

ERIE INDEMNITY CO
Form 10-Q
October 27, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

Commission file number 0-24000

ERIE INDEMNITY COMPANY
(Exact name of registrant as specified in its charter)
PENNSYLVANIA 25-0466020
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

100 Erie Insurance Place, Erie, Pennsylvania 16530
(Address of principal executive offices) (Zip Code)

(814) 870-2000
(Registrant's telephone number, including area code)
Not applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

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

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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

The number of shares outstanding of the registrant's Class A Common Stock as of the latest practicable date, with no par value and a stated value of \$0.0292 per share, was 46,189,068 at October 14, 2016.

The number of shares outstanding of the registrant's Class B Common Stock as of the latest practicable date, with no par value and a stated value of \$70 per share, was 2,542 at October 14, 2016.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ERIE INDEMNITY COMPANY
 STATEMENTS OF OPERATIONS (UNAUDITED)
 (dollars in thousands, except per share data)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Operating revenue | | | | |
| Management fee revenue, net | \$411,139 | \$389,168 | \$1,195,262 | \$1,126,626 |
| Service agreement revenue | 7,267 | 7,469 | 21,756 | 22,502 |
| Total operating revenue | 418,406 | 396,637 | 1,217,018 | 1,149,128 |
| Operating expenses | | | | |
| Commissions | 232,455 | 223,741 | 676,963 | 641,189 |
| Salaries and employee benefits | 53,265 | 58,342 | 161,579 | 170,715 |
| All other operating expenses | 50,431 | 46,265 | 142,797 | 146,522 |
| Total operating expenses | 336,151 | 328,348 | 981,339 | 958,426 |
| Net revenue from operations | 82,255 | 68,289 | 235,679 | 190,702 |
| Investment income | | | | |
| Net investment income | 5,331 | 4,346 | 14,884 | 13,322 |
| Net realized investment gains (losses) | 718 | (483) |) 29 | (125) |
| Net impairment losses recognized in earnings | 0 | (480) |) (345) |) (635) |
| Equity in (losses) earnings of limited partnerships | (1,723) |) 3,837 | (279) |) 16,902 |
| Total investment income | 4,326 | 7,220 | 14,289 | 29,464 |
| Income before income taxes | 86,581 | 75,509 | 249,968 | 220,166 |
| Income tax expense | 29,205 | 25,947 | 85,388 | 75,621 |
| Net income | \$57,376 | \$49,562 | \$164,580 | \$144,545 |
| Earnings Per Share | | | | |
| Net income per share | | | | |
| Class A common stock – basic | \$1.23 | \$1.06 | \$3.53 | \$3.10 |
| Class A common stock – diluted | \$1.09 | \$0.94 | \$3.14 | \$2.75 |
| Class B common stock – basic | \$185 | \$160 | \$530 | \$466 |
| Class B common stock – diluted | \$185 | \$159 | \$529 | \$465 |
| Weighted average shares outstanding – Basic | | | | |
| Class A common stock | 46,188,980 | 46,189,068 | 46,188,971 | 46,189,068 |
| Class B common stock | 2,542 | 2,542 | 2,542 | 2,542 |
| Weighted average shares outstanding – Diluted | | | | |
| Class A common stock | 52,411,303 | 52,602,083 | 52,442,697 | 52,599,783 |
| Class B common stock | 2,542 | 2,542 | 2,542 | 2,542 |

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Dividends declared per share

| | | | | |
|----------------------|-----------|-----------|-----------|-----------|
| Class A common stock | \$0.730 | \$0.681 | \$2.190 | \$2.043 |
| Class B common stock | \$109.500 | \$102.150 | \$328.500 | \$306.450 |

See accompanying notes to Financial Statements. See Note 10, "Accumulated Other Comprehensive Income (Loss)", for amounts reclassified out of accumulated other comprehensive income (loss) into the Statements of Operations.

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ERIE INDEMNITY COMPANY
 STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
 (in thousands)

| | Three months ended September 30, 2016 | | 2015 | | Nine months ended September 30, 2016 | | 2015 | |
|--|--|----------|-----------|-----------|--|--|------|--|
| Net income | \$57,376 | \$49,562 | \$164,580 | \$144,545 | | | | |
| Other comprehensive income (loss), net of tax | | | | | | | | |
| Change in unrealized holding gains (losses) on available-for-sale securities | 355 | (521) | 6,846 | (3,004) | | | | |
| Comprehensive income | \$57,731 | \$49,041 | \$171,426 | \$141,541 | | | | |

See accompanying notes to Financial Statements. See Note 10, "Accumulated Other Comprehensive Income (Loss)", for amounts reclassified out of accumulated other comprehensive income (loss) into the Statements of Operations.

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

| | September 30, 2016 | December 31, 2015 |
|--|-----------------------|----------------------|
| | (Unaudited) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 139,813 | \$ 182,889 |
| Available-for-sale securities | 52,108 | 62,067 |
| Receivables from Erie Insurance Exchange and affiliates | 399,975 | 348,055 |
| Prepaid expenses and other current assets | 29,593 | 24,697 |
| Federal income taxes recoverable | 0 | 11,947 |
| Accrued investment income | 6,261 | 5,491 |
| Total current assets | 627,750 | 635,146 |
| Available-for-sale securities | 652,267 | 537,874 |
| Limited partnership investments | 65,949 | 88,535 |
| Fixed assets, net | 58,311 | 59,087 |
| Deferred income taxes, net | 36,161 | 40,686 |
| Note receivable from Erie Family Life Insurance Company | 25,000 | 25,000 |
| Other assets | 19,577 | 20,968 |
| Total assets | \$ 1,485,015 | \$ 1,407,296 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Commissions payable | \$ 218,267 | \$ 195,542 |
| Agent bonuses | 84,805 | 106,752 |
| Accounts payable and accrued liabilities | 94,504 | 88,532 |
| Dividends payable | 33,996 | 33,996 |
| Deferred executive compensation | 16,873 | 20,877 |
| Federal income taxes payable | 4,813 | 0 |
| Total current liabilities | 453,258 | 445,699 |
| Defined benefit pension plans | 178,257 | 172,700 |
| Employee benefit obligations | 751 | 1,234 |
| Deferred executive compensation | 12,057 | 16,580 |
| Other long-term liabilities | 1,763 | 1,580 |
| Total liabilities | 646,086 | 637,793 |
| Shareholders' equity | | |
| Class A common stock, stated value \$0.0292 per share; 74,996,930 shares authorized; 68,299,200 shares issued; 46,189,068 shares outstanding | 1,992 | 1,992 |
| Class B common stock, convertible at a rate of 2,400 Class A shares for one Class B share, stated value \$70 per share; 3,070 shares authorized; 2,542 shares issued and outstanding | 178 | 178 |
| Additional paid-in-capital | 16,300 | 16,311 |
| Accumulated other comprehensive loss | (90,018 |) (96,864) |

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| | | |
|---|--------------|--------------|
| Retained earnings | 2,056,567 | 1,993,976 |
| Total contributed capital and retained earnings | 1,985,019 | 1,915,593 |
| Treasury stock, at cost; 22,110,132 shares held | (1,155,571) | (1,155,108) |
| Deferred compensation | 9,481 | 9,018 |
| Total shareholders' equity | 838,929 | 769,503 |
| Total liabilities and shareholders' equity | \$ 1,485,015 | \$ 1,407,296 |

See accompanying notes to Financial Statements.

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ERIE INDEMNITY COMPANY
 STATEMENTS OF CASH FLOWS (UNAUDITED)
 (in thousands)

| | Nine months ended September 30, | |
|--|------------------------------------|-------------|
| | 2016 | 2015 |
| Cash flows from operating activities | | |
| Management fee received | \$1,155,234 | \$1,094,122 |
| Service agreement fee received | 21,756 | 22,501 |
| Net investment income received | 19,643 | 18,972 |
| Limited partnership distributions | 7,222 | 12,077 |
| Decrease in reimbursements collected from affiliates | (11,893) | (16,716) |
| Commissions paid to agents | (565,490) | (539,227) |
| Agents bonuses paid | (110,503) | (93,495) |
| Salaries and wages paid | (119,991) | (115,126) |
| Pension contribution and employee benefits paid | (37,341) | (34,125) |
| General operating expenses paid | (133,729) | (143,955) |
| Income taxes paid | (69,357) | (74,033) |
| Net cash provided by operating activities | 155,551 | 130,995 |
| Cash flows from investing activities | | |
| Purchase of investments: | | |
| Available-for-sale securities | (269,237) | (173,330) |
| Limited partnerships | (449) | (693) |
| Proceeds from investments: | | |
| Available-for-sale securities | 164,266 | 153,265 |
| Trading securities | 5,171 | — |
| Limited partnerships | 12,404 | 21,777 |
| Net purchase of fixed assets | (10,415) | (7,176) |
| Net collections on agent loans | 1,622 | 696 |
| Net cash used in investing activities | (96,638) | (5,461) |
| Cash flows from financing activities | | |
| Dividends paid to shareholders | (101,989) | (95,143) |
| Net cash used in financing activities | (101,989) | (95,143) |
| Net (decrease) increase in cash and cash equivalents | (43,076) | 30,391 |
| Cash and cash equivalents, beginning of period | 182,889 | 91,747 |
| Cash and cash equivalents, end of period | \$139,813 | \$122,138 |

See accompanying notes to Financial Statements.

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NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Nature of Operations

Erie Indemnity Company ("Indemnity", "we", "us", "our") is a publicly held Pennsylvania business corporation that has since its incorporation in 1925 served as the attorney-in-fact for the subscribers (policyholders) at the Erie Insurance Exchange ("Exchange"). The Exchange, which also commenced business in 1925, is a Pennsylvania-domiciled reciprocal insurer that writes property and casualty insurance. We function solely as the management company and all insurance operations are performed by the Exchange.

Our primary function, as attorney-in-fact, is to perform certain services for the Exchange relating to the sales, underwriting, and issuance of policies on behalf of the Exchange. This is done in accordance with a subscriber's agreement (a limited power of attorney) executed individually by each subscriber (policyholder), which appoints us as their common attorney-in-fact to transact certain business on their behalf and to manage the affairs of the Exchange. Pursuant to the subscriber's agreement and for its services as attorney-in-fact, we earn a management fee calculated as a percentage of the direct and assumed premiums written by the Exchange.

The services we provide to the Exchange are related to the sales, underwriting and issuance of policies. The sales related services we provide include agent compensation and certain sales and advertising support services. Agent compensation includes scheduled commissions to agents based upon premiums written as well as additional commissions and bonuses to agents, which are earned by achieving targeted measures. The underwriting services we provide include underwriting and policy processing. The remaining services we provide include customer service and administrative support. We also provide information technology services that support all the functions listed above.

By virtue of its legal structure as a reciprocal insurer, the Exchange does not have the ability to enter into contractual relationships and therefore Indemnity serves as the attorney-in-fact on behalf of the Exchange for all claims handling services and certain other common overhead and service department functions in accordance with the subscriber's agreement. The amounts Indemnity incurs on behalf of the Exchange in this capacity are reimbursed to Indemnity from the Exchange at cost. See Note 11, "Related Party" contained within this report.

Our results of operations are tied to the growth and financial condition of the Exchange. If any events occurred that impaired the Exchange's ability to grow or sustain its financial condition, including but not limited to reduced financial strength ratings, disruption in the independent agency relationships, significant catastrophe losses, or products not meeting customer demands, the Exchange could find it more difficult to retain its existing business and attract new business. A decline in the business of the Exchange almost certainly would have as a consequence a decline in the total premiums paid and a correspondingly adverse effect on the amount of the management fees we receive. We also have an exposure to a concentration of credit risk related to the unsecured receivables due from the Exchange for its management fee. See Note 12, "Concentrations of Credit Risk" contained within this report.

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Note 2. Significant Accounting Policies

Basis of presentation

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. For further information, refer to the financial statements and footnotes included in our Form 10-K for the year ended December 31, 2015 as filed with the Securities and Exchange Commission on February 25, 2016.

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.

Certain prior period amounts have been reclassified on the statements of financial position to conform to the current period presentation. These reclassifications had no effect on the previously reported results of operations.

