ERIE INDEMNITY CO
Form 10-Q
July 31, 2014
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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, 2014

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 X No ___

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

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

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

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

(Do not check if a smaller reporting company)

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

The number of shares outstanding of the registrant's Class A Common Stock as of the latest practicable date, with no par value and a stated value of $0.0292 per share, was 46,189,068 at July 18, 2014.

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 July 18, 2014.

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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,		Six months ended June 30,	
	2014	2013	2014	2013
Revenues				
Premiums earned	$1,319	$1,215	$2,607	$2,390
Net investment income	111	104	220	207
Net realized investment gains	133	61	189	310
Net impairment losses recognized in earnings	0	(1)	0	(1)
Equity in earnings of limited partnerships	27	39	77	75
Other income	8	8	16	16
Total revenues	1,598	1,426	3,109	2,997
Benefits and expenses				
Insurance losses and loss expenses	1,126	861	2,160	1,703
Policy acquisition and underwriting expenses	325	302	646	595
Total benefits and expenses	1,451	1,163	2,806	2,298
Income from operations before income taxes and noncontrolling interest	147	263	303	699
Provision for income taxes	44	86	91	232
Net income	$103	$177	$212	$467
Less: Net income attributable to noncontrolling interest in consolidated entity – Exchange	54	133	117	386
Net income attributable to Indemnity	$49	$44	$95	$81
Earnings Per Share				
Net income attributable to Indemnity per share				
Class A common stock – basic	$1.05	$0.95	$2.04	$1.73
Class A common stock – diluted	$0.94	$0.84	$1.82	$1.54
Class B common stock – basic and diluted	$158	$142	$307	$259
Weighted average shares outstanding attributable to Indemnity – Basic				
Class A common stock	46,214,153	46,693,333	46,307,659	46,733,925
Class B common stock	2,542	2,542	2,542	2,542
Weighted average shares outstanding attributable to Indemnity – Diluted				
Class A common stock	52,411,414	52,886,259	52,504,920	52,926,851
Class B common stock	2,542	2,542	2,542	2,542

Dividends declared per share				
Class A common stock	$0.6350	$0.5925	$1.2700	$1.1850
Class B common stock	$95.2500	$88.8750	$190.5000	$177.7500

See accompanying notes to Consolidated Financial Statements. See Note 12. "Indemnity Accumulated Other Comprehensive Loss," for amounts reclassified out of accumulated other comprehensive income (loss) into the Consolidated Statements of Operations. See Note 15. “Indemnity Supplemental Information,” for supplemental statements of operations information.

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Net income	$103	$177	$212	$467
Other comprehensive income (loss)				
Change in unrealized holding gains (losses) on available-for-sale securities, net of tax (expense) benefit of $(37), $105, $(80), and $111 respectively	68	(194)	148	(206)
Reclassification adjustment for gross gains included in net income, net of tax benefit of $2, $2, $7, and $7, respectively	(3)	(3)	(11)	(13)
Other comprehensive income (loss)	65	(197)	137	(219)
Comprehensive income (loss)	$168	$(20)	$349	$248
Less: Comprehensive income (loss) attributable to noncontrolling interest in consolidated entity – Exchange	118	(60)	250	172
Total comprehensive income – Indemnity	$50	$40	$99	$76

See accompanying notes to Consolidated Financial Statements. See Note 12. "Indemnity Accumulated Other Comprehensive Loss," for supplemental statements of comprehensive income (loss) information.

