0 |
| Non-government sponsored enterprises | 17 | 0 | 17 | 0 |
| Total fixed maturities | 7,254 | 23 | 7,181 | 50 |
| Equity securities: | | | | |
| U.S. nonredeemable preferred securities: | | | | |
| Financial | 391 | 107 | 276 | 8 |
| Non-financial | 144 | 48 | 96 | 0 |
| Government sponsored enterprises | 1 | 1 | 0 | 0 |
| Foreign nonredeemable preferred securities: | | | | |
| Financial | 58 | 17 | 41 | 0 |
| Non-financial | 9 | 0 | 9 | 0 |
| Total equity securities | 603 | 173 | 422 | 8 |
| Total available-for-sale securities | 7,857 | 196 | 7,603 | 58 |
| Trading securities: | | | | |
| Common stock | 2,462 | 2,449 | 0 | 13 |
| Total trading securities | 2,462 | 2,449 | 0 | 13 |
| Total Exchange | $10,319 | $2,645 | $7,603 | $71 |
| Total Erie Insurance Group | $10,883 | $2,685 | $8,123 | $75 |

Level 3 Assets Quarterly Change:

| | Erie Insurance Group | | | | | | |
|---|---|---|---|---|---|---|---|
| *(in millions)* | Beginning balance at December 31, 2010 | Included in earnings (1) | Included in other comprehensive income | Purchases | Sales | Transfers in and (out) of Level 3 (2) | Ending balance at March 31, 2011 |
| **Indemnity** | | | | | | | |
| Available-for-sale securities: | | | | | | | |
| Fixed maturities: | | | | | | | |
| U.S. corporate debt financial | $ 0 | $0 | $0 | $0 | $0 | $0 | $ 0 |
| Collateralized debt obligations | 4 | 0 | 0 | 0 | 0 | 0 | 4 |
| Total fixed maturities | 4 | 0 | 0 | 0 | 0 | 0 | 4 |
| Equity securities: | | | | | | | |
| U.S. nonredeemable financial | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total equity securities | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Level 3 assets Indemnity | $ 4 | $0 | $0 | $0 | $0 | $0 | $ 4 |
| **Exchange** | | | | | | | |
| Available-for-sale securities: | | | | | | | |
| Fixed maturities: | | | | | | | |
| Municipal Securities | $ 4 | $0 | $0 | $0 | $0 | $0 | $ 4 |
| U.S. corporate debt non-financial | 9 | 0 | 0 | 0 | 0 | 0 | 9 |
| U.S. corporate debt financial | 2 | 0 | 0 | 0 | 0 | 0 | 2 |
| Asset-backed securities other | 10 | 0 | 0 | 0 | 5 | 0 | 5 |
| Collateralized debt obligations | 30 | 0 | 0 | 0 | 0 | 0 | 30 |
| Total fixed maturities | 55 | 0 | 0 | 0 | 5 | 0 | 50 |
| Equity securities: | | | | | | | |
| U.S. nonredeemable financial | 7 | 0 | 1 | 0 | 0 | 0 | 8 |
| Total equity securities | 7 | 0 | 1 | 0 | 0 | 0 | 8 |
| Trading securities: | | | | | | | |
| Common stock | 12 | 1 | 0 | 0 | 0 | 0 | 13 |
| Total Trading securities | 12 | 1 | 0 | 0 | 0 | 0 | 13 |
| Total Level 3 assets Exchange | $74 | $1 | $1 | $0 | $5 | $0 | $71 |
| Total Level 3 assets Erie Insurance Group | $78 | $1 | $1 | $0 | $5 | $0 | $75 |

*(1) Includes losses as a result of other-than-temporary impairments and accrual of discount and amortization of premium. These amounts are reported in the Consolidated Statements of Operations. There was $1 million in unrealized gains included in earnings for the three months ended March 31, 2011 on Level 3 securities.*

*(2) Transfers in and out of Level 3 are attributable to changes in the availability of market observable information for individual securities within the respective categories. There were no significant transfers in and out of Level 3. Transfers in and out of levels are recognized at the end of the period.*

There were no significant transfers between levels 1 and 2 for the three months ended March 31, 2011.

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

| | | Erie Insurance Group<br>Fair value measurements using: | | |
|---|---|---|---|---|
| *(in millions)* | Total | Quoted prices in active markets for identical assets Level 1 | Significant observable inputs Level 2 | Significant unobservable inputs Level 3 |
| **Indemnity** | | | | |
| Available-for-sale securities: | | | | |
| Fixed maturities: | | | | |
| U.S. treasuries and government agencies | $ 25 | $ 25 | $ 0 | $ 0 |
| Municipal securities | 197 | 0 | 197 | 0 |
| U.S. corporate debt non-financial | 12 | 0 | 12 | 0 |
| U.S. corporate debt financial | 26 | 0 | 26 | 0 |
| Structured securities: | | | | |
| Collateralized debt obligations | 4 | 0 | 0 | 4 |
| Total fixed maturities | 264 | 25 | 235 | 4 |
| Equity securities: | | | | |
| U.S. nonredeemable preferred securities: | | | | |
| Financial | 11 | 5 | 6 | 0 |
| Non-financial | 12 | 6 | 6 | 0 |
| Foreign nonredeemable preferred securities: | | | | |
| Non-financial | 1 | 0 | 1 | 0 |
| Total equity securities | 24 | 11 | 13 | 0 |
| Total available-for-sale securities | 288 | 36 | 248 | 4 |
| Trading securities: | | | | |
| Common stock | 28 | 28 | 0 | 0 |
| Total trading securities | 28 | 28 | 0 | 0 |
| Total Indemnity | $ 316 | $ 64 | $ 248 | $ 4 |
| **Exchange** | | | | |
| Available-for-sale securities: | | | | |
| Fixed maturities: | | | | |
| U.S. treasuries and government agencies | $ 12 | $ 12 | $ 0 | $ 0 |
| U.S. government sponsored enterprises | 75 | 0 | 75 | 0 |
| Foreign government | 21 | 0 | 21 | 0 |
| Municipal securities | 1,471 | 0 | 1,467 | 4 |
| U.S. corporate debt non-financial | 2,535 | 6 | 2,520 | 9 |
| U.S. corporate debt financial | 1,897 | 6 | 1,889 | 2 |
| Foreign corporate debt non-financial | 449 | 0 | 449 | 0 |
| Foreign corporate debt financial | 382 | 0 | 382 | 0 |
| Structured securities: | | | | |
| Asset-backed securities auto loans | 38 | 0 | 38 | 0 |
| Asset-backed securities other | 19 | 0 | 9 | 10 |
| Collateralized debt obligations | 70 | 0 | 40 | 30 |
| Commercial mortgage-backed | 86 | 0 | 86 | 0 |
| Residential mortgage-backed: | | | | |
| Government sponsored enterprises | 205 | 0 | 205 | 0 |
| Non-government sponsored enterprises | 19 | 0 | 19 | 0 |
| Total fixed maturities | 7,279 | 24 | 7,200 | 55 |
| Equity securities: | | | | |
| U.S. nonredeemable preferred securities: | | | | |
| Financial | 373 | 102 | 264 | 7 |
| Non-financial | 133 | 48 | 85 | 0 |
| Government sponsored enterprises | 0 | 0 | 0 | 0 |
| Foreign nonredeemable preferred securities: | | | | |
| Financial | 55 | 16 | 39 | 0 |
| Non-financial | 9 | 0 | 9 | 0 |
| Total equity securities | 570 | 166 | 397 | 7 |
| Total available-for-sale securities | 7,849 | 190 | 7,597 | 62 |

| | | | | |
|---|---|---|---|---|
| Trading securities: | | | | |
| Common stock | 2,306 | 2,294 | 0 | 12 |
| Total trading securities | 2,306 | 2,294 | 0 | 12 |
| Total Exchange | $10,155 | $2,484 | $7,597 | $74 |
| Total Erie Insurance Group | $10,471 | $2,548 | $7,845 | $78 |

Level 3 Assets Quarterly Change:

| | Erie Insurance Group | | | | | |
|---|---|---|---|---|---|---|
| *(in millions)* | Beginning balance at December 31, 2009 | Included in earnings (1) | Included in other comprehensive income | Purchases, sales and adjustments | Transfers in and (out) of Level 3 (2) | Ending balance at March 31, 2010 |
| **Indemnity** | | | | | | |
| Available-for-sale securities: | | | | | | |
| Fixed maturities: | | | | | | |
| U.S. corporate debt financial | $ 2 | $0 | $ 0 | $ 0 | $ 0 | $ 2 |
| Collateralized debt obligations | 8 | 0 | 1 | 0 | 0 | 9 |
| Total fixed maturities | 10 | 0 | 1 | 0 | 0 | 11 |
| Equity securities: | | | | | | |
| U.S. nonredeemable financial | 1 | 0 | 1 | 0 | 0 | 2 |
| Total equity securities | 1 | 0 | 1 | 0 | 0 | 2 |
| Total Level 3 assets Indemnity | $11 | $0 | $ 2 | $ 0 | $ 0 | $ 13 |
| **Exchange** | | | | | | |
| Available-for-sale securities: | | | | | | |
| Fixed maturities: | | | | | | |
| U.S. corporate debt non-financial | $17 | $0 | $ 0 | $(7) | $(1) | $ 9 |
| Asset backed securities other | 5 | 0 | 0 | 0 | 0 | 5 |
| Collateralized debt obligations | 49 | 1 | 7 | 0 | 13 | 70 |
| Total fixed maturities | 71 | 1 | 7 | (7) | 12 | 84 |
| Equity securities: | | | | | | |
| U.S. nonredeemable financial | 4 | 0 | 1 | 0 | 0 | 5 |
| Total equity securities | 4 | 0 | 1 | 0 | 0 | 5 |
| Trading securities: | | | | | | |
| Common stock | 9 | 1 | 0 | 0 | 0 | 10 |
| Total trading securities | 9 | 1 | 0 | 0 | 0 | 10 |
| Total Level 3 assets Exchange | $84 | $2 | $ 8 | $(7) | $12 | $ 99 |
| Total Level 3 assets Erie Insurance Group | $95 | $2 | $10 | $(7) | $12 | $112 |

*(1) Includes losses as a result of other-than-temporary impairments and accrual of discount and amortization of premium. These amounts are reported in the Consolidated Statements of Operations. There was $1 million in unrealized gains included in earnings for the three months ended March 31, 2010 on Level 3 securities.*

*(2) Transfers in and out of Level 3 are attributable to changes in the availability of market observable information for individual securities within the respective categories. There were no significant transfers in and out of Level 3. Transfers in and out of levels are recognized at the end of the period.*

There were no significant transfers between levels 1 and 2 for the three months ended March 31, 2010.