Recently issued accounting standards

In February 2015, the Financial Accounting Standards Board ("FASB") updated Accounting Standards Codification ("ASC") 810 "Consolidation", which amended the existing guidance for determining if a reporting entity has a variable interest in a legal entity. We adopted the new accounting principle on a retrospective basis as of December 31, 2015. In accordance with the new accounting guidance, Indemnity is not deemed to have a variable interest in the Exchange as the fees paid for services provided to the Exchange no longer represent a variable interest. The compensation received from the attorney-in-fact fee arrangement with the subscribers is for services provided by Indemnity acting in its role as attorney-in-fact and is commensurate with the level of effort required to perform those services. Under the previously issued accounting guidance, Indemnity was deemed to be the primary beneficiary of the Exchange and its financial position and operating results were consolidated with Indemnity. Following adoption of the new accounting guidance, the Exchange's results are no longer required to be consolidated with Indemnity. There was no cumulative effect to Indemnity's shareholders' equity or net income from no longer consolidating the Exchange's results with ours.

In August 2016, the FASB issued Accounting Standards Update ("ASU") 2016-15, "Statement of Cash Flows", which provides guidance on how certain cash receipts and cash payments are presented and classified to reduce diversity in practice. ASU 2016-15 is effective for interim and annual reporting periods beginning after December 31, 2017. Early adoption is permitted, including adoption in an interim period. We do not expect the adoption of this guidance to have a material impact on our financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments-Credit Losses", which requires financial assets measured at amortized cost to be presented at the net amount expected to be collected through the use of a new forward-looking expected loss model and credit losses relating to available-for-sale debt securities to be recognized through an allowance for credit losses. ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019. Early adoption for interim and annual periods beginning after December 15, 2018 is permitted. We are currently evaluating the potential impact of this guidance on our financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases", which requires lessees to recognize assets and liabilities arising from operating leases on the statement of financial position and to disclose key information about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. Early adoption is permitted. We are currently evaluating the potential impact of this guidance on our financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments-Overall". ASU 2016-01 revises the accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. ASU 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. We are currently evaluating the potential impact of this guidance on our financial statements.

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In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers". ASU 2014-09 requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for fiscal years beginning after December 15, 2017 including interim periods within that reporting period. We do not expect the adoption of this guidance to have a material impact on our financial statements.

Note 3. Earnings Per Share

Class A and Class B basic earnings per share and Class B diluted earnings per share are calculated under the two-class method. The two-class method allocates earnings to each class of stock based upon its dividend rights. Class B shares are convertible into Class A shares at a conversion ratio of 2,400 to 1. See Note 9, "Capital Stock".

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

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

| (dollars in thousands, except per share data) | Three months ended September 30, | | | | | |
|---|----------------------------------|-------------------------------|------------------|----------------------------------|-------------------------------|------------------|
| | 2016 | | | 2015 | | |
| | Allocated net income (numerator) | Weighted shares (denominator) | Per-share amount | Allocated net income (numerator) | Weighted shares (denominator) | Per-share amount |
| Class A – Basic EPS: | | | | | | |
| Income available to Class A stockholders | \$56,906 | 46,188,980 | \$ 1.23 | \$49,156 | 46,189,068 | \$ 1.06 |
| Dilutive effect of stock-based awards | 0 | 121,523 | — | 0 | 312,215 | — |
| Assumed conversion of Class B shares | 470 | 6,100,800 | — | 406 | 6,100,800 | — |
| Class A – Diluted EPS: | | | | | | |
| Income available to Class A stockholders on Class A equivalent shares | \$57,376 | 52,411,303 | \$ 1.09 | \$49,562 | 52,602,083 | \$ 0.94 |
| Class B – Basic EPS: | | | | | | |
| Income available to Class B stockholders | \$470 | 2,542 | \$ 185 | \$406 | 2,542 | \$ 160 |
| Class B – Diluted EPS: | | | | | | |
| Income available to Class B stockholders | \$469 | 2,542 | \$ 185 | \$405 | 2,542 | \$ 159 |

| (dollars in thousands, except per share data) | Nine months ended September 30, | | | | | |
|---|----------------------------------|-------------------------------|------------------|----------------------------------|-------------------------------|------------------|
| | 2016 | | | 2015 | | |
| | 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 | \$163,233 | 46,188,971 | \$ 3.53 | \$143,361 | 46,189,068 | \$ 3.10 |
| Dilutive effect of stock-based awards | 0 | 152,926 | — | 0 | 309,915 | — |
| Assumed conversion of Class B shares | 1,347 | 6,100,800 | — | 1,184 | 6,100,800 | — |

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Class A – Diluted EPS:

| | | | | | | |
|--|------------|------------|---------|------------|------------|---------|
| Income available to Class A stockholders on Class A equivalent shares | \$ 164,580 | 52,442,697 | \$ 3.14 | \$ 144,545 | 52,599,783 | \$ 2.75 |
|--|------------|------------|---------|------------|------------|---------|

Class B – Basic EPS:

| | | | | | | |
|--|----------|-------|--------|----------|-------|--------|
| Income available to Class B stockholders | \$ 1,347 | 2,542 | \$ 530 | \$ 1,184 | 2,542 | \$ 466 |
|--|----------|-------|--------|----------|-------|--------|

Class B – Diluted EPS:

| | | | | | | |
|--|----------|-------|--------|----------|-------|--------|
| Income available to Class B stockholders | \$ 1,346 | 2,542 | \$ 529 | \$ 1,181 | 2,542 | \$ 465 |
|--|----------|-------|--------|----------|-------|--------|

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Note 4. Fair Value

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

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

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

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

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

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

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

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

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

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

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The following tables present our fair value measurements on a recurring basis by asset class and level of input:

| At September 30, 2016 | | | | |
|--|-----------|---|-------------------|-------------------|
| Fair value measurements using: | | | | |
| (in thousands) | Total | Quoted prices in active markets for identical assets Level 1 | Observable | Unobservable |
| | | | inputs Level 2 | inputs Level 3 |
| Available-for-sale securities: | | | | |
| U.S. government & agencies | \$2,048 | \$ 0 | \$ 2,048 | \$ 0 |
| States & political subdivisions | 246,259 | 0 | 246,259 | 0 |
| Corporate debt securities | 320,268 | 0 | 310,079 | 10,189 |
| Residential mortgage-backed securities | 17,145 | 0 | 17,145 | 0 |
| Commercial mortgage-backed securities | 40,985 | 0 | 40,985 | 0 |
| Collateralized debt obligations | 66,647 | 0 | 61,526 | 5,121 |
| Other debt securities | 2,003 | 0 | 2,003 | 0 |
| Total fixed maturities | 695,355 | 0 | 680,045 | 15,310 |
| Common stock | 9,020 | 9,020 | 0 | 0 |
| Total available-for-sale securities | 704,375 | 9,020 | 680,045 | 15,310 |
| Other investments ⁽¹⁾ | 3,964 | — | — | — |
| Total | \$708,339 | \$ 9,020 | \$ 680,045 | \$ 15,310 |

| At December 31, 2015 | | | | |
|--|-----------|---|-------------------|-------------------|
| Fair value measurements using: | | | | |
| (in thousands) | Total | Quoted prices in active markets for identical assets Level 1 | Observable | Unobservable |
| | | | inputs Level 2 | inputs Level 3 |
| Available-for-sale securities: | | | | |
| States & political subdivisions | \$231,847 | \$ 0 | \$ 231,847 | \$ 0 |
| Corporate debt securities | 250,333 | 0 | 250,264 | 69 |
| Residential mortgage-backed securities | 13,513 | 0 | 13,513 | 0 |
| Commercial mortgage-backed securities | 37,571 | 0 | 37,571 | 0 |
| Collateralized debt obligations | 51,745 | 0 | 43,168 | 8,577 |
| Other debt securities | 2,200 | 0 | 2,200 | 0 |
| Total fixed maturities | 587,209 | 0 | 578,563 | 8,646 |
| Common stock | 12,732 | 12,732 | 0 | 0 |
| Total available-for-sale securities | 599,941 | 12,732 | 578,563 | 8,646 |
| Other investments ⁽¹⁾ | 4,526 | — | — | — |
| Total | \$604,467 | \$ 12,732 | \$ 578,563 | \$ 8,646 |

(1) Other investments measured at fair value represent real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option using the net asset value practical expedient. These amounts are not required to be categorized in the fair value hierarchy. The investments can never be redeemed with the funds. Instead, distributions are received when liquidation of the underlying assets of the funds occur. It is estimated that the underlying assets will generally be liquidated between 5 and 10 years from the inception of the funds. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner. Fair value is based on our proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to our balance sheet date. These values are then analyzed to determine if the NAV represents fair value at our balance sheet date, with adjustment being made where appropriate. We consider observable market data and perform a review validating the appropriateness of the NAV at each balance sheet date. It is likely that all of the investments will be redeemed at a future date for an amount different than the NAV of our ownership interest in partners' capital as of September 30, 2016 and December 31, 2015. During the nine months ended September 30, 2016, no contributions were made and distributions totaling \$0.7 million were received from these investments. During the year ended December 31, 2015, no contributions were made and distributions totaling \$3.5 million were received from these investments. The amount of unfunded commitments related to the investments was \$0.3 million as of September 30, 2016, and \$0.6 million as of December 31, 2015.

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Level 3 Assets – Quarterly Change:

| (in thousands) | Beginning balance at June 30, 2016 | Included in earnings (1) | Included in other comprehensive income | Purchases | Sales | Transfers in and (out) of Level 3 | Ending balance at September 30, 2016 |
|---------------------------------------|--|-----------------------------------|---|-----------|---------|--|---|
| Available-for-sale securities: | | | | | | | |
| Corporate debt securities | \$8,851 | \$ 22 | \$ 38 | \$ 3,217 | \$(318) | \$(1,621) | \$ 10,189 |
| Commercial mortgage-backed securities | 1,003 | 0 | 0 | 0 | 0 | (1,003) | 0 |
| Collateralized debt obligations | 1,200 | 0 | 7 | 3,000 | 0 | 914 | 5,121 |
| Total fixed maturities | 11,054 | 22 | 45 | 6,217 | (318) | (1,710) | 15,310 |
| Total available-for-sale securities | 11,054 | 22 | 45 | 6,217 | (318) | (1,710) | 15,310 |
| Total Level 3 assets | \$11,054 | \$ 22 | \$ 45 | \$ 6,217 | \$(318) | \$(1,710) | \$ 15,310 |

(1) These amounts are reported in the Statement of Operations as net investment income and net realized investment gains (losses) for the three months ended September 30, 2016 on Level 3 securities.

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

There were no transfers between Level 1 and Level 2 for the three months ended September 30, 2016. Level 2 to Level 3 transfers totaled \$4.6 million for 11 fixed maturity holdings due to the use of unobservable market data to determine the fair value at September 30, 2016. Level 3 to Level 2 transfers totaled \$6.3 million for 18 fixed maturity holdings due to the use of observable market data to determine the fair value at September 30, 2016.

Level 3 Assets – Year-to-Date Change:

| (in thousands) | Beginning balance at December 31, 2015 | Included in earnings (1) | Included in other comprehensive income | Purchases | Sales | Transfers in and (out) of Level 3 | Ending balance at September 30, 2016 |
|---------------------------------------|---|-----------------------------------|---|-----------|---------|--|---|
| Available-for-sale securities: | | | | | | | |
| Corporate debt securities | \$ 69 | \$ 67 | \$ 119 | \$ 11,887 | \$(924) | \$(1,029) | \$ 10,189 |
| Commercial mortgage-backed securities | 0 | 0 | 3 | 1,000 | 0 | (1,003) | 0 |
| Collateralized debt obligations | 8,577 | 4 | (5) | 7,722 | (54) | (11,123) | 5,121 |
| Total fixed maturities | 8,646 | 71 | 117 | 20,609 | (978) | (13,155) | 15,310 |
| Total available-for-sale securities | 8,646 | 71 | 117 | 20,609 | (978) | (13,155) | 15,310 |
| Total Level 3 assets | \$ 8,646 | \$ 71 | \$ 117 | \$ 20,609 | \$(978) | \$(13,155) | \$ 15,310 |

(1) These amounts are reported in the Statement of Operations as net investment income and net realized investment gains (losses) for the nine months ended September 30, 2016 on Level 3 securities.