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

	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Investments – Indemnity		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of $484 and $518, respectively)	$497	$526
Equity securities (cost of $25 and $50, respectively)	26	50
Limited partnerships (cost of $114 and $123, respectively)	141	146
Other invested assets	1	1
Investments – Exchange		
Available-for-sale securities, at fair value:		
Fixed maturities (amortized cost of $8,149 and $7,801, respectively)	8,701	8,162
Equity securities (cost of $842 and $778, respectively)	914	819
Trading securities, at fair value (cost of $2,314 and $2,198, respectively)	3,377	3,202
Limited partnerships (cost of $754 and $790, respectively)	931	940
Other invested assets	20	20
Total investments	14,608	13,866
Cash and cash equivalents (Exchange portion of $237 and $403, respectively)	300	452
Premiums receivable from policyholders – Exchange	1,287	1,167
Reinsurance recoverable – Exchange	168	172
Deferred income taxes – Indemnity	1	2
Deferred acquisition costs – Exchange	579	566
Other assets (Exchange portion of $405 and $337, respectively)	517	451
Total assets	$17,460	$16,676
Liabilities and shareholders' equity		
Liabilities		
Indemnity liabilities		
Other liabilities	$451	$476
Exchange liabilities		
Losses and loss expense reserves	3,964	3,747
Life policy and deposit contract reserves	1,789	1,758
Unearned premiums	2,788	2,598
Deferred income taxes	557	450
Other liabilities	90	97
Total liabilities	9,639	9,126
Indemnity shareholders' equity		
Class A common stock, stated value $0.0292 per share; 74,996,930 shares authorized; 68,299,200 shares issued; 46,189,068 and 46,461,125 shares outstanding, respectively	2	2
Class B common stock, convertible at a rate of 2,400 Class A shares for one Class B share, stated value $70 per share; 3,070 shares authorized; 2,542 shares issued and outstanding	0	0
Additional paid-in-capital	16	16

Accumulated other comprehensive loss	(55)	(59)
Retained earnings	1,938	1,902
Total contributed capital and retained earnings	1,901	1,861
Treasury stock, at cost, 22,110,132 and 21,838,075 shares, respectively	(1,146)	(1,127)
Total Indemnity shareholders' equity	755	734
Noncontrolling interest in consolidated entity – Exchange	7,066	6,816
Total equity	7,821	7,550
Total liabilities, shareholders' equity, and noncontrolling interest	$17,460	$16,676

See accompanying notes to Consolidated Financial Statements. See Note 15. "Indemnity Supplemental Information," for supplemental consolidating statements of financial position information.

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

	Six months ended June 30, 2014	2013
Cash flows from operating activities		
Premiums collected	$2,679	$2,450
Net investment income received	235	222
Limited partnership distributions	64	79
Service agreement fee received	15	15
Commissions and bonuses paid to agents	(397)	(356)
Losses paid	(1,630)	(1,359)
Loss expenses paid	(251)	(227)
Other underwriting and acquisition costs paid	(372)	(345)
Income taxes paid	(98)	(149)
Net cash provided by operating activities	245	330
Cash flows from investing activities		
Purchase of investments:		
Fixed maturities	(1,090)	(1,240)
Preferred stock	(168)	(54)
Common stock	(550)	(700)
Limited partnerships	(46)	(52)
Sales/maturities of investments:		
Fixed maturity sales	371	330
Fixed maturity calls/maturities	413	617
Preferred stock	119	42
Common stock	565	654
Sale of and returns on limited partnerships	70	86
Net purchase of property and equipment	(17)	(19)
Net collections on agent loans	1	1
Net cash used in investing activities	(332)	(335)
Cash flows from financing activities		
Annuity deposits and interest	45	47
Annuity surrenders and withdrawals	(39)	(39)
Universal life deposits and interest	14	12
Universal life surrenders	(6)	(5)
Purchase of treasury stock	(20)	(17)
Dividends paid to shareholders	(59)	(28)
Net cash used in financing activities	(65)	(30)
Net decrease in cash and cash equivalents	(152)	(35)
Cash and cash equivalents at beginning of period	452	400
Cash and cash equivalents at end of period	$300	$365

See accompanying notes to Consolidated Financial Statements. See Note 15. “Indemnity Supplemental Information,” 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 has been the managing attorney-in-fact for the subscribers (policyholders) at the Erie Insurance Exchange (“Exchange”) since 1925. The Exchange is a subscriber-owned, Pennsylvania-domiciled reciprocal insurer that writes property and casualty insurance.