Estimates of fair values for our investment portfolio are obtained primarily from a nationally recognized pricing service. Our Level 1 category includes those securities valued using an exchange traded price provided by the pricing service. The methodologies used by the pricing service that support a Level 2 classification of a financial instrument include multiple verifiable, observable inputs including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. Pricing service valuations for Level 3 securities are based on proprietary models and are used when observable inputs are not available in illiquid markets. In limited circumstances we adjust the price received from the pricing service when, in our judgment, a better reflection of fair value is available based on corroborating information and our knowledge and monitoring of market conditions. At March 31, 2011, we adjusted some prices received by the pricing service to reflect an alternate fair market value based on observable market data such as a disparity in price of comparable securities and/or non-binding broker quotes.

The following table displays the number and values of these adjustments for the three months ended March 31, 2011:

| *(dollars in millions)* | Number of holdings | Value of securities using pricing service | Value of securities used in the financial statements |
|---|---|---|---|
| Exchange | 10 | $21 | $19 |
| Total Erie Insurance Group | | $21 | $19 |

We perform continuous reviews of the prices obtained from the pricing service. This includes evaluating the methodology and inputs used by the pricing service to ensure we determine the proper level classification of the financial instrument. Price variances, including large periodic changes, are investigated and corroborated by market data. We have reviewed the pricing methodologies of our pricing service and believe that their prices adequately consider market activity in determining fair value.

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

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

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

| | Erie Insurance Group March 31, 2011 | | | |
|---|---|---|---|---|
| *(in millions)* | Total | Level 1 | Level 2 | Level 3 |
| **Indemnity** | | | | |
| Fixed maturity securities: | | | | |
| Priced via pricing services | $ 499 | $ 0 | $ 499 | $ 0 |
| Priced via market comparables/non-binding broker quote (1) | 0 | 0 | 0 | 0 |
| Priced via internal modeling (2) | 14 | 0 | 10 | 4 |
| Total fixed maturity securities | 513 | 0 | 509 | 4 |
| Preferred stock securities: | | | | |
| Priced via pricing services | 20 | 11 | 9 | 0 |
| Priced via market comparables/non-binding broker quote (1) | 2 | 0 | 2 | 0 |
| Priced via internal modeling (2) | 0 | 0 | 0 | 0 |
| Total preferred stock securities | 22 | 11 | 11 | 0 |
| Common stock securities: | | | | |
| Priced via pricing services | 29 | 29 | 0 | 0 |
| Priced via market comparables/non-binding broker quote (1) | 0 | 0 | 0 | 0 |
| Priced via internal modeling (2) | 0 | 0 | 0 | 0 |
| Total common stock securities | 29 | 29 | 0 | 0 |
| Total available-for-sale/trading securities Indemnity | $ 564 | $ 40 | $ 520 | $ 4 |
| **Exchange** | | | | |
| Fixed maturity securities: | | | | |
| Priced via pricing services | $ 7,097 | $ 23 | $7,074 | $ 0 |
| Priced via market comparables/non-binding broker quote (1) | 107 | 0 | 107 | 0 |
| Priced via internal modeling (2) | 50 | 0 | 0 | 50 |
| Total fixed maturity securities | 7,254 | 23 | 7,181 | 50 |
| Preferred stock securities: | | | | |
| Priced via pricing services | 574 | 173 | 401 | 0 |
| Priced via market comparables/non-binding broker quote (1) | 29 | 0 | 21 | 8 |
| Priced via internal modeling (2) | 0 | 0 | 0 | 0 |
| Total preferred stock securities | 603 | 173 | 422 | 8 |
| Common stock securities: | | | | |
| Priced via pricing services | 2,449 | 2,449 | 0 | 0 |
| Priced via market comparables/non-binding broker quote (1) | 0 | 0 | 0 | 0 |
| Priced via internal modeling (2) | 13 | 0 | 0 | 13 |
| Total common stock securities | 2,462 | 2,449 | 0 | 13 |
| Total available-for-sale/trading securities Exchange | 10,319 | 2,645 | 7,603 | 71 |
| Total available-for-sale/trading securities Erie Insurance Group | $10,883 | $2,685 | $8,123 | $75 |

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

*(2) Internal modeling using a discounted cash flow model was performed on 14 fixed maturities and 3 common equity securities representing less than 0.6% of the total portfolio of the Erie Insurance Group.*

We have no assets that were measured at fair value on a nonrecurring basis during the three months ended March 31, 2011.

**Note 7. Investments**

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

| | Erie Insurance Group March 31, 2011 | | | |
|---|---|---|---|---|
| *(in millions)* | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| **Indemnity** | | | | |
| Fixed maturities: | | | | |
| U.S. treasuries and government agencies | $ 10 | $ 0 | $ 0 | $ 10 |
| U.S. government sponsored enterprises | 9 | 0 | 0 | 9 |
| Municipal securities | 219 | 5 | 2 | 222 |
| U.S. corporate debt non-financial | 77 | 1 | 0 | 78 |
| U.S. corporate debt financial | 104 | 3 | 0 | 107 |
| Foreign corporate debt non-financial | 21 | 0 | 0 | 21 |
| Foreign corporate debt financial | 30 | 0 | 0 | 30 |
| Structured securities: | | | | |
| Asset-backed securities auto loans | 12 | 0 | 0 | 12 |
| Collateralized debt obligations | 4 | 0 | 0 | 4 |
| Commercial mortgage-backed | 20 | 0 | 0 | 20 |
| Total fixed maturities | 506 | 9 | 2 | 513 |
| Equity securities: | | | | |
| U.S. nonredeemable preferred securities: | | | | |
| Financial | 6 | 3 | 0 | 9 |
| Non-financial | 11 | 1 | 0 | 12 |
| Foreign nonredeemable preferred securities: | | | | |
| Non-financial | 1 | 0 | 0 | 1 |
| Total equity securities | 18 | 4 | 0 | 22 |
| Total available-for-sale securities Indemnity | $ 524 | $ 13 | $ 2 | $ 535 |
| **Exchange** | | | | |
| Fixed maturities: | | | | |
| U.S. treasuries and government agencies | $ 10 | $ 1 | $ 0 | $ 11 |
| U.S. government sponsored enterprises | 69 | 1 | 0 | 70 |
| Foreign government | 20 | 1 | 0 | 21 |
| Municipal securities | 1,407 | 39 | 10 | 1,436 |
| U.S. corporate debt non-financial | 2,287 | 169 | 4 | 2,452 |
| U.S. corporate debt financial | 1,800 | 139 | 5 | 1,934 |
| Foreign corporate debt non-financial | 493 | 37 | 0 | 530 |
| Foreign corporate debt financial | 351 | 15 | 1 | 365 |
| Structured securities: | | | | |
| Asset-backed securities auto loans | 34 | 2 | 0 | 36 |
| Asset-backed securities other | 13 | 1 | 0 | 14 |
| Collateralized debt obligations | 69 | 7 | 5 | 71 |
| Commercial mortgage-backed | 78 | 3 | 0 | 81 |
| Residential mortgage-backed: | | | | |
| Government sponsored enterprises | 209 | 8 | 1 | 216 |
| Non-government sponsored enterprises | 17 | 0 | 0 | 17 |
| Total fixed maturities | 6,857 | 423 | 26 | 7,254 |
| Equity securities: | | | | |
| U.S. nonredeemable preferred securities: | | | | |
| Financial | 325 | 67 | 1 | 391 |
| Non-financial | 136 | 9 | 1 | 144 |
| Government sponsored enterprises | 0 | 1 | 0 | 1 |
| Foreign nonredeemable preferred securities: | | | | |
| Financial | 50 | 8 | 0 | 58 |
| Non-financial | 8 | 1 | 0 | 9 |
| Total equity securities | 519 | 86 | 2 | 603 |

| | | | | | |
|---|---|---|---|---|---|
| Total available-for-sale securities | Exchange | $7,376 | $509 | $28 | $7,857 |
| Total available-for-sale securities | Erie Insurance Group | $7,900 | $522 | $30 | $8,392 |

| | Erie Insurance Group December 31, 2010 | | | |
|---|---|---|---|---|
| *(in millions)* | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| **Indemnity** | | | | |
| Fixed maturities: | | | | |
| U.S. treasuries and government agencies | $ 25 | $ 0 | $ 0 | $ 25 |
| U.S. government sponsored enterprises | 0 | 0 | 0 | 0 |
| Municipal securities | 193 | 6 | 2 | 197 |
| U.S. corporate debt non-financial | 12 | 0 | 0 | 12 |
| U.S. corporate debt financial | 24 | 2 | 0 | 26 |
| Structured securities: | | | | |
| Collateralized debt obligations | 3 | 1 | 0 | 4 |
| Total fixed maturities | 257 | 9 | 2 | 264 |
| Equity securities: | | | | |
| U.S. nonredeemable preferred securities: | | | | |
| Financial | 8 | 3 | 0 | 11 |
| Non-financial | 11 | 1 | 0 | 12 |
| Foreign nonredeemable preferred securities: | | | | |
| Non-financial | 1 | 0 | 0 | 1 |
| Total equity securities | 20 | 4 | 0 | 24 |
| Total available-for-sale securities Indemnity | $ 277 | $ 13 | $ 2 | $ 288 |
| **Exchange** | | | | |
| Fixed maturities: | | | | |
| U.S. treasuries and government agencies | $ 11 | $ 1 | $ 0 | $ 12 |
| U.S. government sponsored enterprises | 74 | 1 | 0 | 75 |
| Foreign government | 20 | 1 | 0 | 21 |
| Municipal securities | 1,437 | 43 | 9 | 1,471 |
| U.S. corporate debt non-financial | 2,354 | 186 | 5 | 2,535 |
| U.S. corporate debt financial | 1,767 | 137 | 7 | 1,897 |
| Foreign corporate debt non-financial | 415 | 34 | 0 | 449 |
| Foreign corporate debt financial | 364 | 20 | 2 | 382 |
| Structured securities: | | | | |
| Asset-backed securities auto loans | 36 | 2 | 0 | 38 |
| Asset-backed securities other | 18 | 1 | 0 | 19 |
| Collateralized debt obligations | 69 | 6 | 5 | 70 |
| Commercial mortgage-backed | 82 | 5 | 1 | 86 |
| Residential mortgage-backed: | | | | |
| Government sponsored enterprises | 196 | 9 | 0 | 205 |
| Non-government sponsored enterprises | 20 | 0 | 1 | 19 |
| Total fixed maturities | 6,863 | 446 | 30 | 7,279 |
| Equity securities: | | | | |
| U.S. nonredeemable preferred securities: | | | | |
| Financial | 317 | 58 | 2 | 373 |
| Non-financial | 126 | 9 | 2 | 133 |
| Government sponsored enterprises | 0 | 0 | 0 | 0 |
| Foreign nonredeemable preferred securities: | | | | |
| Financial | 52 | 6 | 3 | 55 |
| Non-financial | 8 | 1 | 0 | 9 |
| Total equity securities | 503 | 74 | 7 | 570 |
| Total available-for-sale securities Exchange | $7,366 | $520 | $37 | $7,849 |
| Total available-for-sale securities Erie Insurance Group | $7,643 | $533 | $39 | $8,137 |

