ERIE INDEMNITY CO
Form 10-Q
July 29, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PERSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2010
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 incorporation or organization)	(I.R.S. Employer 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 þ No o

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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

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 $.0292 per share, was 50,662,752 at July 21, 2010.

The number of shares outstanding of the registrant s Class B Common Stock as of the latest practicable date, with no par value and a stated value of $70 per share, was 2,546 at July 21, 2010.

The common stock is the only class of stock the registrant is presently authorized to issue.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	Three months ended June 30, 2010	Three months ended June 30, 2009 (As adjusted Note 2)	Six months ended June 30, 2010	Six months ended June 30, 2009 (As adjusted Note 2)
Revenues				
Premiums earned	$ 989	$ 964	$ 1,967	$ 1,921
Net investment income	108	105	212	222
Net realized investment (losses) gains	(213)	208	(88)	53
Net impairment losses recognized in earnings	(4)	(12)	(6)	(83)
Equity in earnings (losses) of limited partnerships	27	(126)	30	(287)
Other income	9	10	17	18
Total revenues	916	1,149	2,132	1,844
Benefits and expenses				
Insurance losses and loss expenses	737	660	1,498	1,463
Policy acquisition and underwriting expenses	230	231	457	463
Total benefits and expenses	967	891	1,955	1,926
(Loss) income from operations before income taxes and noncontrolling interests	(51)	258	177	(82)
(Benefit) provision for income taxes	(20)	(13)	46	(102)
Net (loss) income	**$ (31)**	**$ 271**	**$ 131**	**$ 20**
Less: Net (loss) income attributable to noncontrolling interest in consolidated entity Exchange	**(80)**	**238**	**35**	**(24)**
Net income attributable to Indemnity	**$ 49**	**$ 33**	**$ 96**	**$ 44**
Earnings Per Share				
Net income attributable to Indemnity per share				

Class A common stock basic	$	0.96	$	0.63	$	1.87	$	0.85
Class A common stock diluted	**$**	**0.86**	**$**	**0.57**	**$**	**1.68**	**$**	**0.76**
Class B common stock basic and diluted	$	138.21	$	93.19	$	271.03	$	127.98
Weighted average shares outstanding attributable to Indemnity Basic								
Class A common stock		51,013,358		51,240,693		51,099,071		51,255,385
Class B common stock		2,546		2,551		2,546		2,551
Weighted average shares outstanding attributable to Indemnity Diluted								
Class A common stock		57,146,855		57,390,302		57,231,936		57,404,994
Class B common stock		2,546		2,551		2,546		2,551
Dividends declared per share								
Class A common stock	$	0.48	$	0.45	$	0.96	$	0.90
Class B common stock	$	72.00	$	67.50	$	144.00	$	135.00

See accompanying notes to Consolidated Financial Statements.

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

	June 30, 2010 (Unaudited)	December 31, 2009
Assets		
Investments Indemnity		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of $637 and $642, respectively)	$ 671	$ 664
Equity securities (cost of $41 and $35, respectively)	45	38
Trading securities, at fair value (cost of $36 and $36, respectively)	40	42
Limited partnerships (cost of $273 and $281, respectively)	234	235
Other invested assets	1	1
Investments Exchange		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of $6,379 and $6,277, respectively)	6,789	6,517
Equity securities (cost of $477 and $425, respectively)	523	472
Trading securities, at fair value (cost of $1,604 and $1,556, respectively)	1,712	1,835
Limited partnerships (cost of $1,341 and $1,392, respectively)	1,123	1,116
Other invested assets	19	20
Total investments	**11,157**	**10,940**
Cash and cash equivalents (Exchange portion of $189 and $158, respectively)	223	234
Premiums receivable from policyholders (Exchange portion of $770 and $715, respectively)	977	906
Reinsurance recoverable (Exchange portion of $198 and $212, respectively)	201	215
Deferred income taxes (Exchange portion of $72 and $75, respectively)	101	116
Deferred acquisition costs (Exchange portion of $417 and $416, respectively)	473	467
Other assets (Exchange portion of $322 and $306, respectively)	438	409
Total assets	**$ 13,570**	**$ 13,287**
Liabilities and shareholders equity		
Liabilities		
Indemnity liabilities		
Losses and loss expense reserves	$ 739	$ 752
Unearned premiums	345	325
Other liabilities	350	387
Exchange liabilities		
Losses and loss expense reserves	2,883	2,846
Life policy and deposit contract reserves	1,574	1,540
Unearned premiums	1,748	1,656
Other liabilities	62	56