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There were no transfers between Level 1 and Level 2 for the nine months ended September 30, 2016. Level 2 to Level 3 transfers totaled \$7.6 million for 27 fixed maturity holdings due to the use of unobservable market data to determine the fair value at September 30, 2016. Level 3 to Level 2 transfers totaled \$20.8 million for 40 fixed maturity holdings due to the use of observable market data to determine the fair value at September 30, 2016.

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Level 3 Assets – Quarterly Change:

| (in thousands) | Beginning balance at June 30, 2015 | Included in earnings (1) | Included in other comprehensive income | Purchases | Sales | Transfers in and (out) of Level 3 | Ending balance at September 30, 2015 |
|-------------------------------------|---|-----------------------------------|---|-----------|-------|--|---|
| Available-for-sale securities: | | | | | | | |
| Corporate debt securities | \$ 0 | \$ (1) | \$ (58) | \$ 0 | \$ 0 | \$ 124 | \$ 65 |
| Collateralized debt obligations | 660 | 1 | (3) | 4,546 | 0 | 0 | 5,204 |
| Total fixed maturities | 660 | 0 | (61) | 4,546 | 0 | 124 | 5,269 |
| Total available-for-sale securities | 660 | 0 | (61) | 4,546 | 0 | 124 | 5,269 |
| Total Level 3 assets | \$ 660 | \$ 0 | \$ (61) | \$ 4,546 | \$ 0 | \$ 124 | \$ 5,269 |

(1) These amounts are reported in the Statement of Operations as net investment income for the three months ended September 30, 2015 on Level 3 securities.

There were no transfers between Level 1 and Level 2 or from Level 3 to Level 2 for the three months ended September 30, 2015. Level 2 to Level 3 transfers totaled \$0.1 million for one fixed maturity holding due to the use of unobservable market data to determine the fair value at September 30, 2015.

Level 3 Assets – Year-to-Date Change:

| (in thousands) | Beginning balance at December 31, 2014 | Included in earnings (1) | Included in other comprehensive income | Purchases | Sales | Transfers in and (out) of Level 3 | Ending balance at September 30, 2015 |
|-------------------------------------|---|-----------------------------------|---|-----------|-------|--|---|
| Available-for-sale securities: | | | | | | | |
| Corporate debt securities | \$ 0 | \$ (1) | \$ (58) | \$ 110 | \$ 0 | \$ 14 | \$ 65 |
| Collateralized debt obligations | 0 | 1 | (3) | 5,206 | 0 | 0 | 5,204 |
| Total fixed maturities | 0 | 0 | (61) | 5,316 | 0 | 14 | 5,269 |
| Total available-for-sale securities | 0 | 0 | (61) | 5,316 | 0 | 14 | 5,269 |
| Total Level 3 assets | \$ 0 | \$ 0 | \$ (61) | \$ 5,316 | \$ 0 | \$ 14 | \$ 5,269 |

(1) These amounts are reported in the Statement of Operations as net investment income for the nine months ended September 30, 2015 on Level 3 securities.

There were no transfers between Level 1 and Level 2 for the nine months ended September 30, 2015. Level 2 to Level 3 transfers totaled \$0.1 million for one fixed maturity holding due to the use of unobservable market data to determine the fair value at September 30, 2016. Level 3 to Level 2 transfers totaled \$0.1 million for one fixed maturity holding due to the use of observable market data to determine the fair value at September 30, 2015.

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Quantitative and Qualitative Disclosures about Unobservable Inputs

When a non-binding broker quote was the only input available, the security was classified within Level 3. Use of non-binding brokers quotes totaled \$15.3 million at September 30, 2016. The unobservable inputs are not reasonably available to us.

The following table presents our fair value measurements on a recurring basis by pricing source:

| (in thousands) | At September 30, 2016 | | | |
|---|-----------------------|---------|-----------|----------|
| | Total | Level 1 | Level 2 | Level 3 |
| Fixed maturities: | | | | |
| Priced via pricing services | \$689,205 | \$0 | \$679,955 | \$9,250 |
| Priced via market comparables/broker quotes | 6,150 | 0 | 90 | 6,060 |
| Total fixed maturities | 695,355 | 0 | 680,045 | 15,310 |
| Common stock: | | | | |
| Priced via pricing services | 9,020 | 9,020 | 0 | 0 |
| Total common stock | 9,020 | 9,020 | 0 | 0 |
| Other investments: | | | | |
| Priced via unobservable inputs ⁽¹⁾ | 3,964 | — | — | — |
| Total other investments | 3,964 | — | — | — |
| Total | \$708,339 | \$9,020 | \$680,045 | \$15,310 |

Other investments measured at fair value represent real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option using the net asset value practical expedient. ⁽¹⁾ These amounts are not required to be categorized in the fair value hierarchy. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner.

There were no assets measured at fair value on a nonrecurring basis during the nine months ended September 30, 2016.

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Note 5. Investments

Available-for-sale securities

The following table summarizes the cost and fair value of our available-for-sale securities:

| (in thousands) | At September 30, 2016 | | | |
|--|-----------------------|------------------------|-------------------------|----------------------|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| Available-for-sale securities: | | | | |
| U.S. government & agencies | \$2,008 | \$ 40 | \$ 0 | \$2,048 |
| States & political subdivisions | 234,111 | 12,207 | 59 | 246,259 |
| Corporate debt securities | 317,745 | 3,351 | 828 | 320,268 |
| Residential mortgage-backed securities | 17,246 | 65 | 166 | 17,145 |
| Commercial mortgage-backed securities | 41,565 | 213 | 793 | 40,985 |
| Collateralized debt obligations | 66,448 | 263 | 64 | 66,647 |
| Other debt securities | 2,000 | 3 | 0 | 2,003 |
| Total fixed maturities | 681,123 | 16,142 | 1,910 | 695,355 |
| Common stock | 8,949 | 71 | 0 | 9,020 |
| Total available-for-sale securities | \$690,072 | \$ 16,213 | \$ 1,910 | \$ 704,375 |

| (in thousands) | At December 31, 2015 | | | |
|--|----------------------|------------------------|-------------------------|----------------------|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| Available-for-sale securities: | | | | |
| States & political subdivisions | \$221,093 | \$ 10,761 | \$ 7 | \$231,847 |
| Corporate debt securities | 254,464 | 281 | 4,412 | 250,333 |
| Residential mortgage-backed securities | 13,639 | 4 | 130 | 13,513 |
| Commercial mortgage-backed securities | 38,630 | 30 | 1,089 | 37,571 |
| Collateralized debt obligations | 51,905 | 61 | 221 | 51,745 |
| Other debt securities | 2,241 | 0 | 41 | 2,200 |
| Total fixed maturities | 581,972 | 11,137 | 5,900 | 587,209 |
| Common stock | 12,865 | 0 | 133 | 12,732 |
| Total available-for-sale securities | \$594,837 | \$ 11,137 | \$ 6,033 | \$ 599,941 |

The amortized cost and estimated fair value of fixed maturities at September 30, 2016 are shown below by remaining contractual term to maturity. Mortgage-backed securities are allocated based upon their stated maturity dates. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (in thousands) | At September 30, 2016 | |
|--|-----------------------|----------------------|
| | Amortized cost | Estimated fair value |
| Due in one year or less | \$51,666 | \$51,821 |
| Due after one year through five years | 314,652 | 319,198 |
| Due after five years through ten years | 195,967 | 203,310 |
| Due after ten years | 118,838 | 121,026 |

Total fixed maturities \$681,123 \$695,355

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

| (dollars in thousands) | At September 30, 2016 | | | | | | |
|--|--------------------------------|-------------------|---------------------|-------------------|------------|-------------------|-----------------|
| | Less than 12 months | | 12 months or longer | | Total | | No. of holdings |
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses | |
| Available-for-sale securities: | | | | | | | |
| States & political subdivisions | \$ 14,735 | \$ 59 | \$ 0 | \$ 0 | \$ 14,735 | \$ 59 | 7 |
| Corporate debt securities | 71,837 | 407 | 14,876 | 421 | 86,713 | 828 | 152 |
| Residential mortgage-backed securities | 7,225 | 27 | 2,816 | 139 | 10,041 | 166 | 11 |
| Commercial mortgage-backed securities | 18,373 | 107 | 8,426 | 686 | 26,799 | 793 | 25 |
| Collateralized debt obligations | 11,092 | 31 | 8,727 | 33 | 19,819 | 64 | 10 |
| Total fixed maturities | 123,262 | 631 | 34,845 | 1,279 | 158,107 | 1,910 | 205 |
| Total available-for-sale securities | \$ 123,262 | \$ 631 | \$ 34,845 | \$ 1,279 | \$ 158,107 | \$ 1,910 | 205 |
| Quality breakdown of fixed maturities: | | | | | | | |
| Investment grade | \$ 100,205 | \$ 296 | \$ 27,442 | \$ 688 | \$ 127,647 | \$ 984 | 79 |
| Non-investment grade | 23,057 | 335 | 7,403 | 591 | 30,460 | 926 | 126 |
| Total fixed maturities | \$ 123,262 | \$ 631 | \$ 34,845 | \$ 1,279 | \$ 158,107 | \$ 1,910 | 205 |
| | | | | | | | |
| | At December 31, 2015 | | | | | | |
| (dollars in thousands) | Less than 12 months | | 12 months or longer | | Total | | No. of holdings |
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses | |
| | Available-for-sale securities: | | | | | | |
| States & political subdivisions | \$ 5,867 | \$ 7 | \$ 0 | \$ 0 | \$ 5,867 | \$ 7 | 3 |
| Corporate debt securities | 172,831 | 2,447 | 19,086 | 1,965 | 191,917 | 4,412 | 349 |
| Residential mortgage-backed securities | 9,827 | 84 | 936 | 46 | 10,763 | 130 | 9 |
| Commercial mortgage-backed securities | 13,081 | 68 | 19,081 | 1,021 | 32,162 | 1,089 | 24 |
| Collateralized debt obligations | 27,981 | 103 | 9,174 | 118 | 37,155 | 221 | 19 |
| Other debt securities | 1,960 | 40 | 241 | 1 | 2,201 | 41 | 2 |
| Total fixed maturities | 231,547 | 2,749 | 48,518 | 3,151 | 280,065 | 5,900 | 406 |
| Common stock | 12,732 | 133 | 0 | 0 | 12,732 | 133 | 1 |
| Total available-for-sale securities | \$ 244,279 | \$ 2,882 | \$ 48,518 | \$ 3,151 | \$ 292,797 | \$ 6,033 | 407 |
| Quality breakdown of fixed maturities: | | | | | | | |
| Investment grade | \$ 174,723 | \$ 1,296 | \$ 38,369 | \$ 1,256 | \$ 213,092 | \$ 2,552 | 105 |
| Non-investment grade | 56,824 | 1,453 | 10,149 | 1,895 | 66,973 | 3,348 | 301 |
| Total fixed maturities | \$ 231,547 | \$ 2,749 | \$ 48,518 | \$ 3,151 | \$ 280,065 | \$ 5,900 | 406 |

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

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Net investment income

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

| (in thousands) | Three months ended | | Nine months ended | |
|----------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2016 | September 30, 2015 | September 30, 2016 | September 30, 2015 |
| Fixed maturities | \$5,245 | \$4,010 | \$14,629 | \$12,239 |
| Equity securities | 50 | 218 | 132 | 718 |
| Cash equivalents and other | 366 | 287 | 1,011 | 862 |
| Total investment income | 5,661 | 4,515 | 15,772 | 13,819 |
| Less: investment expenses | 330 | 169 | 888 | 497 |
| Net investment income | \$5,331 | \$4,346 | \$14,884 | \$13,322 |

Realized investment gains (losses)

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

| (in thousands) | Three months ended | | Nine months ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2016 | September 30, 2015 | September 30, 2016 | September 30, 2015 |
| Available-for-sale securities: | | | | |
| Fixed maturities: | | | | |
| Gross realized gains | \$603 | \$120 | \$1,175 | \$491 |
| Gross realized losses | (27) | (661) | (1,819) | (1,036) |
| Net realized gains (losses) | 576 | (541) | (644) | (545) |
| Equity securities: | | | | |
| Gross realized gains | 0 | 57 | 0 | 419 |
| Gross realized losses | 0 | 0 | (34) | 0 |
| Net realized gains (losses) | 0 | 57 | (34) | 419 |
| Trading securities: | | | | |
| Common stock: | | | | |
| Gross realized gains | 121 | 0 | 707 | 0 |
| Gross realized losses | 0 | 0 | 0 | 0 |
| Increases in fair value ⁽¹⁾ | 21 | 0 | 0 | 0 |
| Net realized gains | 142 | 0 | 707 | 0 |
| Miscellaneous: | | | | |
| Gross realized gains | 0 | 1 | 0 | 1 |
| Gross realized losses | 0 | 0 | 0 | 0 |
| Net realized gains | 0 | 1 | 0 | 1 |
| Net realized investment gains (losses) | \$718 | \$(483) | \$29 | \$(125) |

(1) The fair value of our common stocks is determined based upon exchange traded prices provided by a nationally recognized pricing service.