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

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

The Exchange, together with its wholly owned subsidiaries, Erie Insurance Company (“EIC”), Erie Insurance Company of New York (“ENY”), Erie Insurance Property and Casualty Company (“EPC”), and Flagship City Insurance Company (“Flagship”), operate as a property and casualty insurer and are collectively referred to as the “Property and Casualty Group”. The Property and Casualty Group operates in 11 Midwestern, Mid-Atlantic and Southeastern states and the District of Columbia.

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

Indemnity plans to expand the property and casualty and life insurance operations of the Erie Insurance Group into the Commonwealth of Kentucky by the first quarter of 2015 or earlier if possible.

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

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

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

Note 2. Significant Accounting Policies

Basis of presentation
The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) and include the accounts of Indemnity together with its affiliate companies in which

Indemnity holds a majority voting or economic interest.

Use of estimates

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

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of our financial position, results of operations, and cash flows for the interim periods have been included. Operating results for the six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ended December 31, 2014. The accompanying consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission on February 27, 2014.

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

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

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

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

Pending accounting pronouncements
In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. This guidance permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Generally, investors in qualified affordable housing project investments expect to receive substantially all of their return through the receipt of tax credits and other tax benefits. ASU No. 2014-01 allows for the recording of the investment performance net of taxes as a component of income tax expense to more fairly represent the economics of the investments and provide users with a better understanding of the returns from such investments. The qualifications to make this accounting election were also made less restrictive. ASU No. 2014-01 is effective for annual and interim periods beginning after December 15, 2014, with early adoption permitted. While we are currently evaluating whether to make the accounting election and whether the election would be made for early adoption, such election is not expected to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. ASU No. 2014-09 clarifies the principles for recognizing revenue and provides a common revenue standard for GAAP. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Insurance contracts are not within the scope of this guidance. ASU No. 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early application is not permitted. We do not expect the adoption of ASU No. 2014-09 related to the management fee and service agreement revenue to have a material impact on our consolidated financial statements.

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Note 3. Indemnity Earnings Per Share

Class A and Class B basic earnings per share and Class B diluted earnings per share are calculated under the two-class method. The two-class method allocates earnings to each class of stock based upon its dividend rights. Class B shares are convertible into Class A shares at a conversion ratio of 2,400 to 1. See Note 11. "Indemnity Capital Stock".

Class A diluted earnings per share are calculated under the if-converted method, which reflects the conversion of Class B shares to Class A shares. Diluted earnings per share calculations include the effect of any potential common shares. Potential common shares include outstanding vested and not yet vested awards related to our outside directors' stock compensation plan and any employee stock based awards.

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

(dollars in millions, except per share data)	Indemnity Shareholder Interest					
	Three months ended June 30,					
	2014			2013		
	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	46,214,153	$1.05	$44	46,693,333	$0.95
Dilutive effect of stock-based awards	0	96,461	—	0	92,126	—
Assumed conversion of Class B shares	0	6,100,800	—	0	6,100,800	—
Class A – Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	$49	52,411,414	$0.94	$44	52,886,259	$0.84
Class B – Basic and diluted EPS:						
Income available to Class B stockholders	$0	2,542	$158	$0	2,542	$142

(dollars in millions, except per share data)	Indemnity Shareholder Interest					
	Six months ended June 30,					
	2014			2013		
	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	$94	46,307,659	$2.04	$80	46,733,925	$1.73
Dilutive effect of stock-based awards	0	96,461	—	0	92,126	—
	1	6,100,800	—	1	6,100,800	—

Assumed conversion of Class B shares						
Class A – Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	$95	52,504,920	$1.82	$81	52,926,851	$1.54
Class B – Basic and diluted EPS:						
Income available to Class B stockholders	$1	2,542	$307	$1	2,542	$259

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Note 4. Variable Interest Entity

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

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

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

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

Indemnity has not provided financial or other support to the Exchange for any of the reporting periods presented. At June 30, 2014, there are no explicit or implicit arrangements that would require Indemnity to provide future financial support to the Exchange. Indemnity is not liable if the Exchange was to be in violation of its debt covenants or was unable to meet its obligation for unfunded commitments to limited partnerships.