The amortized cost and estimated fair value of fixed maturities at March 31, 2011, are shown below by remaining contractual term to maturity. Mortgage-backed securities are allocated based on their stated maturity dates. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Erie Insurance Group | |
|---|---|---|
| *(in millions)* | Amortized cost | Estimated fair value |
| **Indemnity** | | |
| Due in one year or less | $ 131 | $ 134 |
| Due after one year through five years | 231 | 235 |
| Due after five years through ten years | 59 | 60 |
| Due after ten years | 85 | 84 |
| Total fixed maturities Indemnity | $ 506 | $ 513 |
| **Exchange** | | |
| Due in one year or less | $ 310 | $ 329 |
| Due after one year through five years | 2,421 | 2,563 |
| Due after five years through ten years | 2,766 | 2,952 |
| Due after ten years | 1,360 | 1,410 |
| Total fixed maturities Exchange | $6,857 | $7,254 |
| Total fixed maturities Erie Insurance Group | $7,363 | $7,767 |

Fixed maturities and equity securities in a gross unrealized loss position at March 31, 2011 are as follows for Indemnity. Data is provided by length of time securities were in a gross unrealized loss position.

| | Erie Insurance Group March 31, 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| *(dollars in millions)* | Less than 12 months | | 12 months or longer | | Total | | |
| **Indemnity** | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair Value | Unrealized losses | No. of holdings |
| Fixed maturities: | | | | | | | |
| U.S. treasuries and government agencies | $ 10 | $0 | $0 | $0 | $ 10 | $0 | 1 |
| Municipal securities | 61 | 2 | 1 | 0 | 62 | 2 | 28 |
| U.S. corporate debt non-financial | 63 | 0 | 0 | 0 | 63 | 0 | 8 |
| U.S. corporate debt financial | 39 | 0 | 0 | 0 | 39 | 0 | 7 |
| Foreign corporate debt financial | 20 | 0 | 0 | 0 | 20 | 0 | 3 |
| Structured securities: | | | | | | | |
| Asset-backed securities auto loans | 7 | 0 | 0 | 0 | 7 | 0 | 1 |
| Commercial mortgage-backed | 20 | 0 | 0 | 0 | 20 | 0 | 3 |
| Total fixed maturities Indemnity | $220 | $2 | $1 | $0 | $221 | $2 | 51 |
| Equity securities: | | | | | | | |
| U.S. nonredeemable preferred securities: | | | | | | | |
| Non-financial | 3 | 0 | 0 | 0 | 3 | 0 | 1 |
| Total equity securities Indemnity | $ 3 | $0 | $0 | $0 | $ 3 | $0 | 1 |
| | | | | | | | |
| **Quality breakdown of fixed maturities:** | | | | | | | |
| Investment grade | $220 | $2 | $1 | $0 | $221 | $2 | 51 |
| Non-investment grade | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total fixed maturities Indemnity | $220 | $2 | $1 | $0 | $221 | $2 | 51 |

Fixed maturities and equity securities in a gross unrealized loss position at March 31, 2011 are as follows for the Exchange. Data is provided by length of time securities were in a gross unrealized loss position.

| | Erie Insurance Group March 31, 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| *(dollars in millions)* | Less than 12 months | | 12 months or longer | | Total | | |
| **Exchange** | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair Value | Unrealized losses | No. of holdings |
| Fixed maturities: | | | | | | | |
| U.S. treasuries and government agencies | $ 2 | $ 0 | $ 0 | $0 | $ 2 | $ 0 | 1 |
| U.S. government sponsored enterprises | 34 | 0 | 0 | 0 | 34 | 0 | 5 |
| Foreign government | 10 | 0 | 0 | 0 | 10 | 0 | 1 |
| Municipal securities | 329 | 9 | 5 | 1 | 334 | 10 | 66 |
| U.S. corporate debt non-financial | 223 | 4 | 10 | 0 | 233 | 4 | 40 |
| U.S. corporate debt financial | 206 | 2 | 48 | 3 | 254 | 5 | 46 |
| Foreign corporate debt non-financial | 26 | 0 | 5 | 0 | 31 | 0 | 7 |
| Foreign corporate debt financial | 44 | 1 | 7 | 0 | 51 | 1 | 7 |
| Structured securities: | | | | | | | |
| Asset-backed other | | | | | | | |
| Collateralized debt obligations | 0 | 0 | 32 | 5 | 32 | 5 | 5 |
| Commercial mortgage-backed | 0 | 0 | 7 | 0 | 7 | 0 | 1 |
| Residential mortgage-backed: | | | | | | | |
| Government sponsored enterprises | 27 | 1 | 0 | 0 | 27 | 1 | 3 |
| Non-government sponsored enterprises | 0 | 0 | 4 | 0 | 4 | 0 | 1 |
| Total fixed maturities Exchange | $901 | $17 | $118 | $9 | $1,019 | $26 | 183 |
| Equity securities: | | | | | | | |
| U.S. nonredeemable preferred securities: | | | | | | | |
| Financial | $ 15 | $ 0 | $ 13 | $1 | $ 28 | $ 1 | 4 |
| Non-financial | 25 | 0 | 15 | 1 | 40 | 1 | 4 |
| Foreign nonredeemable preferred securities: | | | | | | | |
| Financial | 0 | 0 | 7 | 0 | 7 | 0 | 2 |
| Total equity securities Exchange | $ 40 | $ 0 | $ 35 | $2 | $ 75 | $ 2 | 10 |
| | | | | | | | |
| **Quality breakdown of fixed maturities:** | | | | | | | |
| Investment grade | $874 | $17 | $103 | $8 | $ 977 | $25 | 169 |
| Non-investment grade | 27 | 0 | 15 | 1 | 42 | 1 | 14 |
| Total fixed maturities Exchange | $901 | $17 | $118 | $9 | $1,019 | $26 | 183 |

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

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

Erie Insurance Group
December 31, 2010

| *(dollars in millions)* | Less than 12 months | | 12 months or longer | | Total | | |
|---|---|---|---|---|---|---|---|
| **Indemnity** | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses | No. of holdings |
| Fixed maturities: | | | | | | | |
| U.S. government sponsored enterprises | $25 | $0 | $0 | $0 | $25 | $0 | 1 |
| Municipal securities | 39 | 2 | 1 | 0 | 40 | 2 | 20 |
| U.S. corporate debt non-financial | 11 | 0 | 0 | 0 | 11 | 0 | 1 |
| U.S. corporate debt financial | 20 | 0 | 0 | 0 | 20 | 0 | 2 |
| Total fixed maturities Indemnity | $95 | $2 | $1 | $0 | $96 | $2 | 24 |
| Equity securities: | | | | | | | |
| U.S. nonredeemable preferred securities: | | | | | | | |
| Non-financial | $ 3 | $0 | $0 | $0 | $ 3 | $0 | 1 |
| Total equity securities Indemnity | $ 3 | $0 | $0 | $0 | $ 3 | $0 | 1 |
| | | | | | | | |
| **Quality breakdown of fixed maturities:** | | | | | | | |
| Investment grade | $95 | $2 | $1 | $0 | $96 | $2 | 24 |
| Non-investment grade | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total fixed maturities Indemnity | $95 | $2 | $1 | $0 | $96 | $2 | 24 |

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

Erie Insurance Group
December 31, 2010

| *(dollars in millions)* | Less than 12 months | | 12 months or longer | | Total | | |
|---|---|---|---|---|---|---|---|
| **Exchange** | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses | No. of holdings |
| Fixed maturities: | | | | | | | |
| U.S. treasuries and government agencies | $ 2 | $ 0 | $ 0 | $ 0 | $ 2 | $ 0 | 1 |
| U.S. government sponsored enterprises | 20 | 0 | 0 | 0 | 20 | 0 | 2 |
| Foreign government | 10 | 0 | 0 | 0 | 10 | 0 | 1 |
| Municipal securities | 299 | 8 | 5 | 1 | 304 | 9 | 59 |
| U.S. corporate debt non-financial | 217 | 4 | 36 | 1 | 253 | 5 | 43 |
| U.S. corporate debt financial | 141 | 2 | 85 | 5 | 226 | 7 | 47 |
| Foreign corporate debt non-financial | 8 | 0 | 16 | 0 | 24 | 0 | 5 |
| Foreign corporate debt financial | 32 | 2 | 7 | 0 | 39 | 2 | 6 |
| Structured securities: | | | | | | | |
| Collateralized debt obligations | 1 | 0 | 33 | 5 | 34 | 5 | 6 |
| Commercial mortgage-backed | 0 | 0 | 12 | 1 | 12 | 1 | 2 |
| Residential mortgage-backed: | | | | | | | |
| Government sponsored enterprises | 6 | 0 | 0 | 0 | 6 | 0 | 2 |
| Non-government sponsored enterprises | 0 | 0 | 7 | 1 | 7 | 1 | 2 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Total fixed maturities Exchange | $736 | $ 16 | $201 | $14 | $937 | $30 | 176 |
| Equity securities: | | | | | | | |
| U.S. nonredeemable preferred securities: | | | | | | | |
| Financial | $ 25 | $ 0 | $ 24 | $ 2 | $ 49 | $ 2 | 6 |
| Non-financial | 14 | 1 | 20 | 1 | 34 | 2 | 4 |
| Foreign nonredeemable preferred securities: | | | | | | | |
| Financial | 6 | 1 | 15 | 2 | 21 | 3 | 5 |
| Total equity securities Exchange | $ 45 | $ 2 | $ 59 | $ 5 | $104 | $ 7 | 15 |
| | | | | | | | |
| **Quality breakdown of fixed maturities:** | | | | | | | |
| Investment grade | $703 | $ 16 | $155 | $11 | $858 | $27 | 154 |
| Non-investment grade | 33 | 0 | 46 | 3 | 79 | 3 | 22 |
| Total fixed maturities Exchange | $736 | $ 16 | $201 | $14 | $937 | $30 | 176 |

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

| | Erie Insurance Group Three months ended March 31, | |
|---|---|---|
| *(in millions)* | 2011 | 2010 |
| **Indemnity** | | |
| Fixed maturities | $ 3 | $ 8 |
| Equity securities | 1 | 1 |
| Cash equivalents and other | 0 | 0 |
| Total investment income | 4 | 9 |
| Less: investment expenses | 0 | 0 |
| Investment income, net of expenses Indemnity | $ 4 | $ 9 |
| **Exchange** | | |
| Fixed maturities | $ 92 | $ 86 |
| Equity securities | 18 | 16 |
| Cash equivalents and other | 0 | 0 |
| Total investment income | 110 | 102 |
| Less: investment expenses | 9 | 7 |
| Investment income, net of expenses Exchange | $101 | $ 95 |
| Investment income, net of expenses Erie Insurance Group | $105 | $104 |