Net impairment losses

The components of other-than-temporary impairments on investments were as follows:

| (in thousands) | Three months ended | | Nine months ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2016 | September 30, 2015 | September 30, 2016 | September 30, 2015 |
| Fixed maturities | \$0 | \$(480) | \$(345) | \$(635) |
| Total other-than-temporary impairments | 0 | (480) | (345) | (635) |
| Portion recognized in other comprehensive income | 0 | 0 | 0 | 0 |
| Net impairment losses recognized in earnings | \$0 | \$(480) | \$(345) | \$(635) |

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.

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Limited partnerships

Limited partnership investments, excluding certain real estate limited partnerships recorded at fair value, are generally reported on a one-quarter lag; therefore, our year-to-date limited partnership results through September 30, 2016 are comprised of partnership financial results for the fourth quarter of 2015 and the first two quarters of 2016. Given the lag in reporting, our limited partnership results do not reflect the market conditions of the third quarter of 2016. Cash contributions made to and distributions received from the partnerships are recorded in the period in which the transaction occurs.

In October 2016, a real estate partnership had a sale of its remaining assets that resulted in a distribution, generating significant gains. Because this was a final distribution, the gain of approximately \$7.5 million will be recorded in equity in earnings of limited partnerships from this investment in our fourth quarter 2016 financial statements.

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

| (in thousands) | Three months ended September 30, 2016 | | Nine months ended September 30, 2015 | |
|---|--|---------|---|----------|
| Equity in (losses) earnings of limited partnerships accounted for under the equity method | \$(1,778) | \$3,235 | \$(436) | \$16,554 |
| Change in fair value of limited partnerships accounted for under the fair value option | 55 | 602 | 157 | 348 |
| Equity in (losses) earnings of limited partnerships | \$(1,723) | \$3,837 | \$(279) | \$16,902 |

The following table summarizes limited partnership investments by sector:

| (in thousands) | At September 30, 2016 | At December 31, 2015 |
|---------------------------------------|-----------------------------|----------------------------|
| Private equity | \$ 37,248 | \$ 48,397 |
| Mezzanine debt | 8,404 | 12,701 |
| Real estate | 16,333 | 22,911 |
| Real estate - fair value option | 3,964 | 4,526 |
| Total limited partnership investments | \$ 65,949 | \$ 88,535 |

See also Note 13, "Commitments and Contingencies" for investment commitments related to limited partnerships.

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Note 6. Bank Line of Credit

As of September 30, 2016, we have access to a \$100 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on November 3, 2020. As of September 30, 2016, a total of \$99.0 million remains available under the facility due to \$1.0 million outstanding letters of credit, which reduce the availability for letters of credit to \$24.0 million. We had no borrowings outstanding on our line of credit as of September 30, 2016. Bonds with a fair value of \$109.4 million were pledged as collateral on the line at September 30, 2016. The securities pledged as collateral have no trading restrictions and are reported as available-for-sale securities in the Statements of Financial Position as of September 30, 2016. The bank requires compliance with certain covenants, which include leverage ratios, for our line of credit. We are in compliance with all bank covenants at September 30, 2016.

Note 7. Postretirement Benefits

Pension plans

Our pension plans consist of a noncontributory defined benefit pension plan covering substantially all employees and an unfunded supplemental employee retirement plan for certain members of executive and senior management. Although we are the sponsor of these postretirement plans and record the funded status of these plans, the Exchange reimburses us for approximately 58% of the annual benefit expense of these plans, which represents pension benefits for our employees performing claims and life insurance functions.

A \$17.4 million contribution was made to the defined benefit pension plan in the first quarter of 2016.

Prior to 2003, the employee pension plan purchased annuities from Erie Family Life Insurance Company ("EFL"), a wholly owned subsidiary of the Exchange, for certain plan participants that were receiving benefit payments under the pension plan. These are nonparticipating annuity contracts under which EFL has unconditionally contracted to provide specified benefits to beneficiaries; however, the pension plan remains the primary obligor to the beneficiaries. A contingent liability of \$21.4 million at September 30, 2016 exists in the event EFL does not honor the annuity contracts.

The cost of our pension plans are as follows:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|--------------------------------------|--|----------|------------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Service cost for benefits earned | \$7,050 | \$7,608 | \$21,150 | \$22,824 |
| Interest cost on benefits obligation | 8,281 | 7,689 | 24,844 | 23,067 |
| Expected return on plan assets | (9,880) | (8,980) | (29,640) | (26,940) |
| Prior service cost amortization | 174 | 168 | 522 | 502 |
| Net actuarial loss amortization | 2,029 | 3,507 | 6,084 | 10,523 |
| Pension plan cost ⁽¹⁾ | \$7,654 | \$9,992 | \$22,960 | \$29,976 |

(1) Pension plan costs represent the total cost before reimbursements from the Exchange and EFL.

Note 8. Income Taxes

Our effective tax rate is calculated after consideration of permanent differences related to our investment revenues. Given that these amounts represent over 98% of the total permanent differences, the effective tax rate is approximately

35% when the investment related permanent differences are excluded.

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Note 9. Capital Stock

Class A and B common stock

Holders of Class B shares may, at their option, convert their shares into Class A shares at the rate of 2,400 Class A shares per Class B share. There were no shares of Class B common stock converted into Class A common stock during the nine months ended September 30, 2016 and the year ended December 31, 2015. There is no provision for conversion of Class A shares to Class B shares, and Class B shares surrendered for conversion cannot be reissued.

Stock repurchase program

In October 2011, our Board of Directors approved a continuation of the current stock repurchase program for a total of \$150 million, with no time limitation. There were no shares repurchased under this program during the nine months ended September 30, 2016 and the year ended December 31, 2015. We had approximately \$17.8 million of repurchase authority remaining under this program at September 30, 2016.

Note 10. Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) by component, including amounts reclassified out of accumulated other comprehensive income (loss) and the related line item in the Statements of Operations where net income is presented, are as follows:

| (in thousands) | Three months ended | | Nine months ended | |
|---|--------------------|-------------|-------------------|-------------|
| | September 30, | 2015 | September 30, | 2015 |
| | 2016 | 2015 | 2016 | 2015 |
| Investment securities: | | | | |
| Accumulated other comprehensive income, beginning of the period | \$9,018 | \$4,324 | \$2,527 | \$6,807 |
| Other comprehensive income (loss) before reclassifications, net of tax (expense) benefit of \$(392), \$618, \$(3,328) and \$1,884, respectively | 729 | (1,147) |)6,181 | (3,498) |
| Reclassifications: | | | | |
| Realized investment (gains) losses, net of tax benefit (expense) of \$202, \$(169), \$(237), and \$(44), respectively | (374) |)314 | 441 | 81 |
| Impairment losses, net of tax expense of \$0, \$168, \$121 and \$222, respectively | 0 | 312 | 224 | 413 |
| Other comprehensive income (loss), net of tax | 355 | (521) |)6,846 | (3,004) |
| Accumulated other comprehensive income, end of the period | \$9,373 | \$3,803 | \$9,373 | \$3,803 |
| Pension and other postretirement plans ⁽¹⁾ : | | | | |
| Accumulated other comprehensive loss, beginning of the period | \$(99,391) | \$(124,508) | \$(99,391) | \$(124,508) |
| Other comprehensive income (loss) before reclassifications, net of tax | 0 | 0 | 0 | 0 |
| Reclassifications: | | | | |
| Amortization of prior service costs, net of tax | 0 | 0 | 0 | 0 |
| Amortization of net actuarial loss, net of tax | 0 | 0 | 0 | 0 |
| Other comprehensive income (loss), net of tax | 0 | 0 | 0 | 0 |
| Accumulated other comprehensive loss, end of the period | \$(99,391) | \$(124,508) | \$(99,391) | \$(124,508) |
| Total | | | | |
| Accumulated other comprehensive loss, beginning of the period | \$(90,373) | \$(120,184) | \$(96,864) | \$(117,701) |
| Investment securities | 355 | (521) |)6,846 | (3,004) |
| Pension and other postretirement plans | 0 | 0 | 0 | 0 |
| Other comprehensive income (loss), net of tax | 355 | (521) |)6,846 | (3,004) |

| | | | | |
|---|-------------|--------------|-------------|--------------|
| Accumulated other comprehensive loss, end of the period | \$ (90,018) | \$ (120,705) | \$ (90,018) | \$ (120,705) |
|---|-------------|--------------|-------------|--------------|

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

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Note 11. Related Party

Amounts incurred on behalf of the Exchange and EFL

As discussed in Note 1, "Nature of Operations", all claims handling services for the Exchange are performed by our employees who are entirely dedicated to claims related activities. All costs associated with these employees, including postretirement benefits, are reimbursed to us from the Exchange's revenues in accordance with the subscriber's agreement. Also, we are reimbursed by EFL from its revenues for all costs, including postretirement benefits, associated with employees who perform life insurance related operating activities for EFL in accordance with its service agreement with us. See also Note 7, "Postretirement Benefits" for a discussion of intercompany expense allocations under the postretirement benefit plans. In addition, common overhead expenses and certain service department costs incurred by us on behalf of the Exchange and EFL are reimbursed by the proper entity based upon appropriate utilization statistics (employee count, square footage, vehicle count, project hours, etc.) specifically measured to accomplish proportional allocations, which we believe are reasonable.

All reimbursements are made on an actual cost basis and do not include a profit component. We record these reimbursements as receivables from the Exchange and EFL with a corresponding reduction to our expenses. Reimbursements are settled on a monthly basis. The amounts incurred on behalf of the Exchange and EFL were as follows:

| (in thousands) | Three months ended | | Nine months ended | |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2016 | September 30, 2015 | September 30, 2016 | September 30, 2015 |
| Erie Insurance Exchange | \$ 103,498 | \$ 106,307 | \$ 329,761 | \$ 313,353 |
| Erie Family Life Insurance | 9,535 | 8,517 | 29,039 | 27,273 |
| Total cash settlements | \$ 113,033 | \$ 114,824 | \$ 358,800 | \$ 340,626 |

Note 12. Concentrations of Credit Risk

Financial instruments could potentially expose us to concentrations of credit risk, including unsecured receivables from the Exchange. A large majority of our revenue and receivables are from the Exchange and affiliates. See also Note 1, "Nature of Operations". Management fee amounts and other reimbursements due from the Exchange and affiliates were \$400.0 million and \$348.1 million at September 30, 2016 and December 31, 2015, respectively.

Note 13. Commitments and Contingencies

We have contractual commitments to invest up to \$18.6 million related to our limited partnership investments at September 30, 2016. These commitments are split among private equity securities of \$7.1 million, mezzanine debt securities of \$8.4 million, and real estate activities of \$3.1 million. These commitments will be funded as required by the limited partnership agreements.

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

We believe that our accruals for legal proceedings are appropriate and, individually and in the aggregate, are not

expected to be material to our financial condition, results of operations, or cash flows.

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

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Note 14. Subsequent Events

No items were identified in this period subsequent to the financial statement date that required adjustment or additional disclosure, other than the disclosure made in Note 5, "Investments" regarding limited partnerships.

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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 Erie Indemnity Company ("Indemnity", "we", "us", "our"). This discussion should be read in conjunction with the historical financial statements and the related notes thereto included in Part I, 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, 2015, as contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 25, 2016.