Total liabilities	**7,701**	**7,562**
Indemnity s shareholders equity		
Class A common stock, stated value $0.0292 per share; authorized 74,996,930 shares; 68,289,600 issued; 50,759,754 and 51,203,473 shares outstanding, respectively	2	2
Class B common stock, convertible at a rate of 2,400 Class A shares for one Class B share, stated value $70 per share; 2,546 authorized, issued and outstanding, respectively	0	0
Additional paid-in-capital	8	8
Accumulated other comprehensive loss	(32)	(43)
Retained earnings, before cumulative effect adjustment	1,796	1,743
Cumulative effect of accounting changes, net of tax	0	6
Retained earnings, after cumulative effect adjustment	1,796	1,749
Total contributed capital and retained earnings	1,774	1,716
Treasury stock, at cost, 17,529,846 and 17,086,127 shares, respectively	(834)	(814)
Total Indemnity shareholders equity	**940**	**902**
Noncontrolling interest in consolidated entity Exchange	**4,929**	**4,823**
Total equity	**5,869**	**5,725**
Total liabilities, shareholders equity and noncontrolling interest	**$13,570**	**$13,287**

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

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

	Erie Insurance Group			
	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
		(As adjusted Note 2)		(As adjusted Note 2)
Accumulated other comprehensive loss:				
Balance, beginning of period	$ (37)	$ (138)	$ (43)	$ (136)
Adjustments to opening balance, net of tax*		(6)		(6)
Adjusted balance, beginning of period	(37)	(144)	(43)	(142)
Gross unrealized holding gains on investments arising during period	7	60	14	54
Reclassification adjustment for gross losses included in net income	0	6	3	9
Unrealized holding gains excluding realized losses, gross	7	66	17	63
Income tax expense related to unrealized gains	(2)	(23)	(6)	(22)
Change in other comprehensive income, net of tax Indemnity	5	43	11	41
Balance, end of period Indemnity	$ (32)	$ (101)	$ (32)	$ (101)
Change in other comprehensive income, net of tax Indemnity	$ 5	$ 43	$ 11	$ 41
Change in other comprehensive income, net of tax Exchange	$ 26	$ 293	$ 71	$ 292
Change in other comprehensive income, net of tax Erie Insurance Group	$ 31	$ 336	$ 82	$ 333
Comprehensive income:				
Net (loss) income Erie Insurance Group	$ (31)	$ 271	$ 131	$ 20
Change in other comprehensive income, net of tax Erie Insurance Group	31	336	82	333
Total comprehensive income Erie Insurance Group	0	607	213	353
	54	531	106	268

Less: Noncontrolling interest in consolidated entity Exchange					
Total comprehensive income	**Indemnity**	$ 54	$ 76	$ 107	$ 85

* Previously recognized non-credit other-than-temporary impairment losses were reclassified from retained earnings to other comprehensive income upon the implementation of FASB ASC 320, *Investments Debt and Equity Securities*, during the second quarter of 2009.

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

	Six months ended June 30, 2010	2009 (As adjusted Note 2)
Cash flows from operating activities		
Premiums collected	$ 2,011	$ 1,947
Net investment income received	217	210
Limited partnership distributions	48	44
Service agreement fee received	17	17
Commissions and bonuses paid to agents	(290)	(300)
Losses paid	(1,216)	(1,145)
Loss expenses paid	(212)	(205)
Other underwriting and acquisition costs paid	(278)	(259)
Income taxes (paid) recovered	(85)	162
Net cash provided by operating activities	**212**	**471**
Cash flows from investing activities		
Purchase of investments:		
Fixed maturities	(930)	(866)
Preferred stock	(112)	(77)
Common stock	(546)	(854)
Limited partnerships	(59)	(97)
Sales/maturities of investments:		
Fixed maturity sales	359	277
Fixed maturity calls/maturities	509	327
Preferred stock	66	96
Common stock	538	819
Sale of and returns on limited partnerships	15	6
Purchase of property and equipment	(21)	(8)
Net distributions on agent loans	1	(2)
Net cash used in investing activities	**(180)**	**(379)**
Cash flows from financing activities		
Annuity and supplementary contract deposits and interest	61	88
Annuity and supplementary contract surrenders and withdrawals	(39)	(88)
Universal life deposits and interest	21	14
Universal life surrenders	(19)	(18)
Purchase of treasury stock	(17)	(1)
Dividends paid to shareholders	(50)	(46)
Decrease in collateral from securities lending	0	(70)
Redemption of securities lending collateral	0	70

Net cash used in financing activities	**(43)**	**(51)**
Net (decrease) increase in cash and cash equivalents	(11)	41
Cash and cash equivalents at beginning of period	234	277
Cash and cash equivalents at end of period	**$ 223**	**$ 318**

See accompanying notes to Consolidated Financial Statements. See Note 14 for supplemental cash flow information.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Nature of Operations

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

Indemnity s primary function is to perform certain services for the Exchange relating to sales, underwriting and issuance of policies on behalf of the Exchange. This is done in accordance with a subscriber s agreement (a limited power of attorney) executed by each subscriber (policyholder), appointing Indemnity as their common attorney-in-fact to transact business on their behalf and to manage the affairs of the Exchange. Indemnity earns a management fee from the Exchange for these services, which is paid from the premiums collected from subscribers (policyholders).