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

Realized gains (losses) on Indemnity s investments were as follows:

| | Erie Insurance Group Three months ended March 31, | |
|---|---|---|
| *(in millions)* | | |
| **Indemnity** | 2011 | 2010 |
| Available-for-sale securities: | | |
| Fixed maturities: | | |
| Gross realized gains | $ 0 | $ 2 |
| Gross realized losses | 0 | 0 |
| Net realized gains | 0 | 2 |
| Equity securities: | | |
| Gross realized gains | 1 | 0 |
| Gross realized losses | 0 | 0 |
| Net realized gains | 1 | 0 |
| Trading securities: | | |
| Common stock: | | |
| Gross realized gains | 1 | 1 |
| Gross realized losses | 0 | 0 |
| Valuation adjustments | (1) | 2 |
| Net realized gains | 0 | 3 |
| Net realized gains on investments Indemnity | $ 1 | $ 5 |

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Realized gains (losses) on the Exchange s investments were as follows:

| *(in millions)* | Erie Insurance Group Three months ended March 31, | |
|---|---|---|
| **Exchange** | 2011 | 2010 |
| Available-for-sale securities: | | |
| Fixed maturities: | | |
| Gross realized gains | $ 25 | $ 21 |
| Gross realized losses | (12) | (9) |
| Net realized gains | 13 | 12 |
| Equity securities: | | |
| Gross realized gains | 6 | 4 |
| Gross realized losses | (1) | 0 |
| Net realized gains | 5 | 4 |
| Trading securities: | | |
| Common stock: | | |
| Gross realized gains | 56 | 45 |
| Gross realized losses | (8) | (12) |
| Valuation adjustments | 82 | 71 |
| Net realized gains | 130 | 104 |
| Net realized gains on investments Exchange | $148 | $120 |
| Net realized gains on investments Erie Insurance Group | $149 | $125 |

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

| *(in millions)* | Erie Insurance Group Three months ended March 31, | |
|---|---|---|
| | 2011 | 2010 |
| **Indemnity** | | |
| Fixed maturities | $ 0 | $ 0 |
| Equity securities | 0 | 0 |
| Total | 0 | 0 |
| Portion recognized in other comprehensive income | 0 | 0 |
| Net impairment losses recognized in earnings Indemnity | $ 0 | $ 0 |
| **Exchange** | | |
| Fixed maturities | $ 0 | $ (2) |
| Equity securities | 0 | 0 |
| Total | 0 | (2) |
| Portion recognized in other comprehensive income | 0 | 0 |
| Net impairment losses recognized in earnings Exchange | $ 0 | $ (2) |
| Net impairment losses recognized in earnings Erie Insurance Group | $ 0 | $ (2) |

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

Limited partnerships

Our limited partnership investments are recorded using the equity method of accounting. As these investments are generally reported on a one-quarter lag, our limited partnership results through March 31, 2011 are comprised of general partnership financial results for the fourth quarter of 2010. Given the lag in reporting, our limited partnership results do not reflect the market conditions of the first quarter of 2011. Cash contributions made to and distributions received from the partnerships are recorded in the period in which the transaction occurs.

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

As these investments are generally reported on a one-quarter lag, our limited partnership results through March 31, 2011 include the general partnership financial results for the fourth quarter of 2010.

| *(dollars in millions)* | As of and for the three months ended March 31, 2011 | | | |
|---|---|---|---|---|
| Investment percentage in partnership for Erie Insurance Group | Number of partnerships | Asset recorded | Income (loss) recognized due to valuation adjustments by the partnerships | Income (1oss) recorded |
| **Indemnity** | | | | |
| Private equity: | | | | |
| Less than 10% | 26 | $ 82 | $ 5 | $ 1 |
| Greater than or equal to 10% but less than 50% | 3 | 8 | 0 | 1 |
| Greater than 50% | 0 | 0 | 0 | 0 |
| Total private equity | 29 | 90 | 5 | 2 |
| Mezzanine debt: | | | | |
| Less than 10% | 11 | 29 | 0 | 2 |
| Greater than or equal to 10% but less than 50% | 3 | 15 | 0 | 0 |
| Greater than 50% | 1 | 2 | 0 | 0 |
| Total mezzanine debt | 15 | 46 | 0 | 2 |
| Real estate: | | | | |
| Less than 10% | 12 | 60 | 2 | 0 |
| Greater than or equal to 10% but less than 50% | 4 | 16 | 0 | 0 |
| Greater than 50% | 4 | 10 | 0 | 0 |
| Total real estate | 20 | 86 | 2 | 0 |
| Total limited partnerships Indemnity | 64 | $ 222 | $ 7 | $ 4 |
| | | | | |
| **Exchange** | | | | |
| Private equity: | | | | |
| Less than 10% | 41 | $ 547 | $26 | $11 |
| Greater than or equal to 10% but less than 50% | 3 | 35 | (1) | 4 |
| Greater than 50% | 0 | 0 | 0 | 0 |
| Total private equity | 44 | 582 | 25 | 15 |
| Mezzanine debt: | | | | |
| Less than 10% | 14 | 141 | (1) | 7 |
| Greater than or equal to 10% but less than 50% | 3 | 42 | 1 | 0 |
| Greater than 50% | 3 | 32 | 0 | 1 |
| Total mezzanine debt | 20 | 215 | 0 | 8 |
| Real estate: | | | | |
| Less than 10% | 25 | 263 | 14 | (3) |
| Greater than or equal to 10% but less than 50% | 6 | 55 | 1 | 0 |
| Greater than 50% | 4 | 38 | 1 | 0 |
| Total real estate | 35 | 356 | 16 | (3) |
| Total limited partnerships Exchange | 99 | $1,153 | $41 | $20 |
| Total limited partnerships Erie Insurance Group | | $1,375 | $48 | $24 |

Per the limited partner financial statements, total partnership assets were $52 billion and total partnership liabilities were $5 billion at March 31, 2011 (as recorded in the December 31, 2010 limited partnership financial statements). For the three month period comparable to that presented in the preceding table (fourth quarter 2010), total partnership valuation adjustment gains were $2 billion and total partnership net income was $830 million.

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

| *(dollars in millions)* | As of and for the year ended December 31, 2010 | | | |
|---|---|---|---|---|
| Investment percentage in partnership for Erie Insurance Group | Number of partnerships | Asset recorded | Income (loss) recognized due to valuation adjustments by the partnerships | Income (1oss) recorded |
| **Indemnity** | | | | |
| Private equity: | | | | |
| Less than 10% | 26 | $ 78 | $ 4 | $ 7 |
| Greater than or equal to 10% but less than 50% | 3 | 8 | 3 | 0 |
| Greater than 50% | 0 | 0 | 0 | 0 |
| Total private equity | 29 | 86 | 7 | 7 |
| Mezzanine debt: | | | | |
| Less than 10% | 11 | 30 | 4 | 3 |
| Greater than or equal to 10% but less than 50% | 3 | 15 | 2 | (2) |
| Greater than 50% | 1 | 2 | 0 | 0 |
| Total mezzanine debt | 15 | 47 | 6 | 1 |
| Real estate: | | | | |
| Less than 10% | 12 | 59 | 30 | (31) |
| Greater than or equal to 10% but less than 50% | 4 | 14 | 10 | (10) |
| Greater than 50% | 4 | 10 | 4 | (3) |
| Total real estate | 20 | 83 | 44 | (44) |
| Total limited partnerships Indemnity | 64 | $ 216 | $ 57 | $(36) |
| **Exchange** | | | | |
| Private equity: | | | | |
| Less than 10% | 41 | $ 517 | $ 28 | $40 |
| Greater than or equal to 10% but less than 50% | 3 | 38 | 10 | 0 |
| Greater than 50% | 0 | 0 | 0 | (1) |
| Total private equity | 44 | 555 | 38 | 39 |
| Mezzanine debt: | | | | |
| Less than 10% | 14 | 142 | 12 | 13 |
| Greater than or equal to 10% but less than 50% | 3 | 41 | 2 | (2) |
| Greater than 50% | 3 | 31 | 0 | 2 |
| Total mezzanine debt | 20 | 214 | 14 | 13 |
| Real estate: | | | | |
| Less than 10% | 25 | 250 | (11) | 10 |
| Greater than or equal to 10% but less than 50% | 6 | 52 | 7 | (7) |
| Greater than 50% | 4 | 37 | 15 | (11) |
| Total real estate | 35 | 339 | 11 | (8) |
| Total limited partnerships Exchange | 99 | $1,108 | $ 63 | $44 |
| Total limited partnerships Erie Insurance Group | | $1,324 | $120 | $ 8 |

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

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

**Note 8. Bank Line of Credit**

As of March 31, 2011, Indemnity has available a $100 million line of credit that expires on December 31, 2011. There were no borrowings outstanding on the line of credit as of March 31, 2011. Bonds with a fair value of $134 million are pledged as collateral on the line at March 31, 2011.

As of March 31, 2011, the Exchange has available a $200 million revolving line of credit that expires on September 30, 2012. There were no borrowings outstanding on the line of credit as of March 31, 2011. Bonds with a fair value of $258 million are pledged as collateral on the line at March 31, 2011.

Securities pledged as collateral on both lines have no restrictions and are reported as available-for-sale fixed maturities in the Consolidated Statements of Financial Position as of March 31, 2011. The banks require compliance with certain covenants, which include statutory surplus and risk based capital ratios for the Exchange s line of credit and minimum net worth and leverage ratios for Indemnity s line of credit. We are in compliance with all covenants at March 31, 2011.

**Note 9. Income Taxes**

Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the financial statement or tax returns. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. At March 31, 2011, we recorded a net deferred tax liability of $323 million on our Consolidated Statements of Financial Position. Of this amount, $309 million is attributable to the Exchange and $14 million is attributable to Indemnity. There was no deferred tax valuation allowance recorded at March 31, 2011. Our effective tax rate is calculated after consideration of permanent differences related to our investment revenues as described in FASB ASC 740, *Income Taxes.* Given that these amounts represent 99% of the total permanent differences, the effective tax rate is approximately 35% for both Indemnity and Exchange when the investment related permanent differences are considered using FASB ASC 740.