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Note 5. Segment Information

Our reportable segments include management operations, property and casualty insurance operations, life insurance operations, and investment operations. Accounting policies for segments are the same as those described in the summary of significant accounting policies. See Item 8. “Financial Statements and Supplementary Data, Note 2. Significant Accounting Policies,” in our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission on February 27, 2014. Assets are not allocated to the segments, but rather, are reviewed in total for purposes of decision-making. No single customer or agent provides 10% or more of revenues.

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

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

Life insurance operations
Our life insurance operations segment includes traditional and universal life insurance products and fixed annuities marketed to individuals using the same independent agency force utilized by our property and casualty insurance operations. We evaluate profitability of the life insurance segment principally based upon segment net income, including investments, which for segment purposes are reflected in the investment operations segment. At the same time, we recognize that investment-related income is integral to the evaluation of the life insurance segment because of the long duration of life products. For the second quarters of 2014 and 2013, investment activities on life insurance related assets generated revenues of $24 million and $26 million, respectively, resulting in EFL reporting income before income taxes of $10 million and $13 million, respectively, before intercompany eliminations. For the six months ended June 30, 2014 and June 30, 2013, investment activities on life insurance related assets generated

revenues of $53 million and $52 million, respectively, resulting in EFL reporting income before income taxes of $23 million and $24 million, respectively, before intercompany eliminations.

Investment operations

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

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

(in millions)	Erie Insurance Group Three months ended June 30, 2014					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		$1,298	$22		$ (1)	$ 1,319
Net investment income				$116	(5)	111
Net realized investment gains				133		133
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				27		27
Management fee revenue	$366				(366)	—
Service agreement and other revenue	8		0			8
Total revenues	374	1,298	22	276	(372)	1,598
Cost of management operations	306				(306)	—
Insurance losses and loss expenses		1,101	27		(2)	1,126
Policy acquisition and underwriting expenses		380	9		(64)	325
Total benefits and expenses	306	1,481	36	—	(372)	1,451
Income (loss) before income taxes	68	(183)	(14)	276	—	147
Provision for income taxes	24	(64)	(5)	89	—	44
Net income (loss)	$44	$(119)	$(9)	$187	—	$ 103

(in millions)	Erie Insurance Group Three months ended June 30, 2013					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		$1,196	$20		$ (1)	$ 1,215
Net investment income				$107	(3)	104
Net realized investment gains				61		61
Net impairment losses recognized in earnings				(1)		(1)
Equity in earnings of limited partnerships				39		39
Management fee revenue	$336				(336)	—
Service agreement and other revenue	8		0			8
Total revenues	344	1,196	20	206	(340)	1,426
Cost of management operations	285				(285)	—
Insurance losses and loss expenses		837	26		(2)	861

Policy acquisition and underwriting expenses		348	7		(53)	302
Total benefits and expenses	285	1,185	33	—	(340)	1,163
Income (loss) before income taxes	59	11	(13)	206	—	263
Provision for income taxes	21	4	(5)	66	—	86
Net income (loss)	$38	$7	$(8)	$140	$—	$ 177

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(in millions)	Erie Insurance Group Six months ended June 30, 2014					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		$2,566	$42		$(1)	$ 2,607
Net investment income				$228	(8)	220
Net realized investment gains				189		189
Net impairment losses recognized in earnings				0		0
Equity in earnings of limited partnerships				77		77
Management fee revenue	$685				(685)	—
Service agreement and other revenue	15		1			16
Total revenues	700	2,566	43	494	(694)	3,109
Cost of management operations	574				(574)	—
Insurance losses and loss expenses		2,108	55		(3)	2,160
Policy acquisition and underwriting expenses		745	18		(117)	646
Total benefits and expenses	574	2,853	73	—	(694)	2,806
Income (loss) before income taxes	126	(287)	(30)	494	—	303
Provision for income taxes	44	(100)	(11)	158	—	91
Net income (loss)	$82	$(187)	$(19)	$336	$—	$ 212