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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, 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:

- dependence upon our relationship with the Erie Insurance Exchange ("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;
- credit risk from the Exchange;
- dependence upon our relationship with the Exchange and the growth of the Exchange, including:
 - general business and economic conditions;
 - factors affecting insurance industry competition;
 - dependence upon the independent agency system; and
 - ability to maintain our reputation for customer service;
- dependence upon our relationship with the Exchange and the financial condition of the Exchange, including:
 - the Exchange’s ability to maintain acceptable financial strength ratings;

factors affecting the quality and liquidity of the Exchange's investment portfolio;
changes in government regulation of the insurance industry;
emerging claims and coverage issues in the industry; and
severe weather conditions or other catastrophic losses, including terrorism;
• ability to attract and retain talented management and employees;
• ability to maintain uninterrupted business operations;
• factors affecting the quality and liquidity of our investment portfolio;
• our ability to meet liquidity needs and access capital; and
• outcome of pending and potential litigation.

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

RECENT ACCOUNTING STANDARDS

We adopted amended guidance related to the consolidation of legal entities effective December 31, 2015, as required under generally accepted accounting principles. As a result of this new guidance, we are not deemed to have a variable interest in the Erie Insurance Exchange ("Exchange") as the fees paid for services provided to the Exchange no longer represent a variable interest. The compensation received from the attorney-in-fact fee arrangement with the subscribers is for services provided by us acting in our role as attorney-in-fact and is commensurate with the level of effort required to perform those services. Following adoption of the new accounting guidance, the Exchange's results are no longer required to be consolidated with ours. No longer consolidating the Exchange resulted in no change to our net income or equity.

See Part I, Item 1. "Financial Statements - Note 2, Significant Accounting Policies, of Notes to Financial Statements" contained within this report for a discussion of this adopted standard as well as other recently issued accounting standards and the impact on our financial statements if known.

OPERATING OVERVIEW

Overview

We serve as the attorney-in-fact for the subscribers (policyholders) at the Exchange, a reciprocal insurer that writes personal and commercial property and casualty insurance. Our primary function is to perform certain services relating to the sales, underwriting and issuance of policies on behalf of the Exchange.

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 business on their behalf.

Pursuant to the subscriber's agreement and for its services as attorney-in-fact, we earn a management fee calculated as a percentage of the direct and assumed premiums written by the Exchange. Our earnings are primarily driven by the management fee revenue generated for the services we provide relating to certain sales, underwriting, and issuance of policies for the Exchange.

The sales related services we provide to the Exchange include agent compensation and certain sales and advertising support services. Agent compensation includes scheduled commissions to agents based upon premiums written as well as additional commissions and bonuses to agents, which are earned by achieving targeted measures. Agent compensation generally comprises approximately two-thirds of our expenses. The underwriting services we provide include underwriting and policy processing. The remaining services we provide include customer service and administrative support. We also provide information technology services that support all the functions listed above.

Our results of operations are tied to the growth and financial condition of the Exchange as the Exchange is our sole customer, and our earnings are largely generated from management fees based on the direct and assumed premiums written by the Exchange. The Exchange generates revenue by insuring preferred and standard risks, with personal lines comprising 70% of the 2015 direct and assumed written premiums and commercial lines comprising the remaining 30%. The principal personal lines products are private passenger automobile and homeowners. The

principal commercial lines products are commercial multi-peril, workers compensation and commercial automobile.

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Financial Overview

| (dollars in thousands, except per share data) | Three months ended September 30, | | | Nine months ended September 30, | | |
|---|-------------------------------------|-----------|-------------|------------------------------------|-------------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (Unaudited) | | | (Unaudited) | | |
| Total operating revenue | \$418,406 | \$396,637 | 5.5 % | \$1,217,018 | \$1,149,128 | 5.9 % |
| Total operating expenses | 336,151 | 328,348 | 2.4 | 981,339 | 958,426 | 2.4 |
| Net revenue from operations | 82,255 | 68,289 | 20.5 | 235,679 | 190,702 | 23.6 |
| Total investment income | 4,326 | 7,220 | (40.1) | 14,289 | 29,464 | (51.5) |
| Income before income taxes | 86,581 | 75,509 | 14.7 | 249,968 | 220,166 | 13.5 |
| Income tax expense | 29,205 | 25,947 | 12.6 | 85,388 | 75,621 | 12.9 |
| Net income | \$57,376 | \$49,562 | 15.8 % | \$164,580 | \$144,545 | 13.9 % |
| Net income per share - diluted | \$1.09 | \$0.94 | 16.2 % | \$3.14 | \$2.75 | 14.2 % |

Net revenue from operations increased in both the third quarter and nine months ended September 30, 2016 compared to the same periods in 2015 as revenue growth outpaced the growth in expenses. The two components of our primary revenue source, management fee revenue, are the management fee rate we charge, and the direct and assumed premiums written by the Exchange. The management fee rate was 25% for both 2016 and 2015. The direct and assumed premiums written by the Exchange were \$1.6 billion in both the third quarters of 2016 and 2015, and \$4.8 billion and \$4.5 billion for the nine months ended September 30, 2016 and 2015, respectively.

Total operating expenses increased 2.4% in both the third quarter of 2016 and the nine months ended September 30, 2016 compared to the same respective periods in 2015. The increase in operating expenses for the third quarter of 2016 was driven by an increase in commissions, partially offset by lower non-commission expenses primarily from lower personnel costs across all expense categories. The increase in operating expenses for the nine months ended September 30, 2016 was driven by an increase in commissions, partially offset by lower non-commission expenses primarily from information technology costs coupled with lower personnel costs across all expense categories.

Gross margin from operations increased to 19.7% in the third quarter of 2016 from 17.2% in the third quarter of 2015, and increased to 19.4% for the nine months ended September 30, 2016 from 16.6% for the nine months ended September 30, 2015.

Total investment income decreased 40.1% in the third quarter of 2016 compared to the third quarter of 2015, and decreased 51.5% for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015 primarily due to losses generated from limited partnership investments.

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Reconciliation of Operating Income to Net Income

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

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

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

The following table reconciles operating income and net income:

| (in thousands, except per share data) | Three months ended September 30, | | Nine months ended September 30, | |
|--|--|---------------------|------------------------------------|---------------------|
| | 2016 (Unaudited) | 2015 (Unaudited) | 2016 (Unaudited) | 2015 (Unaudited) |
| Operating income | \$56,910 | \$50,188 | \$164,786 | \$145,039 |
| Net realized gains (losses) and impairments on investments | 718 | (963) | (316) | (760) |
| Income tax (expense) benefit | (252) | 337 | 110 | 266 |
| Realized gains (losses) and impairments, net of income taxes | 466 | (626) | (206) | (494) |
| Net income | \$57,376 | \$49,562 | \$164,580 | \$144,545 |
| Per Class A common share-diluted: | | | | |
| Operating income | \$1.08 | \$0.95 | \$3.14 | \$2.76 |
| Net realized gains (losses) and impairments on investments | 0.01 | (0.01) | 0.00 | (0.01) |
| Income tax (expense) benefit | 0.00 | 0.00 | 0.00 | 0.00 |
| Realized gains (losses) and impairments, net of income taxes | 0.01 | (0.01) | 0.00 | (0.01) |
| Net income | \$1.09 | \$0.94 | \$3.14 | \$2.75 |

General Conditions and Trends Affecting Our Business

Economic conditions

Unfavorable changes in economic conditions, including declining consumer confidence, inflation, high unemployment, and the threat of recession, among others, may lead the Exchange's customers to modify coverage, not renew policies, or even cancel policies, which could adversely affect the premium revenue of the Exchange, and consequently our management fee. Further, unanticipated increased inflation costs including medical cost inflation, construction and auto repair cost inflation, and tort issues may impact the estimated loss reserves and future premium rates. If any of these items impacted the financial condition or continuing operations of the Exchange, it could have an impact on our financial results.

Financial market volatility

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

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RESULTS OF OPERATIONS

We earn management fee revenue from providing services relating to the sales, underwriting, and issuance of policies on behalf of the Exchange as a result of its attorney-in-fact relationship. A summary of the financial results of these operations is as follows:

| (dollars in thousands) | Three months ended September 30, | | | Nine months ended September 30, | | |
|-----------------------------|----------------------------------|-----------|------------|---------------------------------|-------------|------------|
| | 2016 (Unaudited) | 2015 | % Change | 2016 (Unaudited) | 2015 | % Change |
| Management fee revenue, net | \$411,139 | \$389,168 | 5.6 % | \$1,195,262 | \$1,126,626 | 6.1 % |
| Service agreement revenue | 7,267 | 7,469 | (2.7) | 21,756 | 22,502 | (3.3) |
| Total operating revenue | 418,406 | 396,637 | 5.5 | 1,217,018 | 1,149,128 | 5.9 |
| Total operating expenses | 336,151 | 328,348 | 2.4 | 981,339 | 958,426 | 2.4 |
| Net revenue from operations | \$82,255 | \$68,289 | 20.5 % | \$235,679 | \$190,702 | 23.6 % |
| Gross margin | 19.7 | % 17.2 | % 2.5 pts. | 19.4 | % 16.6 | % 2.8 pts. |

Management fee revenue

Management fee revenue is based upon all direct and assumed premiums written by the Exchange and the management fee rate, which is determined by our Board of Directors at least annually. The management fee rate was set at 25%, the maximum rate, for both 2016 and 2015. Changes in the management fee rate can affect our revenue and net income significantly. Management fee revenue is calculated by multiplying the management fee rate by the direct and assumed premiums written by the Exchange. The following table presents the calculation of management fee revenue:

| (dollars in thousands) | Three months ended September 30, | | | Nine months ended September 30, | | |
|--|----------------------------------|-------------|----------|---------------------------------|-------------|----------|
| | 2016 (Unaudited) | 2015 | % Change | 2016 (Unaudited) | 2015 | % Change |
| Direct and assumed premiums written by the Exchange | \$1,643,755 | \$1,557,873 | 5.5 % | \$4,795,446 | \$4,520,506 | 6.1 % |
| Management fee rate | 25 | % 25 | % | 25 | % 25 | % |
| Management fee revenue, gross | 410,939 | 389,468 | 5.5 | 1,198,862 | 1,130,126 | 6.1 |
| Change in allowance for management fee returned on cancelled policies ⁽¹⁾ | 200 | (300) | NM | (3,600) | (3,500) | NM |
| Management fee revenue, net of allowance | \$411,139 | \$389,168 | 5.6 % | \$1,195,262 | \$1,126,626 | 6.1 % |

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 and assumed premiums written by the Exchange

Direct and assumed premiums include premiums written directly by the Exchange and premiums assumed from its wholly owned property and casualty subsidiaries. Direct and assumed premiums written by the Exchange increased 5.5% to \$1.6 billion in the third quarter of 2016 compared to the third quarter of 2015, driven by increases in both policies in force and average premium per policy. Year-over-year policies in force for all lines of business increased 3.3% in the third quarter of 2016, compared to 3.8% in the third quarter of 2015. The year-over-year average premium per policy for all lines of business increased 2.7% at September 30, 2016, compared to 3.9% at

September 30, 2015.

Premiums generated from new business increased 3.9% to \$194 million in the third quarter of 2016, compared to a decrease of 1.0% to \$187 million in the third quarter of 2015. Underlying the trend in new business premiums was a 1.1% increase in new business policies written in the third quarter of 2016, compared to a 0.2% decrease in the third quarter of 2015, while the year-over-year average premium per policy on new business increased 1.9% at September 30, 2016, compared to 2.8% at September 30, 2015. Premiums generated from renewal business increased 5.7% to \$1.4 billion in the third quarter of 2016, compared to an increase of 8.8% to \$1.4 billion in the third quarter of 2015. Underlying the trend in renewal business premiums was an increase in year-over-year average premium per policy of 2.8% at September 30, 2016, compared to 4.1% at September 30, 2015, and steady policy retention ratios.

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Personal lines – Total personal lines premiums written increased 6.3% to \$1.2 billion in the third quarter of 2016, from \$1.1 billion in the third quarter of 2015, driven by an increase of 3.4% in total personal lines policies in force and an increase of 2.9% in the total personal lines year-over-year average premium per policy.