**Note 10. Postretirement Benefits**

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

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

| *(in millions)* | Three months ended March 31, 2011 | 2010 |
|---|---|---|
| Service cost | $4 | $ 4 |
| Interest cost | 6 | 5 |
| Expected return on plan assets | (7) | (6) |
| Amortization of prior service cost | 0 | 0 |
| Amortization of actuarial loss | 2 | 1 |
| Net periodic benefit cost | $5 | $ 4 |

**Note 11. Reconciliation of Shareholders Equity**

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

| *(in millions, except per share data)* | Indemnity shareholders interest | Exchange noncontrolling interest | Erie Insurance Group |
|---|---|---|---|
| **Balance at December 31, 2009** | $902 | $4,823 | $5,725 |
| Comprehensive income: | | | |
| Net income | 162 | 498 | 660 |
| Other comprehensive income, net of tax: | | | |
| Unrealized gains on securities | 9 | 101 | 110 |
| Reclassification of unrealized gain on sale of P&C affiliated subsidiaries | (15) | | (15) |
| Postretirement plans: | | | |
| Amortization of prior service cost | 0 | | 0 |
| Amortization of net actuarial loss | 2 | | 2 |
| Net actuarial loss during year | (6) | | (6) |
| Loss due to plan changes during year | 0 | | 0 |
| Curtailment/settlement loss arising during year | 0 | | 0 |
| Postretirement plans | (4) | | (4) |
| Other comprehensive (loss) income, net of tax | (10) | 101 | 91 |
| Reclassification of unrealized gain on sale of P&C affiliated subsidiaries, net of tax | 15 | | 15 |
| Comprehensive income | 167 | 599 | 766 |
| Purchase of treasury stock | (58) | | (58) |
| Dividends declared: | | | |
| Class A $1.995 per share | (99) | | (99) |
| Class B $293.25 per share | 0 | | 0 |
| **Balance at December 31, 2010** | $912 | $5,422 | $6,334 |
| Comprehensive income: | | | |
| Net income | 44 | 230 | 274 |
| Other comprehensive income, net of tax: | | | |
| Unrealized (loss) gains on securities | (1) | 6 | 5 |
| Reclassification of unrealized gain on sale of EFL | (9) | | (9) |
| Other comprehensive (loss) income, net of tax | (10) | 6 | (4) |
| Reclassification of unrealized gain on sale of EFL, net of tax | 9 | | 9 |
| Comprehensive income | 43 | 236 | 279 |
| Purchase of treasury stock | (36) | | (36) |
| Dividends declared: | | | |
| Class A $0.515 per share | (26) | | (26) |
| Class B $77.25 per share | 0 | | 0 |
| **Balance at March 31, 2011** | $893 | $5,658 | $6,551 |

**Note 12. Commitments and Contingencies**

Indemnity has contractual commitments to invest up to $47 million related to its limited partnership investments at March 31, 2011. These commitments are split between private equity securities of $20 million, real estate activities of $15 million and mezzanine debt securities of $12 million. These commitments will be funded as required by the partnership agreements.

The Exchange, including EFL, has contractual commitments to invest up to $429 million related to its limited partnership investments at March 31, 2011. These commitments are split between private equity securities of $170 million, real estate activities of $132 million and mezzanine debt securities of $127 million. These commitments will be funded as required by the partnership agreements.

We are involved in litigation arising in the ordinary course of business. In our opinion, the effects, if any, of such litigation are not expected to be material to our consolidated financial condition, operations or cash flows.

**Note 13. Statutory Information**

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

**Note 14. Indemnity Supplemental Information**

| | Consolidating Statement of Financial Position March 31, 2011 | | | |
|---|---|---|---|---|
| *(in millions)* **Assets** | Indemnity shareholder interest | Exchange noncontrolling interest | Reclassifications and eliminations | Erie Insurance Group |
| Investments | | | | |
| Available-for-sale securities, at fair value: | | | | |
| Fixed maturities | $513 | $7,254 | $ | $7,767 |
| Equity securities | 22 | 603 | | 625 |
| Trading securities, at fair value | 29 | 2,462 | | 2,491 |
| Limited partnerships | 222 | 1,153 | | 1,375 |
| Other invested assets | 1 | 18 | | 19 |
| Total investments | 787 | 11,490 | | 12,277 |
| Cash and cash equivalents | 86 | 125 | | 211 |
| Premiums receivable from policyholders | | 959 | | 959 |
| Reinsurance recoverable | | 199 | | 199 |
| Deferred acquisition costs | | 469 | | 469 |
| Other assets | 106 | 332 | | 438 |
| Receivables from Exchange and other affiliates | 239 | | (239) | |
| Note receivable from EFL | 25 | | (25) | |
| Total assets | $1,243 | $13,574 | $(264) | $14,553 |
| **Liabilities** | | | | |
| Losses and loss expense reserves | $ | $3,559 | $ | $3,559 |
| Life policy and deposit contract reserves | | 1,615 | | 1,615 |
| Unearned premiums | | 2,093 | | 2,093 |
| Deferred income taxes | 14 | 309 | | 323 |
| Other liabilities | 336 | 340 | (264) | 412 |
| Total liabilities | 350 | 7,916 | (264) | 8,002 |
| **Shareholders equity and noncontrolling interest** | | | | |
| Total Indemnity shareholders equity | 893 | | | 893 |
| Noncontrolling interest in consolidated entity Exchange | | 5,658 | | 5,658 |
| Total equity | 893 | 5,658 | | 6,551 |
| Total liabilities, shareholders equity and noncontrolling interest | $1,243 | $13,574 | $(264) | $14,553 |

| | | Consolidating Statement of Financial Position December 31, 2010 | | |
|---|---|---|---|---|
| *(in millions)* **Assets** | Indemnity shareholder interest | Exchange noncontrolling interest | Reclassifications and eliminations | Erie Insurance Group |
| Investments | | | | |
| Available-for-sale securities, at fair value: | | | | |
| Fixed maturities | $ 264 | $ 7,279 | $ | $ 7,543 |
| Equity securities | 24 | 570 | | 594 |
| Trading securities, at fair value | 28 | 2,306 | | 2,334 |
| Limited partnerships | 216 | 1,108 | | 1,324 |
| Other invested assets | 1 | 19 | | 20 |
| Total investments | 533 | 11,282 | | 11,815 |
| Cash and cash equivalents | 310 | 120 | | 430 |
| Premiums receivable from policyholders | | 942 | | 942 |
| Reinsurance recoverable | | 201 | | 201 |
| Deferred acquisition costs | | 467 | | 467 |
| Other assets | 132 | 357 | | 489 |
| Receivables from Exchange and other affiliates | 232 | | (232) | |
| Note receivable from EFL | 25 | | (25) | |
| Equity in EFL(1) | 80 | | (80) | |
| Total assets | $1,312 | $13,369 | $(337) | $14,344 |
| **Liabilities** | | | | |
| Losses and loss expense reserves | $ | $ 3,584 | $ | $ 3,584 |
| Life policy and deposit contract reserves | | 1,603 | | 1,603 |
| Unearned premiums | | 2,082 | | 2,082 |
| Deferred income taxes | 26 | 257 | | 283 |
| Other liabilities | 374 | 341 | (257) | 458 |
| Total liabilities | 400 | 7,867 | (257) | 8,010 |
| **Shareholders equity and noncontrolling interest** | | | | |
| Total Indemnity shareholders equity | 912 | | | 912 |
| Noncontrolling interest in consolidated entity Exchange | | 5,502 | (80) | 5,422 |
| Total equity | 912 | 5,502 | (80) | 6,334 |
| Total liabilities, shareholders equity and noncontrolling interest | $1,312 | $13,369 | $(337) | $14,344 |

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

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. EFL accrued interest to Indemnity of $0.4 million in each of the first quarters ended March 31, 2011 and 2010.

| | | Income attributable to Indemnity shareholder interest | |
|---|---|---|---|
| | | Three months ended March 31, | |
| *(in millions)* | Percent | 2011 | 2010 |
| **Management operations:** | | | |
| Management fee revenue, net | 100.0% | $251 | $237 |
| Service agreement revenue | 100.0% | 8 | 8 |
| Total revenue from management operations | | 259 | 245 |
| Cost of management operations | 100.0% | 211 | 192 |
| ***Income from management operations before taxes*** | | 48 | 53 |
| **Property and casualty insurance operations:** (2) | | | |
| Net premiums earned | 5.5% (2) | | 53 |
| Losses and loss expenses | 5.5% (2) | | 40 |
| Policy acquisition and other underwriting expenses | 5.5% (2) | | 15 |
| ***Loss from property and casualty insurance operations before taxes*** | | | (2) |
| **Life insurance operations:** (1) | | | |
| Total revenue | 21.6% (3) | 10 | 9 |
| Total benefits and expenses | 21.6% (3) | 7 | 7 |
| ***Income from life insurance operations before taxes*** | | 3 | 2 |
| **Investment operations:** | | | |
| Net investment income (2) | | 4 | 9 |
| Net realized gains on investments (2) | | 1 | 5 |
| Net impairment losses recognized in earnings (2) | | 0 | 0 |
| Equity in earnings of limited partnerships | | 11 | 0 |
| ***Income from investment operations before taxes*** (2) | | 16 | 14 |
| **Income from operations before income taxes** | | 67 | 67 |
| Provision for income taxes | | 23 | 20 |
| **Net income** | | $ 44 | $ 47 |

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

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

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

Direct method of cash flows

Indemnity s components of direct cash flows as presented in the Consolidated Statements of Cash Flows is as follows for the three months ended March 31:

| | Indemnity Three months ended March 31, | |
|---|---|---|
| *(in millions)* | 2011 | 2010 |
| Management fee received | $ 252 | $ 225 |
| Service agreement fee received | 8 | 8 |
| Premiums collected (1) | | 52 |
| Net investment income received (1) | 4 | 10 |
| Limited partnership distributions | 5 | 2 |
| Decrease in reimbursements collected from affiliates | (8) | (1) |
| Commissions and bonuses paid to agents | (178) | (169) |
| Salaries and wages paid | (38) | (33) |
| Employee benefits paid | (4) | (2) |
| Losses paid (1) | | (34) |
| Loss expenses paid (1) | | (6) |
| Other underwriting and acquisition costs paid (1) | | (16) |
| General operating expenses paid | (35) | (35) |
| Income taxes paid | 0 | (1) |
| Net cash provided by operating activities | 6 | 0 |
| Net cash used in investing activities | (168) | (19) |
| Net cash used in financing activities | (62) | (28) |
| Net decrease in cash | (224) | (47) |
| Cash and cash equivalents at beginning of period | 310 | 77 |
| Cash and cash equivalents at end of period | $ 86 | $ 30 |

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

**Note 15. Capital Stock**

Stock repurchase program

In December 2010, our Board of Directors approved a continuation of the current stock repurchase program for a total of $150 million, with no time limitation. Indemnity had approximately $109.7 million of repurchase authority remaining under this program at March 31, 2011.

**Note 16. Subsequent Events**

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

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

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

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## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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

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

Risk factors related to the Indemnity shareholder interest:

- dependence on Indemnity s relationship with the Exchange and the management fee under the agreement with the subscribers at the Exchange;
- costs of providing services to the Exchange under the subscriber s agreement;
- ability to attract and retain talented management and employees;
- ability to maintain the uninterrupted operations of our business, including our information technology systems;
- factors affecting the quality and liquidity of our investment portfolio;
- credit risk from the Exchange;
- ability to meet liquidity needs and access capital; and
- outcome of pending and potential litigations against us.