(in millions)	Erie Insurance Group Six months ended June 30, 2013					
	Management operations	Property and casualty insurance operations	Life insurance operations	Investment operations	Eliminations	Consolidated
Premiums earned/life policy revenue		$2,352	$39		$(1)	$ 2,390
Net investment income				$213	(6)	207
Net realized investment gains				310		310
Net impairment losses recognized in earnings				(1)		(1)
Equity in earnings of limited partnerships				75		75
Management fee revenue	$632				(632)	—
Service agreement and other revenue	15		1			16
Total revenues	647	2,352	40	597	(639)	2,997
Cost of management operations	539				(539)	—
Insurance losses and loss expenses		1,654	52		(3)	1,703
Policy acquisition and underwriting expenses		676	16		(97)	595
Total benefits and expenses	539	2,330	68	—	(639)	2,298
Income (loss) before income taxes	108	22	(28)	597	—	699

Provision for income taxes	38	8	(10)	196	—	232
Net income (loss)	$70	$14	$(18)	$401	$—	$ 467

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Note 6. Fair Value

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

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

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

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

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

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

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

We perform continuous reviews of the prices obtained from the pricing service. This includes evaluating the methodology and inputs used by the pricing service to ensure that we determine the proper classification level of the financial instrument. Price variances, including large periodic changes, are investigated and corroborated by market data. We have reviewed the pricing methodologies of our pricing service as well as other observable inputs, such as data, and transaction volumes and believe that 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 table represents our consolidated fair value measurements on a recurring basis by asset class and level of input at June 30, 2014:

	Erie Insurance Group June 30, 2014 Fair value measurements using:			
(in millions)	Total	Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3
Indemnity				
Available-for-sale securities:				
States & political subdivisions	$241	$0	$241	$0
Corporate debt securities	256	0	255	1
Collateralized debt obligations	0	0	0	0
Total fixed maturities	497	0	496	1
Nonredeemable preferred stock	14	2	12	0
Common stock	12	12	0	0
Total available-for-sale securities	523	14	508	1
Other investments (1)	18	0	0	18
Total – Indemnity	$541	$14	$508	$19
Exchange				
Available-for-sale securities:				
U.S. treasury	$31	$0	$31	$0
Government sponsored enterprises	4	0	4	0
States & political subdivisions	1,519	0	1,519	0
Foreign government securities	15	0	15	0
Corporate debt securities	6,866	0	6,841	25
Residential mortgage-backed securities	146	0	146	0
Commercial mortgage-backed securities	34	0	34	0
Collateralized debt obligations	14	0	14	0
Other debt securities	72	0	72	0
Total fixed maturities	8,701	0	8,676	25
Nonredeemable preferred stock	717	303	413	1
Common stock	197	197	0	0
Total available-for-sale securities	9,615	500	9,089	26
Trading securities:				
Common stock	3,377	3,362	0	15
Total trading securities	3,377	3,362	0	15
Other investments (1)	102	0	0	102
Total – Exchange	$13,094	$3,862	$9,089	$143
Total – Erie Insurance Group	$13,635	$3,876	$9,597	$162

(1) Other investments measured at fair value represent four real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option. These investments can never be redeemed with the funds. Instead, distributions are received when liquidation of the underlying assets of the funds occur. It is estimated that the underlying assets will generally be liquidated between 5 and 10 years from the inception

of the funds. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner. Fair value is based on our proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to our balance sheet date. These values are then analyzed to determine if they represent the NAV 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 June 30, 2014. During the six months ended June 30, 2014, Indemnity made no contributions and received distributions totaling $1.8 million, and the Exchange made no contributions and received distributions totaling $6.9 million for these investments. As of June 30, 2014, the amount of unfunded commitments related to the investments was $1.5 million for Indemnity and $4.5 million for the Exchange.