Commercial lines – Total commercial lines premiums written increased 3.5% to \$440 million in the third quarter of 2016, from \$424 million in the third quarter of 2015, driven by a 2.3% increase in total commercial lines policies in force and a 3.1% increase in the total commercial lines year-over-year average premium per policy.

Future trends-premium revenue – The Exchange plans to continue its efforts to grow premiums and improve its competitive position in the marketplace. Expanding the size of its agency force through a careful agency selection process and increased market penetration in our existing operating territories will contribute to future growth as existing and new agents build their books of business.

Changes in premium levels attributable to the growth in policies in force and rate changes directly affect the profitability of the Exchange and have a direct bearing on our management fee. The Exchange's continued focus on underwriting discipline and the maturing of its pricing sophistication models has contributed to its growth in new policies in force, steady policy retention ratios, and increased average premium per policy.

Service agreement revenue

Service agreement revenue includes service charges we collect from policyholders for providing extended payment terms on policies written and assumed by the Exchange, and late payment and policy reinstatement fees. The service charges are fixed dollar amounts per billed installment. Service agreement revenue totaled \$7.3 million and \$7.5 million in the third quarters of 2016 and 2015, respectively, and \$21.8 million and \$22.5 million for the nine months ended September 30, 2016 and 2015, respectively. The decrease in service agreement revenue compared to the growth in policies in force reflects the continued shift in policies to the monthly direct debit payment plan, which does not incur service charges, and the no-fee single payment plan, which offers a premium discount. The shift to these plans is driven by the consumers' desire to avoid paying service charges and to take advantage of the discount in pricing offered for paid-in-full policies.

Cost of management operations

| (in thousands) | Three months ended | | | Nine months ended | | |
|-------------------------------------|--------------------------------------|-----------|----------|--------------------------------------|-----------|----------|
| | September 30, 2016 (Unaudited) | 2015 | % Change | September 30, 2016 (Unaudited) | 2015 | % Change |
| Commissions: | | | | | | |
| Total commissions | \$232,455 | \$223,741 | 3.9 % | \$676,963 | \$641,189 | 5.6 % |
| Non-commission expense: | | | | | | |
| Underwriting and policy processing | \$33,946 | \$34,003 | (0.2) % | \$102,108 | \$101,531 | 0.6 % |
| Information technology | 31,114 | 27,885 | 11.6 | 87,714 | 94,125 | (6.8) |
| Sales and advertising | 14,869 | 15,638 | (4.9) | 46,872 | 47,247 | (0.8) |
| Customer service | 5,381 | 7,255 | (25.8) | 18,689 | 21,565 | (13.3) |
| Administrative and other | 18,386 | 19,826 | (7.3) | 48,993 | 52,769 | (7.2) |
| Total non-commission expense | 103,696 | 104,607 | (0.9) | 304,376 | 317,237 | (4.1) |
| Total cost of management operations | \$336,151 | \$328,348 | 2.4 % | \$981,339 | \$958,426 | 2.4 % |

Commissions – Commissions increased \$8.7 million in the third quarter of 2016 and \$35.8 million for the nine months ended September 30, 2016, compared to the same respective periods in 2015. The majority of the increases were driven by the 5.5% and 6.1% increases in direct and assumed premiums written by the Exchange for the third quarter

and nine months ended September 30, 2016, respectively. The remaining portion of the increase for the nine months ended September 30, 2016 was due to higher agent incentive costs primarily related to profitable growth, compared to the same respective period in 2015. The estimated agent incentive payout at September 30, 2016 is based on actual underwriting results for the two prior years and current year-to-date actual results and forecasted results for the remainder of 2016. Therefore, fluctuations in the current quarter underwriting results can impact the estimated incentive payout on a quarter-to-quarter basis.

Non-commission expense – Non-commission expense decreased \$0.9 million in the third quarter of 2016 compared to the same period in 2015. Information technology costs increased \$3.2 million primarily due to increased professional fees somewhat offset by a decrease in personnel costs. Customer service costs decreased \$1.9 million primarily due to decreased credit card processing fees. Administrative and other costs decreased \$1.4 million primarily due to decreased personnel costs somewhat

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offset by an increase in professional fees. Personnel costs in all expense categories were impacted by decreased pension costs primarily due to an increase in the pension discount rate.

Non-commission expense decreased \$12.9 million for the nine months ended September 30, 2016, compared to the nine months ended September 30, 2015. Information technology costs decreased \$6.4 million primarily due to decreased personnel costs and professional fees. Customer service costs decreased \$2.9 million primarily due to decreased credit card processing fees. Administrative and other expenses decreased \$3.8 million primarily due to decreased personnel costs somewhat offset by an increase in professional fees. Personnel costs in all expense categories were impacted by decreased pension costs primarily due to an increase in the pension discount rate.

Gross margin

The gross margin in the third quarter of 2016 was 19.7% compared to 17.2% in the third quarter of 2015, and was 19.4% for the nine months ended September 30, 2016, compared to 16.6% for the nine months ended September 30, 2015.

Total Investment Income

A summary of the results of our investment operations is as follows:

| (in thousands) | Three months ended September 30, | | | Nine months ended September 30, | | |
|---|-------------------------------------|---------|----------|------------------------------------|----------|----------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (Unaudited) | | | (Unaudited) | | |
| Net investment income | \$5,331 | \$4,346 | 22.7 % | \$14,884 | \$13,322 | 11.7 % |
| Net realized investment gains (losses) | 718 | (483) | NM | 29 | (125) | NM |
| Net impairment losses recognized in earnings | 0 | (480) | NM | (345) | (635) | (45.7) |
| Equity in (losses) earnings of limited partnerships | (1,723) | 3,837 | NM | (279) | 16,902 | NM |
| Total investment income | \$4,326 | \$7,220 | (40.1)% | \$14,289 | \$29,464 | (51.5)% |

NM = not meaningful

Net investment income

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

Net investment income increased \$1.0 million in the third quarter of 2016, compared to the third quarter of 2015, and increased \$1.6 million for the nine months ended September 30, 2016, compared to the nine months ended September 30, 2015. The increase in net investment income during both periods was primarily due to an increase in the invested balance and yield of fixed maturity securities, partially offset by lower income from equity securities as a result of the sale of our preferred stock holdings in the fourth quarter of 2015.

Net realized investments gains (losses)

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

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|------------------|--|------|---------------------------------------|------|
| | 2016 | 2015 | 2016 | 2015 |
| Securities sold: | (Unaudited) | | (Unaudited) | |

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| | | | | |
|---|-------|---------|---------|---------|
| Fixed maturities | \$576 | \$(541) | \$(644) | \$(545) |
| Equity securities | 0 | 57 | (34) | 419 |
| Common stock trading securities | 121 | 0 | 707 | 0 |
| Common stock increases in fair value ⁽¹⁾ | 21 | 0 | 0 | 0 |
| Miscellaneous | 0 | 1 | 0 | 1 |
| Net realized investment gains (losses) ⁽²⁾ | \$718 | \$(483) | \$29 | \$(125) |

(1) The fair value of our common stocks is determined based upon exchange traded prices provided by a nationally recognized pricing service.

(2) See Part I, Item 1. "Financial Statements - Note 5, Investments, of Notes to Financial Statements" contained within this report for additional disclosures regarding net realized investment gains (losses.)

Net realized investment gains and losses include gains and losses resulting from the sales of our fixed maturity or equity securities, as well as changes in fair value of common stocks designated as trading securities.

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Net realized gains during the third quarter of 2016 primarily reflected gains from sales of common stock and fixed maturity securities, while net realized losses in the third quarter of 2015 resulted from losses on sales of fixed maturity securities, partially offset by gains on preferred equity securities. Net realized gains for the nine months ended September 30, 2016 primarily reflected gains from sales of common stock, partially offset by losses from sales of fixed maturity securities, while net realized losses for the nine months ended September 30, 2015 primarily reflected losses from sales of fixed maturity securities, partially offset by gains on preferred equity securities.

Net impairment losses recognized in earnings

Impairments recorded for the third quarter of 2015 and both the nine months ended September 30, 2016 and 2015 were primarily related to several securities in an unrealized loss position where we determined the loss was other-than-temporary based on credit factors.

Equity in (losses) earnings of limited partnerships

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

| (in thousands) | Three months | | Nine months | |
|---|-----------------|---------|-----------------|----------|
| | ended September | | ended September | |
| | 30, | 30, | 30, | 2015 |
| | 2016 | 2015 | 2016 | 2015 |
| | (Unaudited) | | (Unaudited) | |
| Private equity | \$(443) | \$2,627 | \$(2,240) | \$12,784 |
| Mezzanine debt | (120) | 611 | (26) | 1,748 |
| Real estate | (1,160) | 599 | 1,987 | 2,370 |
| Total equity in (losses) earnings of limited partnerships | \$(1,723) | \$3,837 | \$(279) | \$16,902 |

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

Limited partnership earnings tend to be cyclical based upon market conditions, the age of the partnership, and the nature of the investments. Generally, limited partnership earnings are recorded on a quarter lag from financial statements we receive from our general partners. As a consequence, earnings from limited partnerships reported at September 30, 2016 reflect investment valuation changes resulting from the financial markets and the economy in the fourth quarter of 2015 and the first two quarters of 2016.

Equity in earnings of limited partnerships decreased by \$5.6 million in the third quarter of 2016, compared to the third quarter of 2015, and decreased by \$17.2 million for the nine months ended September 30, 2016, compared to the nine months ended September 30, 2015. The decrease in earnings during both periods was primarily due to lower earnings from private equity investments.

In October 2016, a real estate partnership had a sale of its remaining assets that resulted in a distribution, generating significant gains. Because this was a final distribution, the gain of approximately \$7.5 million will be recorded in equity in earnings of limited partnerships from this investment in our fourth quarter 2016 financial statements.

Financial Condition of Erie Insurance Exchange

Serving in the capacity of attorney-in-fact for the Exchange, we are dependent on the growth and financial condition of the Exchange, who is our sole customer. The strength of the Exchange and its wholly owned subsidiaries is rated

annually by A.M. Best Company. Higher ratings of insurance companies generally indicate financial stability and a strong ability to pay claims. The ratings are generally based upon factors relevant to policyholders and are not directed toward return to investors. The Exchange and each of its property and casualty subsidiaries are rated A+ "Superior". As of June 28, 2016, the outlook for the financial strength rating was affirmed as stable. According to A.M. Best, this second highest financial strength rating category is assigned to those companies that, in A.M. Best's opinion, have achieved superior overall performance when compared to the

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standards established by A.M. Best and have a superior ability to meet obligations to policyholders over the long term. As of December 31, 2015, only 11% of insurance groups are rated A+ or higher, and the Exchange is included in that group.

The financial statements of the Exchange are prepared in accordance with statutory accounting principles prescribed by the Commonwealth of Pennsylvania. Financial statements prepared under statutory accounting principles focus on the solvency of the insurer and generally provide a more conservative approach than under GAAP. Statutory direct written premiums of the Exchange and its wholly owned property and casualty subsidiaries grew 6.1% to \$4.8 billion for the nine months ended September 30, 2016 from \$4.5 billion for the nine months ended September 30, 2015. These premiums, along with investment income, are the major sources of cash that support the operations of the Exchange. Policyholders' surplus, determined under statutory accounting principles, was \$7.6 billion at September 30, 2016, \$7.1 billion at December 31, 2015, and \$7.0 billion at September 30, 2015. The Exchange and its wholly owned property and casualty subsidiaries' year-over-year policy retention ratio continues to be high at 89.8% at September 30, 2016, 89.9% at December 31, 2015, and 90.0% at September 30, 2015.

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FINANCIAL CONDITION

Investments

Our investment portfolio is managed with the objective of maximizing after-tax returns on a risk-adjusted basis.