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

- general business and economic conditions;
- dependence on the independent agency system;
- ability to maintain our reputation for superior customer service;
- factors affecting price competition;
- government regulation of the insurance industry, including approval of rate increases and rating factors such as credit and prior experience, and required processes related to underwriting and claims handling;
- the uncertain role of the Federal Government, and the ongoing role of the States, in regulating the property/casualty or life insurance industries;
- premium rates and reserves must be established from forecasts of ultimate costs;
- emerging claims, coverage issues in the industry, and changes in reserve estimates related to the property and casualty business;
- changes in reserve estimates related to the life business;
- severe weather conditions or other catastrophic losses, including terrorism;
- ability to acquire reinsurance coverage and collectability from reinsurers;
- factors affecting the quality and liquidity of our investment portfolio;
- ability to meet liquidity needs and access capital;
- ability to maintain acceptable financial strength rating;
- outcome of pending and potential litigation against us; and
- dependency on service provided by Indemnity.

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

**<u>RECENT ACCOUNTING PRONOUNCEMENTS</u>**

See Item 1. Financial Statements - Note 2, Significant Accounting Policies, contained within this report for a discussion of adopted and/or pending accounting pronouncements.

**RECENT EVENTS**

The sale of Indemnity s 21.6% ownership interest in EFL to the Exchange was completed on March 31, 2011, at which time Indemnity received cash consideration from the Exchange based upon an estimated purchase price of $82 million. Final settlement of the transaction was made on April 25, 2011 for a final purchase price of $82 million. Net after-tax cash proceeds to Indemnity from the sale are estimated to be $58 million. There was no gain or loss resulting from this sale as Indemnity and the Exchange are deemed to be under common control.

For further information relating to the consolidation of Indemnity and the Exchange, see Item 1. Financial Statements - Note 2, Significant Accounting Policies, contained within this report. For further information relating to the sale of Indemnity s wholly owned property and casualty subsidiaries and its equity interest in EFL, see Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report and the Operating Overview section that follows.

**OPERATING OVERVIEW**

**Overview**

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

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

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

Indemnity shareholders benefit from their interest in Indemnity s equity and income, but not the equity or income of the ExchangeThe Exchange s equity, which is comprised of its retained earnings and accumulated other comprehensive income, is held for the benefit 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 benefit of the subscribers (policyholders).

Indemnity shareholders interest in income generally comprises:

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

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

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

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

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

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

**Results of the Erie Insurance Group s operations by interest (unaudited)**

The following table represents a breakdown of the composition of the income attributable to Indemnity and the income attributable to the noncontrolling interest (Exchange) for the three months ended March 31, 2011. For purposes of this discussion, EFL s investments are included in the life insurance operations.

| (*in millions*) | Indemnity shareholder interest | | | Noncontrolling interest (Exchange) | | | Eliminations of related party transactions | | Erie Insurance Group | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Three months ended March 31, | | | Three months ended March 31, | | Three months ended March 31, | | Three months ended March 31, | |
| | Percent | 2011 | 2010 | Percent | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| **Management operations:** | | | | | | | | | | |
| Management fee revenue, net | 100.0% | $251 | $237 | | $ | $ | $(251) | $(237) | $ | $ |
| Service agreement revenue | 100.0% | 8 | 8 | | | | | | 8 | 8 |
| Total revenue from management operations | | 259 | 245 | | | | (251) | (237) | 8 | 8 |
| Cost of management operations | 100.0% | 211 | 192 | | | | (211) | (192) | | |
| ***Income from management operations before taxes*** | | 48 | 53 | | | | (40) | (45) | 8 | 8 |
| **Property and casualty insurance operations:** (2) | | | | | | | | | | |
| Net premiums earned | 5.5% (2) | | 53 | 94.5% (2) | 1,014 | 909 | | | 1,014 | 962 |
| Losses and loss expenses | 5.5% (2) | | 40 | 94.5% (2) | 683 | 698 | (1) | (1) | 682 | 737 |
| Policy acquisition and other underwriting expenses | 5.5% (2) | | 15 | 94.5% (2) | 282 | 250 | (42) | (46) | 240 | 219 |
| ***Income (loss) from property and casualty insurance operations before taxes*** | | | (2) | | 49 | (39) | 43 | 47 | 92 | 6 |
| **Life insurance operations:** (1) | | | | | | | | | | |
| Total revenue | 21.6% (3) | 10 | 9 | 78.4% (3) | 34 | 34 | 0 | 0 | 44 | 43 |
| Total benefits and expenses | 21.6% (3) | 7 | 7 | 78.4% (3) | 24 | 26 | 0 | (1) | 31 | 32 |
| ***Income from life insurance operations before taxes*** | | 3 | 2 | | 10 | 8 | 0 | 1 | 13 | 11 |
| **Investment operations:** | | | | | | | | | | |
| Net investment income (2) | | 4 | 9 | | 81 | 75 | (3) | (3) | 82 | 81 |
| Net realized gains on investments (2) | | 1 | 5 | | 144 | 115 | | | 145 | 120 |
| Net impairment losses recognized in earnings (2) | | 0 | 0 | | 0 | (2) | | | 0 | (2) |
| Equity in earnings of limited partnerships | | 11 | 0 | | 61 | 4 | | | 72 | 4 |
| ***Income from investment operations before taxes*** (2) | | 16 | 14 | | 286 | 192 | (3) | (3) | 299 | 203 |
| **Income from operations before income taxes and noncontrolling interest** | | 67 | 67 | | 345 | 161 | | | 412 | 228 |
| Provision for income taxes | | 23 | 20 | | 115 | 46 | | | 138 | 66 |
| **Net income** | | $ 44 | $ 47 | | $ 230 | $115 | $ | $ | $ 274 | $162 |

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

*(2) Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the benefit of the Indemnity shareholder interest. Due to the sale of Indemnity s property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results and all investment results for these companies accrue to the benefit of the subscribers (policyholders) of the Exchange,*

*or noncontrolling interest, after December 31, 2010. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)*

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

Net income in the first quarter of 2011 was positively impacted by improved results in our property and casualty insurance operations compared to the first quarter of 2010. Our property and casualty insurance operation s direct written premium increased 6.3% driven by an increase in policies in force and modest increases in average premium per policy. Property and casualty insurance losses were lower due to lower catastrophe loss and favorable development on prior accident years. Our investment operations were positively impacted by increased earnings on limited partnerships.

**Reconciliation of operating income to net income (unaudited)**

We believe that an investor s understanding of our performance related to the Indemnity shareholder interest is enhanced by the disclosure of operating income, a non-GAAP financial measure. Our method of calculating this measure may differ from those used by other companies, and therefore comparability may be limited.

Indemnity defines operating income as income generated from management operations, life insurance operations (1), property and casualty insurance underwriting operations (2), net investment income (2), and equity in earnings or losses of limited partnerships, net of related federal income taxes. It does not include realized capital gains and losses, impairment losses and related federal income taxes.

Indemnity uses operating income to evaluate the results of its operations. It reveals trends that may be obscured by the net effects of realized capital gains and losses including impairment losses. Realized capital gains and losses including impairment losses, may vary significantly between periods and are generally driven by business decisions and economic developments such as capital market conditions which are not related to our ongoing operations. We believe it is useful for investors to evaluate these components separately and in the aggregate when reviewing our performance. 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. GAAP and does not reflect Indemnity s overall profitability.

The following table reconciles operating income and net income for the Indemnity shareholder interest: (1) (2)

| *(in millions, except per share data)* | Indemnity shareholder interest Three Months Ended March 31, 2011 | 2010 |
|---|---|---|
| Operating income attributable to Indemnity | $43 | $44 |
| Net realized gains and impairments on investments | 1 | 5 |
| Income tax expense | 0 | (2) |
| Realized gains and impairments, net of income taxes | 1 | 3 |
| Net income attributable to Indemnity | $44 | $47 |
| | | |
| Per Indemnity Class A common share-diluted: | | |
| Operating income attributable to Indemnity | $0.77 | $0.77 |
| Net realized gains and impairments on investments | 0.02 | 0.09 |
| Income tax expense | (0.01) | (0.04) |
| Realized gains and impairments, net of income taxes | 0.01 | 0.05 |
| Net income attributable to Indemnity | $0.78 | $0.82 |

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

*(2) Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY and the investment results of EIC, ENY and EPC accrued to the benefit of the Indemnity shareholder interest. Due to the sale of Indemnity s property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results and all investment results for these companies accrue to the benefit of the subscribers (policyholders) of the Exchange,*

*or noncontrolling interest, after December 31, 2010. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)*

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

Property and casualty insurance operations

The property and casualty insurance industry is highly cyclical, with periods of rising premium rates and shortages of underwriting capacity followed by periods of substantial price competition and excess capacity. The cyclical nature of the insurance industry has a direct impact on the direct written premiums of the Property and Casualty Group. Industry property and casualty premium rates in 2010 showed signs of firming for personal lines, where most commercial lines continued to reflect rate reductions as the economy began to show signs of a sluggish recovery.

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

The property and casualty insurance operations insure standard and preferred risks while adhering to a set of consistent underwriting standards. Nearly 50% of premiums are derived from personal auto, 20% from homeowners and 30% from commercial lines. Pennsylvania, Maryland and Virginia made up 63% of the property and casualty lines insurance business 2010 direct written premium.

The members of the Property and Casualty Group pool their underwriting results under an intercompany pooling agreement. Under the pooling agreement, the Exchange retains a 94.5% interest in the net underwriting results of the Property and Casualty Group, while EIC retains a 5.0% interest and ENY retains a 0.5% interest. Prior to and through December 31, 2010, the underwriting results retained by EIC and ENY accrued to the benefit of the Indemnity shareholder interest. Due to the sale of Indemnity s property and casualty subsidiaries to the Exchange on December 31, 2010, all property and casualty underwriting results accrue to the benefit of the subscribers (policyholders) of the Exchange, or noncontrolling interest, after December 31, 2010.

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

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

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

Life insurance operations

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

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

Investment operations

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

Our investment operations reflected the improvement experienced in the financial markets in the first quarter of 2011. In the first quarter of 2011 there were minimal impairments of securities compared to $2 million in the first quarter of 2010. Our alternative investments benefited from the improved financial market conditions in the fourth quarter of 2010. The upturn across all markets had a significant impact on the portfolios of our partnerships. Equity in earnings of limited partnerships was $72 million in the first quarter of 2011 compared to $3 million in the first quarter of 2010. The valuation adjustments in the limited partnerships are based on financial statements received from our general partners, which are generally received on a quarter lag. As a result, the first quarter 2011 partnership earnings do not reflect the valuation changes from the first quarter of 2011, but reflect conditions from the fourth quarter of 2010.