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Level 3 Assets – Quarterly Change:

	Erie Insurance Group						
(in millions)	Beginning balance at March 31, 2014	Included in earnings (1)	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 (2)	Ending balance at June 30, 2014
Indemnity							
Available-for-sale securities:							
Corporate debt securities	$1	$0	$ 0	$ 0	$0	$0	$1
Collateralized debt obligations	0	0	0	0	0	0	0
Total fixed maturities	1	0	0	0	0	0	1
Total available-for-sale securities	1	0	0	0	0	0	1
Other investments	18	1	0	0	(1)	0	18
Total Level 3 assets – Indemnity	$19	$1	$ 0	$ 0	$(1)	$0	$19
Exchange							
Available-for-sale securities:							
Corporate debt securities	$26	$0	$ 0	$ 0	$(1)	$0	$25
Collateralized debt obligations	0	0	0	0	0	0	0
Total fixed maturities	26	0	0	0	(1)	0	25
Nonredeemable preferred stock	1	0	0	0	0	0	1
Total available-for-sale securities	27	0	0	0	(1)	0	26
Trading securities:							
Common stock	15	0	0	0	0	0	15
Total trading securities	15	0	0	0	0	0	15
Other investments	98	6	0	0	(2)	0	102
Total Level 3 assets – Exchange	$140	$6	$ 0	$ 0	$(3)	$0	$143
Total Level 3 assets – Erie Insurance Group	$159	$7	$ 0	$ 0	$(4)	$0	$162

(1) These amounts are reported in the Consolidated Statement of Operations. There is $7 million included in equity in earnings of limited partnerships for the three months ended June 30, 2014 on Level 3 securities.

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

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.

For Indemnity, there were no transfers between Level 1 and Level 2 or between Level 2 and Level 3 for the three months ended June 30, 2014.

For the Exchange, Level 1 to Level 2 transfers totaled $11 million due to trading activity levels for one preferred stock holding, and there were no transfers from Level 2 to Level 1 or between Level 2 and Level 3 for the three months ended June 30, 2014.

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Level 3 Assets – Year-to-Date Change:

(in millions)	Erie Insurance Group Beginning balance at December 31, 2013	Included in earnings (1)	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 (2)	Ending balance at June 30, 2014
Indemnity							
Available-for-sale securities:							
Corporate debt securities	$1	$0	$ 0	$ 0	$0	$0	$1
Collateralized debt obligations	1	0	0	0	(1)	0	0
Total fixed maturities	2	0	0	0	(1)	0	1
Total available-for-sale securities	2	0	0	0	(1)	0	1
Other investments	18	2	0	0	(2)	0	18
Total Level 3 assets – Indemnity	$20	$2	$ 0	$ 0	$(3)	$0	$19
Exchange							
Available-for-sale securities:							
Corporate debt securities	$26	$0	$ 0	$ 0	$(1)	$0	$25
Collateralized debt obligations	5	1	(1)	0	(3)	(2)	0
Total fixed maturities	31	1	(1)	0	(4)	(2)	25
Nonredeemable preferred stock	0	0	0	1	0	0	1
Total available-for-sale securities	31	1	(1)	1	(4)	(2)	26
Trading securities:							
Common stock	15	0	0	0	0	0	15
Total trading securities	15	0	0	0	0	0	15
Other investments	98	11	0	0	(7)	0	102
Total Level 3 assets – Exchange	$144	$12	$ (1)	$ 1	$(11)	$(2)	$143
Total Level 3 assets – Erie Insurance Group	$164	$14	$ (1)	$ 1	$(14)	$(2)	$162

(1) These amounts are reported in the Consolidated Statement of Operations. There is $1 million included in net realized investment gains (losses) and $13 million included in equity in earnings of limited partnerships for the six months ended June 30, 2014 on Level 3 securities.

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

For Indemnity, there were no transfers between Level 1 and Level 2 or between Level 2 and Level 3 for the six months ended June 30, 2014.

For the Exchange, Level 1 to Level 2 transfers totaled $14 million due to trading activity levels for two preferred stock holdings, and there were no transfers from Level 2 to Level 1 for the six months ended June 30, 2014. There were no Level 2 to Level 3 transfers, and Level 3 to Level 2 transfers totaled $2 million for one fixed maturity holding as a result of using observable market data to determine the fair value at June 30, 2014.