Distribution of investments

| (dollars in thousands) | Carrying value at September 30, 2016 (Unaudited) | | Carrying value at December 31, 2015 | |
|----------------------------|--|------------|--|------------|
| | | % to total | | % to total |
| Fixed maturities | \$695,355 | 90 % | \$ 587,209 | 85 % |
| Common stock | 9,020 | 1 | 12,732 | 2 |
| Limited partnerships: | | | | |
| Private equity | 37,248 | 5 | 48,397 | 7 |
| Mezzanine debt | 8,404 | 1 | 12,701 | 2 |
| Real estate | 20,297 | 3 | 27,437 | 4 |
| Real estate mortgage loans | 232 | 0 | 333 | 0 |
| Total investments | \$770,556 | 100 % | \$ 688,809 | 100 % |

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

We individually analyze all positions with emphasis on those that have, in management's opinion, declined significantly below cost. In compliance with impairment guidance for debt securities, we perform further analysis to determine if a credit-related impairment has occurred. Some of the factors considered in determining whether a debt security is credit impaired include potential for the default of interest and/or principal, level of subordination, collateral of the issue, compliance with financial covenants, credit ratings and industry conditions. We have the intent to sell all credit-impaired debt securities; therefore, the entire amount of the impairment charges is included in earnings and no impairments are recorded in other comprehensive income. For available-for-sale equity securities, a charge is recorded in the Statements of Operations for positions that have experienced other-than-temporary impairments. (See the "Results of Operations" section contained within this report for further information.) Management believes its investment valuation philosophy and accounting practices result in appropriate and timely measurement of value and recognition of impairment.

Fixed maturities

Under our investment strategy, we maintain a fixed maturity portfolio that is of high quality and well diversified within each market sector. This investment strategy also achieves a balanced maturity schedule. Our fixed maturity portfolio is managed with the goal of achieving reasonable returns while limiting exposure to risk. Our municipal bond portfolio accounts for \$246.3 million, or 35%, of the total fixed maturity portfolio at September 30, 2016. The overall credit rating of the municipal portfolio without consideration of the underlying insurance is AA+.

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

amounted to \$9.3 million at September 30, 2016, compared to \$3.4 million at December 31, 2015.

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The following table presents a breakdown of the fair value of our fixed maturity portfolio by sector and rating: ⁽¹⁾

| (in thousands) | At September 30, 2016 (Unaudited) | | | | | |
|--------------------------------------|--------------------------------------|-----------|----------|-----------|----------------------|------------|
| | AAA | AA | A | BBB | Non-investment grade | Fair value |
| Industry Sector | | | | | | |
| Basic materials | \$0 | \$0 | \$2,027 | \$1,605 | \$11,268 | \$14,900 |
| Communications | 0 | 0 | 2,017 | 10,504 | 18,899 | 31,420 |
| Consumer | 0 | 0 | 2,004 | 31,388 | 46,488 | 79,880 |
| Diversified | 0 | 0 | 0 | 0 | 1,638 | 1,638 |
| Energy | 0 | 2,025 | 5,517 | 5,616 | 15,017 | 28,175 |
| Financial | 0 | 2,000 | 20,347 | 60,221 | 18,042 | 100,610 |
| Government-municipal | 110,565 | 124,858 | 9,812 | 1,024 | 0 | 246,259 |
| Government sponsored enterprises | 0 | 2,048 | 0 | 0 | 0 | 2,048 |
| Industrial | 0 | 0 | 1,989 | 4,083 | 22,250 | 28,322 |
| Structured securities ⁽²⁾ | 59,429 | 35,497 | 15,270 | 11,470 | 5,114 | 126,780 |
| Technology | 0 | 4,028 | 2,250 | 4,269 | 13,718 | 24,265 |
| Utilities | 0 | 0 | 5,137 | 5,031 | 890 | 11,058 |
| Total | \$169,994 | \$170,456 | \$66,370 | \$135,211 | \$153,324 | \$695,355 |

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

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

Common Stock

The following table presents an analysis of the fair value of our common stock securities by sector:

| (in thousands) | Fair value at: | |
|----------------------|--------------------|-------------------|
| | September 30, 2016 | December 31, 2015 |
| Industry sector | (Unaudited) | |
| Funds ⁽¹⁾ | \$ 9,020 | \$ 12,732 |
| Total | \$ 9,020 | \$ 12,732 |

Includes exchange traded funds with underlying holdings of fixed maturity securities. These securities meet the (1) criteria of a common stock under U.S. GAAP, and are included on the balance sheet as available-for-sale equity securities.

Equity securities classified as available-for-sale include certain common stock securities and are carried at fair value on the Statements of Financial Position with all changes in unrealized gains and losses reflected in other comprehensive income. The net unrealized gain on equity securities classified as available-for-sale, net of deferred taxes, was less than \$0.1 million at September 30, 2016, compared to a net unrealized loss of \$0.1 million at December 31, 2015.

Common stocks classified as trading securities are measured at fair value with all changes in fair value reflected in the Statements of Operations.

Limited partnerships

In the third quarter of 2016, investments in limited partnerships decreased from the investment levels at December 31, 2015. Changes in partnership values are a function of contributions and distributions, adjusted for market value changes in the underlying investments. The decrease in limited partnership investments was primarily due to net distributions received from the partnerships. We have made no new limited partnership commitments since 2006, and the balance of limited partnership investments is expected to decline over time as additional distributions are received. The results from our limited partnerships are based upon financial statements received from our general partners, which are generally received on a quarter lag. As a result, the market values and earnings recorded during the third quarter of 2016 reflect the partnership activity experienced in the second quarter of 2016.

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LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

Liquidity is a measure of a company's ability to generate sufficient cash flows to meet the short- and long-term cash requirements of its business operations and growth needs. Our liquidity requirements have been met primarily by funds generated from management fee revenue and income from investments. Cash provided from these sources is used primarily to fund the costs of our management operations including commissions, salaries and wages, pension plans, share repurchases, dividends to shareholders, and the purchase and development of information technology. We expect that our operating cash needs will be met by funds generated from operations.

Volatility in the financial markets presents challenges to us as we do occasionally access our investment portfolio as a source of cash. Some of our fixed income investments, despite being publicly traded, are illiquid. Volatility in these markets could limit our ability to sell certain of our fixed income securities or cause such securities to sell at deep discounts. Additionally, our limited partnership investments are significantly less liquid. We believe we have sufficient liquidity to meet our needs from other sources even if market volatility persists throughout 2016.

Cash flow activities

The following table provides condensed cash flow information for the nine months ended September 30:

| (in thousands) | 2016 | 2015 |
|--|-------------|-----------|
| | (Unaudited) | |
| Net cash provided by operating activities | \$155,551 | \$130,995 |
| Net cash used in investing activities | (96,638) | (5,461) |
| Net cash used in financing activities | (101,989) | (95,143) |
| Net (decrease) increase in cash and cash equivalents | \$(43,076) | \$30,391 |

Net cash provided by operating activities was \$155.6 million in the first nine months of 2016, compared to \$131.0 million in the first nine months of 2015. Increased cash from operating activities for the first nine months of 2016 was primarily due to an increase in management fee revenue received combined with lower general operating expenses paid. Management fee revenues were higher reflecting the increase in direct and assumed premiums written by the Exchange. Somewhat offsetting this increase in cash provided was an increase in commissions and bonuses paid to agents, salaries and wages and employee benefits paid compared to the first nine months of 2015. Cash paid for agent commissions and bonuses increased to \$676.0 million in the first nine months of 2016, compared to \$632.7 million in the first nine months of 2015, as a result of an increase in cash paid for bonus awards due to profitable underwriting results and an increase in scheduled commissions due to premium growth. We contributed \$17.4 million to our pension plan in the first quarter of 2016, compared to \$17.0 million in the first quarter of 2015. Our funding policy is generally to contribute an amount equal to the greater of the target normal cost for the plan year or the amount necessary to fund the plan to 100% plus interest to the date the contribution is made. We are reimbursed approximately 58% of the net periodic benefit cost of the pension plans from the Exchange, which represents pension benefits for our employees performing claims and life insurance functions. At September 30, 2016, we recorded a net deferred tax asset of \$36.2 million. There was no deferred tax valuation allowance recorded at September 30, 2016.

Net cash used in investing activities totaled \$96.6 million in the first nine months of 2016, compared to \$5.5 million in the first nine months of 2015. Increases in purchases of available-for-sale securities, coupled with less cash generated from the return of capital from limited partnerships, contributed to an increase in cash used for the first nine months of 2016, compared to the first nine months of 2015. Somewhat offsetting the increase in cash used was an increase in cash generated from the sale of available-for-sale securities in the first nine months of 2016, compared to the first nine months of 2015. Also impacting our future investing activities are limited partnership commitments, which totaled \$18.6 million at September 30, 2016, and will be funded as required by the partnerships' agreements. Of this amount,

the total remaining commitment to fund limited partnerships that invest in private equity securities was \$7.1 million, mezzanine debt securities was \$8.4 million and real estate activities was \$3.1 million.

Net cash used in financing activities totaled \$102.0 million in the first nine months of 2016, compared to \$95.1 million in the first nine months of 2015, all of which was related to dividends paid to shareholders. We increased both our Class A and Class B shareholder regular quarterly dividends by 7.2% for 2016, compared to 2015. There are no regulatory restrictions on the payment of dividends to our shareholders.

No shares of our Class A nonvoting common stock were repurchased in the first nine months of 2016 and 2015 in conjunction with our stock repurchase program. In October 2011, our Board of Directors approved a continuation of the current stock

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repurchase program for a total of \$150 million with no time limitation. This repurchase authority includes, and is not in addition to, any unspent amounts remaining under the prior authorization. We had approximately \$17.8 million of repurchase authority remaining under this program at September 30, 2016, based upon trade date.

In August 2016, we purchased 2,713 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$269,337, or \$99.28 per share, to fund the rabbi trust for the outside director deferred compensation plan. These shares were transferred to the rabbi trust in August 2016.

In May and June 2016, we purchased 7,661 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$752,309, or \$98.20 per share, for the vesting of stock-based awards in conjunction with our long-term incentive plan. These shares were delivered to plan participants in June 2016.

In May 2016, we purchased 2,041 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$193,349, or \$94.73 per share, to fund the rabbi trust for the outside director deferred compensation plan. These shares were transferred to the rabbi trust in May 2016.

In August 2015, we purchased 2,800 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$241,469, or \$86.24 per share, for the vesting of stock-based awards for executive management. These shares were delivered to executive management in August 2015.

In June 2015, we purchased 1,567 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$128,355, or \$81.91 per share, for the vesting of stock-based awards in conjunction with our long-term incentive plan. These shares were delivered to plan participants in June 2015.

Capital Outlook

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

Outside of our normal operating and investing cash activities, future funding requirements could be met through: 1) cash and cash equivalents, which total approximately \$139.8 million at September 30, 2016, 2) a \$100 million bank revolving line of credit, and 3) liquidation of assets held in our investment portfolio, including common stock and investment grade bonds which totaled approximately \$441.7 million at September 30, 2016. Volatility in the financial markets could impair our ability to sell certain fixed income securities or cause such securities to sell at deep discounts. Additionally, we have the ability to curtail or modify discretionary cash outlays such as those related to shareholder dividends and share repurchase activities.

As of September 30, 2016, we have access to a \$100 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on November 3, 2020. As of September 30, 2016, a total of \$99.0 million remains available under the facility due to \$1.0 million outstanding letters of credit, which reduce the availability for letters of credit to \$24.0 million. We had no borrowings outstanding on our line of credit as of September 30, 2016. Bonds with a fair value of \$109.4 million were pledged as collateral on the line at September 30, 2016. These securities have no trading restrictions and are reported as available-for-sale securities in the Statements of Financial Position. The bank requires compliance with certain covenants, which include leverage ratios. We were in compliance with our bank covenants at September 30, 2016.

Balance Sheet Arrangements

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

Surplus Note

We hold a surplus note for \$25 million from EFL that is payable on demand on or after December 31, 2018; however, no principal or interest payments may be made without prior approval by the Pennsylvania Insurance Commissioner. Interest payments are scheduled to be paid semi-annually. For each of the nine months ended September 30, 2016 and 2015, we recognized interest income on the note of \$1.3 million.

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CRITICAL ACCOUNTING ESTIMATES

We make estimates and assumptions that have a significant effect on the amounts and disclosures reported in the financial statements. The most significant estimates relate to investment valuation and retirement benefit plans for employees. While management believes its estimates are appropriate, the ultimate amounts may differ from estimates provided. Our most critical accounting estimates are described in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for the year ended December 31, 2015 of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 25, 2016. See Part I, Item 1. "Financial Statements - Note 4, Fair Value, of Notes to Financial Statements" contained within this report for additional information on our valuation of investments.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is primarily related to fluctuations in prices and interest rates. Quantitative and qualitative disclosures about market risk resulting from changes in prices, interest rates, and other risk exposures for the year ended December 31, 2015 are included in Item 7A. "Quantitative and Qualitative Disclosures About Market Risk", of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 25, 2016.