**General conditions and trends affecting our business**

Economic conditions

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

Market volatility

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

**RESULTS OF OPERATIONS**

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

**Management operations**

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

| *(dollars in millions)* | Erie Insurance Group Three months ended March 31, | | |
|---|---|---|---|
| | 2011 | 2010 | % Change |
| **Indemnity** | (Unaudited) | | |
| Management fee revenue | $ 251 | $ 237 | 6.2 % |
| Service agreement revenue | 8 | 8 | (1.4) |
| Total revenue from management operations | 259 | 245 | 6.0 |
| Cost of management operations | 211 | 192 | 10.4 |
| Income from management operations Indemnity(1) | $ 48 | $ 53 | (9.7)% |
| Gross margin | 18.6% | 21.8% | 3.2 pts. |

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

Management fee revenue

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

| *(dollars in millions)* | Erie Insurance Group Three months ended March 31, | | |
|---|---|---|---|
| | 2011 | 2010 | % Change |
| **Indemnity** | (Unaudited) | | |
| Property and Casualty Group direct written premiums | $1,008 | $948 | 6.3 % |
| Management fee rate | 25% | 25% | |
| Management fee revenue, gross | $ 252 | $237 | 6.3 % |
| Change in allowance for management fee returned on cancelled policies(1) | (1) | 0 | NM |
| Management fee revenue, net of allowance | $ 251 | $237 | 6.2 % |

NM = not meaningful

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

Direct written premiums of the Property and Casualty Group increased 6.3% in the first quarter of 2011, compared to the first quarter of 2010, due to a 3.2% increase in policies in force and modest increases in average premium. The year-over-year average premium per policy for all lines of business increased 2.1% at March 31, 2011, compared to a decrease of 1.3% at March 31, 2010. The policy retention ratio was 90.7% at March 31, 2011, compared to 90.7% at December 31, 2010 and March 31, 2010. See the Property and casualty insurance operations segment that follows for a complete discussion of property and casualty direct written premiums.

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

Service agreement revenue

Service agreement revenue includes service charges Indemnity collects from policyholders for providing extended payment terms on policies written by the Property and Casualty Group and late payment and policy reinstatement fees. The service charges are fixed dollar amounts per billed installment. Service agreement revenue totaled $8 million in the first quarters of 2011 and 2010.

Cost of management operations

| *(in millions)* | Erie Insurance Group Three months ended March 31, 2011 | 2010 | % Change |
|---|---|---|---|
| **Indemnity** | (Unaudited) | | |
| Commissions | $138 | $129 | 7.0 % |
| Non-commission expense | 73 | 63 | 17.3 |
| Total cost of management operations | $211 | $192 | 10.4 % |

*Commissions* Commissions increased $9 million in the first quarter of 2011, compared to the first quarter of 2010, driven primarily by the 6.3% increase in direct written premiums of the Property and Casualty Group.

*Non-commission expense* Non-commission expense increased $10 million in the first quarter of 2011, compared to the first quarter of 2010. Personnel costs increased $5 million primarily as a result of increases in salaries and benefits, while the first quarter 2010 expenses included a $5 million reduction for a favorable court ruling.

The gross margin of 21.8% in the first quarter of 2010 was positively impacted by a $5 million reduction for a favorable court ruling. Excluding this adjustment, the gross margin would have been 19.8%, compared to 18.6% in the first quarter of 2011. The lower gross margin in the first quarter of 2011 was a result of expense growth slightly outpacing revenue growth.

**Property and casualty insurance operations**

The Property and Casualty Group operates in 11 Midwestern, Mid-Atlantic and Southeastern states and the District of Columbia and primarily writes private passenger automobile, homeowners, commercial multi-peril, commercial automobile, and workers compensation lines of insurance.

| *(dollars in millions)* | Property and Casualty Group Three months ended March 31, 2011 | 2010 | % Change |
|---|---|---|---|
| | (Unaudited) | | |
| Direct written premium | $1,008 | $ 948 | 6.3 % |
| Reinsurance assumed and ceded | (4) | (2) | (69.4) |
| Net written premium | 1,004 | 946 | 6.1 |
| Change in unearned premium | (10) | (16) | 39.1 |
| Net premiums earned | 1,014 | 962 | 5.4 |
| Losses and loss expenses | 683 | 738 | (7.4) |
| Policy acquisition and other underwriting expenses | 282 | 265 | 6.1 |
| Total losses and expenses | 965 | 1,003 | (3.8) |
| Underwriting income (loss) Erie Insurance Group | $ 49 | $ (41) | NM |
| Underwriting income (loss) Indemnity (1) | $ | $ (2) | |
| Underwriting income (loss) Exchange (1) | $ 49 | $ (39) | |
| | | | |
| Loss and loss expense ratio | 67.4% | 76.7% | (9.3) pts. |

| | | | |
|---|---|---|---|
| Policy acquisition and other underwriting expense ratio | 27.8 | 27.6 | 0.2 |
| Combined ratio | 95.2% | 104.3% | (9.1) pts. |

NM = not meaningful

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

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

Direct written premiums

Direct written premiums of the Property and Casualty Group increased 6.3% to $1.0 billion in the first quarter of 2011, compared to $948 million in the first quarter of 2010, driven by an increase in policies in force and modest increases in average premium per policy. Year-over-year policies in force for all lines of business increased by 3.2% in the first quarter of 2011 as the result of continuing strong policyholder retention, compared to an increase of 3.6% in the first quarter of 2010. The year-over-year average premium per policy for all lines of business increased 2.1% at March 31, 2011, compared to a decrease of 1.3% at March 31, 2010. The impact of these increases in the first quarter of 2011 was seen primarily in our personal lines renewal business and commercial lines new and renewal business premiums.

Premiums generated from new business increased 4.2% to $111 million in the first quarter of 2011, compared to an increase of 7.7%, or $106 million, in the first quarter of 2010. Underlying the trend in new business premiums was a slight decrease in new business policies in force, or 0.4%, in the first quarter of 2011, compared to an increase of 7.4% in the first quarter of 2010, while the year-over-year average premium per policy on new business increased 4.9% at March 31, 2011, compared to a decline of 1.5% at March 31, 2010.

Premiums generated from renewal business increased 6.5% to $897 million in the first quarter of 2011, compared to an increase of 2.4%, or $842 million, in the first quarter of 2010. Underlying the trend in renewal business premiums was an increase in renewal business policies in force of 3.7% in the first quarter of 2011, compared to 3.1% in the first quarter of 2010, and an increase in the renewal business year-over-year average premium per policy of 1.7% at March 31, 2011, compared to a decline of 1.2% at March 31, 2010. The Property and Casualty Group s year-over-year policy retention ratio was 90.7% at March 31, 2011 and 90.7% at both December 31, 2010 and March 31, 2010.

*Personal lines* Total personal lines premiums written increased 5.8% to $702 million in the first quarter of 2011 from $663 million in the first quarter of 2010. Total personal lines policies in force increased 3.0% in the first quarter of 2011 and the total personal lines year-over-year average premium per policy increased 2.7%.

New business premiums written on personal lines decreased 1.8% in the first quarter of 2011, compared to an increase of 6.2% in the first quarter of 2010. Personal lines new business policies in force decreased 1.9% in the first quarter of 2011, compared to an increase of 7.3% in the first quarter of 2010, while the year-over-year average premium per policy on personal lines new business increased 2.2% at March 31, 2011, compared to 0.4% at March 31, 2010.

- Private passenger auto new business premiums written decreased 3.6% in the first quarter of 2011, compared to an increase of 6.8% in the first quarter of 2010. New business policies in force for private passenger auto decreased 3.1% in the first quarter of 2011, compared to an increase of 6.5% in the first quarter of 2010, while the new business year-over-year average premium per policy for private passenger auto increased 2.5% at March 31, 2011, compared to 0.3% at March 31, 2010.

- Homeowners new business premiums written decreased 1.2% in the first quarter of 2011, compared to an increase of 6.5% in the first quarter of 2010. New business policies in force for homeowners decreased 2.3% in the first quarter of 2011 compared to an increase of 8.6% in the first quarter of 2010. The new business year-over-year average premium per policy for homeowners increased 2.7% at March 31, 2011, compared to 2.2% at March 31, 2010.

Renewal premiums written on personal lines increased 6.7% in the first quarter of 2011, compared to 5.2% in the first quarter of 2010, driven by a modest increase in average premium per policy and steady policy retention trends. The year-over-year average premium per policy on personal lines renewal business increased 2.7% at March 31, 2011, compared to 0.8% at March 31, 2010. The personal lines year-over-year policy retention ratio was 91.5% at March 31, 2011, December 31, 2010 and March 31, 2010.

- Private passenger auto renewal premiums written increased 4.9% in the first quarter of 2011, compared to 4.6% in the first quarter of 2010. The year-over-year average premium per policy on private passenger auto renewal business increased 2.4% at March 31, 2011, compared to 0.3% at March 31, 2010. The private passenger auto year-over-year policy retention ratio was 91.7% at March 31, 2011, compared to 91.8% at December 31, 2010 and 91.9% at March 31, 2010.

- Homeowners renewal premiums written increased 11.3% in the first quarter of 2011, compared to 6.3% in the first quarter of 2010. The year-over-year average premium per policy on homeowners renewal business increased 5.5% at March 31, 2011, compared to 3.4% at March 31, 2010. The homeowners year-over-year policyholder retention ratio was 91.2% at March 31, 2011 and December 31, 2010, and 91.1% at March 31, 2010.

*Commercial lines* Total commercial lines premiums written increased 7.4%, to $306 million in the first quarter of 2011 from $285 million in the first quarter of 2010. Total commercial lines policies in force increased 4.3%, while the total commercial lines year-over-year average premium per policy decreased slightly, by 0.3%.

New business premiums written on commercial lines increased 15.9% in the first quarter of 2011, compared to 10.3% in the first quarter of 2010. Commercial lines new business policies in force increased 6.6% in the first quarter of 2011, compared to 8.0% in the first quarter of 2010, while the year-over-year average premium per policy on commercial lines new business increased 6.0% at March 31, 2011, compared to a decrease of 5.7% at March 31, 2010.

Renewal premiums for commercial lines increased 6.2% in the first quarter of 2011, compared to a decrease of 3.6% in the first quarter of 2010. The improvement seen in commercial lines renewal premiums was driven by smaller decreases in average premium per policy and steady policy retention trends, the combined impact of which was seen primarily in the workers compensation and commercial multi-peril lines of business. The year-over-year average premium per policy on commercial lines renewal business decreased 1.2% at March 31, 2011, compared to 5.9% at March 31, 2010, due primarily to the workers compensation and commercial auto lines of business in both periods. The workers compensation and commercial auto year-over-year average premium per policy on renewal business decreased 3.7% and 2.4%, respectively, at March 31, 2011, compared to decreases of 14.4% and 4.0%, respectively, at March 31, 2010. Contributing to the lower average premium per policy in the first quarter of 2011 were shifts in the mix of our book of business and lower exposures for the workers compensation and commercial auto lines of business, but to a lesser extent than in the first quarter of 2010. The year-over-year policy retention ratio for commercial lines was 85.8% at March 31, 2011, 85.3% at December 31, 2010, and 85.4% at March 31, 2010.