Indemnity also operates as a property and casualty insurer through its wholly-owned subsidiaries, Erie Insurance Company (EIC), Erie Insurance Company of New York (ENY) and the Erie Insurance Property and Casualty Company (EPC).

The Property and Casualty Group refers to the Exchange and its wholly-owned subsidiary, Flagship City Insurance Company (Flagship) and Indemnity s wholly-owned subsidiaries. The Property and Casualty Group operates in 11 Midwestern, Mid-Atlantic and Southeastern states and the District of Columbia and primarily writes personal auto insurance, which comprises 48% of its 2009 direct premiums.

Erie Family Life Insurance Company (EFL) is an affiliated life insurance company that underwrites and sells nonparticipating individual and group life insurance policies and fixed annuities. Indemnity and Exchange own 21.6% and 78.4% of EFL, respectively.

Indemnity shareholder interest refers to the interest in Erie Indemnity Company owned by the Class A and Class B shareholders. In addition to referring to Erie Insurance Exchange, the term Exchange sometimes refers to the noncontrolling interest held for the benefit of the subscribers (policyholders) and includes its interests in Flagship and EFL.

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

Note 2. Significant Accounting Policies

Basis of presentation and principles of consolidation

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) and include the accounts of Indemnity together with its affiliate companies in which Indemnity holds a majority voting or economic interest. In addition, we consolidate the Exchange as a variable interest entity for which Indemnity is the primary beneficiary. All intercompany accounts and transactions have been eliminated in consolidation. The required presentation of noncontrolling interests is reflected in the consolidated financial statements. Noncontrolling interests represent the ownership interests of the Exchange, all of which is held by parties other than Indemnity (i.e. the Exchange s subscribers (policyholders)). Noncontrolling interests also include the Exchange subscribers 78.4% ownership interest in EFL. See the discussion Retrospective adoption of new accounting principle that follows for additional consolidation information.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. For further information, refer to the consolidated financial statements and footnotes for the year ended December 31, 2009 included in our Form 8-K as filed with the Securities and Exchange Commission on May 6, 2010.

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

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

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

Retrospective adoption of new accounting principle

On June 12, 2009, the Financial Accounting Standards Board (FASB) updated ASC 810, *Consolidation*, which amended the existing guidance for determining whether an enterprise is the primary beneficiary of a variable interest entity (VIE). As of January 1, 2010, Indemnity adopted the new accounting principle on a retrospective basis since inception.

This guidance changed the methodology for assessing whether an enterprise is the primary beneficiary of a VIE by requiring a qualitative analysis to determine if an enterprise s variable interest gives it a controlling financial interest. The qualitative analysis looks at the power to direct activities of the VIE that most significantly impact economic performance and the right to receive benefits (or obligation to absorb losses) from the VIE that could potentially be significant.

In accordance with the new accounting guidance, Indemnity is deemed to be the primary beneficiary of the Exchange given the significance of the management fee to the Exchange and Indemnity s power to direct the Exchange s significant activities. Under the previously issued accounting guidance, Indemnity was not deemed the primary beneficiary of the Exchange and its financial position and operating results were not consolidated with Indemnity s. Following adoption of the new accounting guidance, as primary beneficiary of the Exchange, Erie Indemnity Company has consolidated Indemnity and the Exchange s financial position and operating results.

Furthermore, upon consolidation of the Exchange, 100% of the ownership of EFL resides within the consolidated entity and consequently EFL s financial results are also consolidated. The financial statements and notes to the financial statements presented herein have all been adjusted to reflect the retrospective adoption of the new accounting principle.

There was no cumulative effect to Indemnity s shareholders equity from consolidation of the Exchange and EFL. The noncontrolling interest in total equity represents the amount of the Exchange s subscribers (policyholders) equity.

Recent Accounting Updates

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

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Note 3. Earnings Per Share

Basic earnings per share is calculated under the two-class method, which allocates earnings to each class of stock based on its dividend rights. Class B shares are convertible into Class A shares at a conversion ratio of 2,400 to 1. Class A diluted earnings per share is calculated under the if-converted method which reflects the conversion of Class B shares and the effect of potentially dilutive outstanding employee stock-based awards and awards not yet vested related to the outside directors stock compensation plan.

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

(dollars in millions, except per share data)	Indemnity Earnings Per Share Calculation Three months ended June 30, 2010			2009		
	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	$49	51,013,358	$ 0.96	$33	51,240,693	$ 0.63
Dilutive effect of stock awards	0	23,097		0	27,209	
Assumed conversion of Class B shares	0	6,110,400		0	6,122,400	
Class A Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	$49	57,146,855	$ 0.86	$33	57,390,302	$ 0.57
Class B Basic and diluted EPS:						
Income available to Class B stockholders	$ 0	2,546	$138.21	$ 0	2,551	$93.19

(dollars in millions, except per share data)	Indemnity Earnings Per Share Calculation Six months ended June 30, 2010			2009		
	Allocated net income (numerator)	Weighted shares (denominator)	Per-share amount	Allocated net income (numerator)	Weighted Shares (denominator)	Per-share amount