There have been no material changes that impact our portfolio or reshape our periodic investment reviews of asset allocations during the nine months ended September 30, 2016. For a recent discussion of conditions surrounding our investment portfolio, see the "Operating Overview", "Results of Operations", and "Financial Condition" discussions contained in Part I, Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained within this report.

ITEM 4. CONTROLS AND PROCEDURES

We carried out an evaluation, with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

Our management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, any change in our internal control over financial reporting and determined there has been no change in our internal control over financial reporting during the nine months ended September 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

State Court Lawsuit Against Erie Indemnity Company

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

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

Indemnity filed a motion in the state court in November 2012 seeking dismissal of the lawsuit. On December 19, 2013, the court granted Indemnity’s motion in part, holding that the Pennsylvania Insurance Holding Company Act “provides the [Pennsylvania Insurance] Department with special competence to address the subject matter of plaintiff’s claims” and referring “all issues” in the Sullivan lawsuit to the Pennsylvania Insurance Department (the “Department”) for “its views and any determination.” The court stayed all further proceedings and reserved decision on all other grounds for dismissal raised by Indemnity. Plaintiffs sought reconsideration of the court’s order, and on January 13, 2014, the court entered a revised order affirming its prior order and clarifying that the Department “shall decide any and all issues within its jurisdiction.” On January 30, 2014, Plaintiffs asked the court to certify its order to permit an immediate appeal to the Superior Court of Pennsylvania and to stay any proceedings in the Department pending completion of any appeal. On February 18, 2014, the court issued an order denying Plaintiffs’ motion. On March 20, 2014, Plaintiffs filed a petition for review with the Superior Court, which was denied by the Superior Court on May 5, 2014.

The Sullivan matter was assigned to an Administrative Judge within the Department for determination. The parties agreed that an evidentiary hearing was not required, entered into a stipulated record, and submitted briefing to the Department. Oral argument was held before the Administrative Judge on January 6, 2015. On April 29, 2015, the Department issued a declaratory opinion and order: (1) finding that the transactions between Exchange and Indemnity in which Indemnity retained or received revenue from installment and other service charges from Exchange subscribers complied with applicable insurance laws and regulations and that Indemnity properly retained charges paid by Exchange policyholders for certain installment premium payment plans, dishonored payments, policy cancellations, and policy reinstatements; and (2) returning jurisdiction over the matter to the Fayette County Court of Common Pleas.

On May 26, 2015, Plaintiffs appealed the Department’s decision to the Pennsylvania Commonwealth Court. Oral argument was held before the Commonwealth Court en banc on December 9, 2015. On January 27, 2016, the Commonwealth Court issued an opinion vacating the Department’s ruling and directing the Department to return the case to the Court of Common Pleas, essentially holding that the primary jurisdiction referral of the trial court was improper at this time because the allegations of the complaint do not implicate the special competency of the

Department.

On February 26, 2016, Indemnity filed a petition for allowance of appeal to the Pennsylvania Supreme Court seeking further review of the Commonwealth Court opinion. On March 14, 2016, Plaintiffs filed an answer opposing Indemnity's petition for allowance of appeal; and, on March 28, 2016, Indemnity sought permission to file a reply brief in further support of its petition for allowance of appeal. On August 10, 2016, the Pennsylvania Supreme Court denied Indemnity's petition for allowance of appeal; and the Sullivan lawsuit returned to the Court of Common Pleas of Fayette County.

On September 12, 2016, Plaintiffs filed a motion to stay the Sullivan lawsuit pending the outcome of the Federal Court Lawsuit they filed against Indemnity and former and current Directors of Indemnity on July 8, 2016. (See below.) Indemnity filed an opposition to Plaintiff's motion to stay on September 19, 2016; and filed amended preliminary objections seeking dismissal of the Sullivan lawsuit on September 20, 2016. The motion to stay and the amended preliminary objections remain pending.

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Indemnity believes that it continues to have meritorious legal and factual defenses to the Sullivan lawsuit and intends to vigorously defend against all allegations and requests for relief.

Federal Court Lawsuit Against Directors

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

As subsequently amended, the Beltz lawsuit asserts many of the same allegations and claims for monetary relief as in the Sullivan lawsuit. Plaintiffs purport to sue on behalf of all policyholders of Exchange, or, alternatively, on behalf of Exchange itself. Indemnity filed a motion to intervene as a Party Defendant in the Beltz lawsuit in July 2013, and the Directors filed a motion to dismiss the lawsuit in August 2013. On February 10, 2014, the court entered an order granting Indemnity’s motion to intervene and permitting Indemnity to join the Directors’ motion to dismiss; granting in part the Directors’ motion to dismiss; referring the matter to the Department to decide any and all issues within its jurisdiction; denying all other relief sought in the Directors’ motion as moot; and dismissing the case without prejudice. To avoid duplicative proceedings and expedite the Department’s review, the Parties stipulated that only the Sullivan action would proceed before the Department and any final and non-appealable determinations made by the Department in the Sullivan action will be applied to the Beltz action.

On March 7, 2014, Plaintiffs filed a notice of appeal to the United States Court of Appeals for the Third Circuit. Indemnity filed a motion to dismiss the appeal on March 26, 2014. On November 17, 2014, the Third Circuit deferred ruling on Indemnity’s motion to dismiss the appeal and instructed the parties to address that motion, as well as the merits of Plaintiffs’ appeal, in the parties’ briefing. Briefing was completed on April 2, 2015. In light of the Department’s April 29, 2015 decision in Sullivan, the Parties then jointly requested that the Beltz appeal be voluntarily dismissed as moot on June 5, 2015. The Third Circuit did not rule on the Parties’ request for dismissal and instead held oral argument as scheduled on June 8, 2015. On July 16, 2015, the Third Circuit issued an opinion and judgment dismissing the appeal. The Third Circuit found that it lacked appellate jurisdiction over the appeal, because the District Court’s February 10, 2014 order referring the matter to the Department was not a final, appealable order.

On July 8, 2016, the Beltz plaintiffs filed a new action labeled as a “Verified Derivative And Class Action Complaint” in the United States District Court for the Western District of Pennsylvania. The action is captioned Patricia R. Beltz, Joseph S. Sullivan, and Anita Sullivan, individually and on behalf of all others similarly situated, and derivatively on behalf of Nominal Defendant Erie Insurance Exchange v. Erie Indemnity Company; Kaj Ahlmann; John T. Baily; Samuel P. Black, III; J. Ralph Borneman, Jr.; Terrence W. Cavanaugh; Wilson C. Cooney; LuAnn Datesh; Patricia A. Goldman; Jonathan Hirt Hagen; Thomas B. Hagen; C. Scott Hartz; Samuel P. Katz; Gwendolyn King; Claude C. Lilly, III; Martin J. Lippert; George R. Lucore; Jeffrey A. Ludrof; Edmund J. Mehl; Henry N. Nassau; Thomas W. Palmer; Martin P. Sheffield; Seth E. Schofield; Richard L. Stover; Jan R. Van Gorder; Elizabeth A. Hirt Vorsheck; Harry H. Weil; and Robert C. Wilburn (the “Beltz II” lawsuit). The individual defendants are all present or former Directors of Indemnity (the “Directors”).

The allegations of the Beltz II lawsuit arise from the same fundamental, underlying claims as the Sullivan and prior Beltz litigation, i.e., that Indemnity improperly retained Service Charges and Added Service Charges. The Beltz II lawsuit alleges that the retention of the Service Charges and Added Service Charges was improper because, for among other reasons, that retention constituted a breach of the Subscriber’s Agreement and an Implied Covenant of Good Faith and Fair Dealing by Indemnity, breaches of fiduciary duty by Indemnity and the other defendants, conversion by

Indemnity, and unjust enrichment by defendants Jonathan Hirt Hagen, Thomas B. Hagen, Elizabeth A. Hirt Vorsheck, and Samuel P. Black, III, at the expense of Exchange. The Beltz II lawsuit requests, among other things, that a judgment be entered against the Defendants certifying the action as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure; declaring Plaintiffs as representatives of the Class and Plaintiffs' counsel as counsel for the Class; declaring the conduct alleged as unlawful, including, but not limited to, Defendants' retention of the Service Charges and Added Service Charges; enjoining Defendants from continuing to retain the Service Charges and Added Service Charges; and awarding compensatory and punitive damages and interest.

On September 23, 2016, Indemnity filed a motion to dismiss the Beltz II lawsuit. On September 30, 2016, the Directors filed their own motions to dismiss the Beltz II lawsuit. The motions to dismiss remain pending.

Indemnity believes it has meritorious legal and factual defenses and intends to vigorously defend against all allegations and requests for relief in the Beltz II lawsuit. The Directors have advised Indemnity that they intend to vigorously defend against

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the claims in the Beltz II lawsuit and have sought indemnification and advancement of expenses from the Company in connection with the Beltz II lawsuit.

For additional information on contingencies, see Part I, Item 1. "Financial Statements - Note 13, Commitments and Contingencies, of Notes to Financial Statements".

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 as filed with the Securities and Exchange Commission on February 25, 2016.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

In October 2011, our Board of Directors approved a continuation of the current stock repurchase program, authorizing repurchases for a total of \$150 million with no time limitation. This repurchase authority included, and was not in addition to, any unspent amounts remaining under the prior authorization. There were no repurchases of our Class A common stock under this program during the quarter ending September 30, 2016. We had approximately \$17.8 million of repurchase authority remaining under this program at September 30, 2016.

During the quarter ending September 30, 2016, we purchased 2,713 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$269,337, or \$99.28 per share, to fund the rabbi trust for the outside director deferred compensation plan. These shares were transferred to the rabbi trust in August 2016.

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ITEM 6. EXHIBITS

| Exhibit Number | Description of Exhibit |
|-------------------|---|
| 10.1 | Form of Indemnification Agreement by and between Erie Indemnity Company and each of LuAnn Datesh, George R. Lucore, Timothy G. NeCastro and Julie M. Pelkowski. Such exhibit is incorporated by reference to the like titled exhibit in the Registrant's Form 10-K that was filed with the Commission on February 26, 2009. |
| 10.2 | Agreement between Erie Indemnity Company and John F. Kearns dated July 21, 2016. Such exhibit is incorporated by reference to the like titled exhibit in the Registrant's Form 8-K that was filed with the Commission on July 27, 2016. |
| 10.3 | Retirement Agreement between Erie Indemnity Company and Terrence W. Cavanaugh dated July 28, 2016. Such exhibit is incorporated by reference to the like titled exhibit in the Registrant's Form 8-K that was filed with the Commission on July 28, 2016. |
| 10.4* | First Amendment to Erie Insurance Group Retirement Plan for Employees (As Amended and Restated Effective December 31, 2014), dated September 12, 2016. |
| 10.5* | Second Amendment to Erie Insurance Group Retirement Plan for Employees (As Amended and Restated Effective December 31, 2014), dated September 12, 2016. |
| 10.6* | First Amendment to Erie Insurance Group Employee Savings Plan (As Amended and Restated Effective as of January 1, 2015), dated September 12, 2016. |
| 10.7* | First Amendment to Erie Indemnity Company Annual Incentive Plan (As Amended and Restated Effective as of January 1, 2014), dated August 1, 2016. |
| 10.8* | Second Amendment to Erie Indemnity Company Long-Term Incentive Plan (As Amended and Restated Effective as of January 1, 2014), dated August 1, 2016. |
| 31.1* | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32* | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS* | XBRL Instance Document. |
| 101.SCH* | XBRL Taxonomy Extension Schema Document. |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document. |

101.PRE* XBRL Taxonomy Extension Presentation Linkbase Document.

* Filed herewith.

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SIGNATURES

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

Erie Indemnity Company
(Registrant)

Date: October 27, 2016 By: /s/ Timothy G. NeCastro
Timothy G. NeCastro, Chief Executive Officer

By: /s/ Gregory J. Gutting
Gregory J. Gutting, Executive Vice President & CFO