*Future trends premium revenue* We plan to continue our efforts to grow Property and Casualty Group premiums and improve our competitive position in the marketplace, which have a direct bearing on Indemnity s management fee. Expanding the size of our agency force through a careful agency selection process and increased market penetration in our existing operating territories will contribute to future growth as existing and new agents build their book of business with the Property and Casualty Group. At March 31, 2011, we had a total of 2,088 agencies with 9,525 licensed representatives. Our continued focus on underwriting discipline and the maturing of our pricing segmentation model has contributed to the Property and Casualty Group s ability to retain existing and attract new policyholders resulting in growth in new policies in force and steady retention ratios. We expect our pricing actions to result in a net increase in direct written premium in 2011, however, exposure reductions and changes in our mix of business as a result of economic conditions could impact the average premium written by the Property and Casualty Group, as customers may continue to reduce coverages.

<u>Current year losses and loss expenses</u>

The current accident year loss and loss expense ratio, excluding catastrophe losses, was 66.8% in the first quarter of 2011, compared to 70.2% in the first quarter of 2010.

The personal lines loss and loss expense ratio related to the current accident year, excluding catastrophe losses, was 67.7% in the first quarter of 2011, compared to 70.7% in the first quarter of 2010.

The commercial lines loss and loss expense ratio related to the current accident year, excluding catastrophe losses, was 64.7% in the first quarter of 2011, compared to 69.1% in the first quarter of 2010.

Catastrophe losses

Catastrophes are an inherent risk of the property and casualty insurance business and can have a material impact on our insurance underwriting results. In addressing this risk, we employ what we believe are reasonable underwriting standards and monitor our exposure by geographic region. The Property and Casualty Group s definition of catastrophes includes those weather-related or other loss events that we consider significant to our geographic footprint which, individually or in the aggregate, may not reach the level of a national catastrophe as defined by the Property Claim Service (PCS). The Property and Casualty Group maintains sufficient property catastrophe reinsurance coverage from unaffiliated reinsurers and no longer participates in the voluntary assumed reinsurance business, which lowers the variability of the underwriting results of the Property and Casualty Group.

Catastrophe losses, as defined by the Property and Casualty Group, totaled $65 million in the first quarter of 2011, compared to $112 million in the first quarter of 2010, and contributed 6.4 points and 11.7 points to the loss ratios at March 31, 2011 and 2010, respectively.

Prior year loss reserve development

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

| *(in millions)* | Erie Insurance Group Three months ended March 31, | |
|---|---|---|
| | 2011 | 2010 |
| **Prior year loss development:** | (Unaudited) | |
| Direct business including salvage and subrogation | $(61) | $(43) |
| Assumed reinsurance business | 3 | (3) |
| Ceded reinsurance business | (1) | (4) |
| Total prior year loss development | $(59) | $(50) |

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

*Direct business including salvage and subrogation* Favorable development of prior accident years, including the effects of salvage and subrogation recoveries, improved the combined ratio by 6.0 points in the first quarter of 2011, compared to 4.4 points in the first quarter of 2010. The favorable development in the first quarter of 2011 was primarily driven by improved annual claim cost expectations on massive injury lifetime medical benefits and the closing of one massive injury lifetime medical benefits claim in the personal auto line of business, and better than expected severity trends on liability claims in the commercial multi-peril and homeowners lines of business.

In the first quarter of 2010, the favorable development was primarily driven by improvements in frequency trends on automobile bodily injury and uninsured/underinsured motorist bodily injury and the closing of two claims in the personal auto line of business, improvements in severity trends in the commercial multi-peril line of business, and the settlement of one large claim in the homeowners line of business.

*Assumed reinsurance* The Property and Casualty Group experienced adverse development of prior accident year loss reserves on its assumed reinsurance business totaling $3 million in the first quarter of 2011, compared to favorable development of $3 million in the first quarter of 2010. The adverse development in the first quarter of 2011 was due to growth in involuntary reinsurance, while the favorable development in the first quarter of 2010 was due to less than anticipated growth in involuntary reinsurance.

*Ceded reinsurance* The Property and Casualty Group s increase in ceded reinsurance reserves, which is reflected as favorable development of prior accident year loss reserves, totaled $1 million in the first quarter of 2011, compared to $4 million in the first quarter of 2010.

Policy acquisition and other underwriting expenses

Our expense ratio remained relatively flat, increasing only 0.2 points in the first quarter of 2011, compared to the first quarter of 2010. The management fee rate was 25% for the periods ending March 31, 2011 and March 31, 2010.

**Life insurance operations**

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

| | Erie Family Life Insurance Company | | |
|---|---|---|---|
| | Three months ended March 31, | | |
| *( in millions)* | 2011 | 2010 | % Change |
| | (Unaudited) | | |
| Individual life premiums, net of reinsurance | $15 | $15 | 3.0 % |
| Group life and other premiums | 1 | 1 | 2.2 |
| Other revenue | 1 | 0 | 17.2 |
| Total net policy revenue | 17 | 16 | 3.2 |
| Net investment income | 23 | 23 | 0.2 |
| Net realized gains on investments | 4 | 5 | (15.4) |
| Impairment losses recognized in earnings | 0 | 0 | 88.7 |
| Equity in earnings (losses) of limited partnerships | 0 | (1) | NM |
| Total revenues | 44 | 43 | 3.0 |
| Benefits and other changes in policy reserves | 24 | 24 | (0.7) |
| Amortization of deferred policy acquisition costs | 3 | 5 | (28.5) |
| Other operating expenses | 4 | 4 | (4.5) |
| Total benefits and expenses | 31 | 33 | (5.3) |
| Income before income taxes | $13 | $10 | 29.9 % |
| Income before taxes Indemnity(1) | $ 3 | $ 2 | |
| Income before taxes Exchange(1) | $10 | $ 8 | |

NM = not meaningful

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

<u>Premiums</u>

Gross policy revenues increased 4.3% to $26 million in the first quarter of 2011, compared to $25 million in the first quarter of 2010. EFL reinsures a large portion of its traditional products in order to reduce claims volatility. We currently reinsure 75% of our risk on new term business. Ceded reinsurance premiums were $10 million and $9 million in the first quarters of 2011 and 2010, respectively.

Premiums received on annuity and universal life products totaled $24 million in the first quarter of 2011, compared to $32 million in the first quarter of 2010. Of this amount, annuity and universal life premiums which are recorded as deposits, and therefore not reflected in revenue on the Consolidated Statements of Operations, totaled $21 million and $29 million in the first quarters of 2011 and 2010, respectively.

<u>Investments</u>

Due to continued positive market conditions in the first quarter of 2011, EFL experienced low levels of impairments. Equity in earnings of limited partnerships also reflected a slight improvement in market conditions in the fourth quarter of 2010 as limited partnership activity is reported on a one quarter lag. See additional discussion of investments in the Investment Operations segment that follows.

Benefits and expenses

The first quarter of 2011 benefits and other changes in policy reserves were impacted by a decrease in the amortization of deferred policy acquisition costs compared to the first quarter of 2010.

**Investment operations**

| *(in millions)* | Erie Insurance Group Three months ended March 31, 2011 | 2010 | % Change |
|---|---|---|---|
| | (Unaudited) | | |
| **Indemnity** | | | |
| Net investment income (1) | $ 4 | $ 9 | (56.7)% |
| Net realized gains on investments (1) | 1 | 5 | (81.0)% |
| Net impairment losses recognized in earnings (1) | 0 | 0 | NM |
| Equity in earnings of limited partnerships | 11 | 0 | NM |
| Net revenue from investment operations Indemnity (1) (2) | $ 16 | $ 14 | 13.2 % |
| **Exchange** | | | |
| Net investment income (1) | $104 | $ 97 | 6.9 % |
| Net realized gains on investments (1) | 148 | 120 | 24.2 % |
| Net impairment losses recognized in earnings (1) | 0 | (2) | NM |
| Equity in earnings of limited partnerships | 61 | 3 | NM |
| Net revenue from investment operations Exchange (1) (2) | $313 | $218 | 43.4 % |

NM = not meaningful

*(1) As a result of the sale of Indemnity s property and casualty insurance subsidiaries, EIC, ENY and EPC, to the Exchange on December 31, 2010, investment revenue and losses generated from these entities will no longer accrue to the benefit of the Indemnity shareholder interest after this date. Investment revenue from these entities totaled $6 million in the first quarter of 2010. These components of investment income will accrue to the benefit of the subscribers (policyholders) of the Exchange, or noncontrolling interest, in 2011 and thereafter. (See Item 1. Financial Statements - Note 1, Nature of Operations, contained within this report.)*

*(2) The Exchange s results for the first quarter of 2011 and 2010 include net investment revenues from EFL s operations of $27 million and $27 million, respectively.*

Net investment income

Net investment income primarily includes interest and dividends on our fixed maturity and equity security portfolios. Indemnity net investment income decreased $5 million in the first quarter of 2011 compared to 2010, while the Exchange s net investment income increased $7 million primarily due to $6 million of investment income of EIC, ENY and EPC which were sold to the Exchange on December 31, 2010.

Net realized gains on investments

Net realized gains on investments decreased 81.0% for Indemnity and increased 24.2% for the Exchange in the first quarter of 2011 compared to 2010. Indemnity net realized gains decreased in 2011 primarily due to lower common stock valuation adjustments and lower realized gains on the sale of bonds. Net realized gains for the Exchange increased primarily due to higher valuation adjustments on common stocks of $82 million in 2011 compared to $71 million in 2010. Net realized gains on the sale of common stocks for the Exchange also increased to $48 million in 2011 compared to $33 million in 2010.

Net impairment losses recognized in earnings

Impairment losses recognized in earnings decreased $2 million for the Exchange in the first quarter of 2011 compared to the first quarter of 2010 as a result of improved market conditions.

Equity in earnings of limited partnerships

Indemnity s equity in earnings of limited partnerships totaled $11 million in the first quarter of 2011, compared to minimal earnings in the first quarter of 2010. The Exchange s equity in earnings of limited partnerships totaled $61 million in the first quarter of 2011, compared to $3 million in the first quarter of 2010. The results were due to improved market conditions across all limited partnership sectors.

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

| *(in millions)* | Erie Insurance Group Three months ended March 31, 2011 | 2010 |
|---|---|---|
| **Indemnity** | (Unaudited) | |
| Securities sold: | | |
| Fixed maturities | $ 0 | $ 2 |
| Preferred stock equity securities | 1 | 0 |
| Common stock equity securities | 1 | 1 |
| Common stock valuation adjustments | (1) | 2 |
| Total net realized gains Indemnity(1) | $ 1 | $ 5 |
| **Exchange** | | |
| Securities sold: | | |
| Fixed maturities | $ 13 | $ 12 |
| Preferred stock equity securities | 5 | 4 |
| Common stock equity securities | | |