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Quantitative and Qualitative Disclosures about Unobservable Inputs

	Erie Insurance Group June 30, 2014					
(dollars in millions)	Fair value	No. of holdings	Valuation techniques	Unobservable input	Range	Weighted average
Indemnity						
Corporate debt securities [1]	$ 1	1	Market approach	Non-binding broker quote	114	
Collateralized debt obligations [2]	0	1	Income approach	Projected maturity date	Dec 2014	
				Repayment at maturity	1%	
				Discount rate	15%	
Other investments [4]	18	2				
Total Level 3 assets – Indemnity	$ 19	4				
Exchange						
Corporate debt securities [1][3]	$ 25	7	Market approach	Non-binding broker quote	109-117	111
				Comparable transaction EBITDA multiples	8.0 - 12.1x	8.0x
				Comparable security yield	6%	
Collateralized debt obligations [2]	0	2	Income approach	Projected maturity date	Dec 2014 - Oct 2035	
				Repayment at maturity	1 - 100%	64%
				Discount rate	15 - 18%	17%
Nonredeemable preferred stock [5]	1	1	Market approach	Comparable company price-to-sales ratio	12.0 - 22.0x	19.0x
Common stock [3]	15	4	Market approach	Comparable transaction EBITDA multiples	8.0 - 12.1x	8.0x
				Discount for lack of marketability	5 - 30%	10%
Other investments [4]	102	4				
Total Level 3 assets – Exchange	$ 143	18				
Total Level 3 assets – Erie Insurance Group	$ 162	22				

(1) Corporate debt securities – The unobservable input used in the fair value measurement of certain corporate debt securities is the likelihood of repayment by the underlying entity when there is no market for trading these securities. When available, we obtain non-binding broker quotes to value such securities. When a non-binding broker quote was the only input available, it was considered unobservable.

(2)

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

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

(4) Other investments – Other investments represent certain limited partnerships that are recorded at fair value and are based upon net asset value (NAV) provided by the general partner where the unobservable inputs are not reasonably available to us.

(5) Nonredeemable preferred stock - The unobservable input used in the fair value measurement of a private nonredeemable preferred stock security is the price to sales ratio for comparable publicly traded companies.

Securities valued using unobservable inputs shown above totaled $162 million at June 30, 2014. In total, Level 3 assets represent less than 1.2% of the total assets measured at fair value on a recurring basis for the Erie Insurance Group.

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

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

(1) Other investments measured at fair value represent four real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option. These investments can never be redeemed with the funds. Instead, distributions are received when liquidation of the underlying assets of the funds occur. It is estimated that the underlying assets will generally be liquidated between 5 and 10 years from the inception of the funds. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner. Fair value is based on our proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to our balance sheet date. These

values are then analyzed to determine if they represent the NAV at our balance sheet date, with adjustment being made where appropriate. We consider observable market data and perform a review validating the appropriateness of the NAV at each balance sheet date. It is likely that all of the investments will be redeemed at a future date for an amount different than the NAV of our ownership interest in partners' capital as of December 31, 2013. During the year ended December 31, 2013, Indemnity made no contributions and received distributions totaling $2.4 million, and the Exchange made no contributions and received distributions totaling $21.7 million for these investments. As of December 31, 2013, the amount of unfunded commitments related to the investments was $1.5 million for Indemnity and $4.5 million for the Exchange.

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Level 3 Assets – Quarterly Change:

(in millions)	Erie Insurance Group Beginning balance at March 31, 2013	Included in earnings (1)	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 (2)	Ending balance at June 30, 2013
Indemnity							
Available-for-sale securities:							
Corporate debt securities	$1	$0	$ 0	$ 0	$0	$0	$1
Collateralized debt obligations	2	0	0	0	(1)	0	1
Total fixed maturities	3	0	0	0	(1)	0	2
Total available-for-sale securities	3	0	0	0	(1)	0	2
Other investments	20	0	0	0	0	0	20
Total Level 3 assets – Indemnity	$23	$0	$ 0	$ 0	$(1)	$0	$22
Exchange							
Available-for-sale securities:							
Corporate debt securities	58	0	(1)	1	(2)	(23)	33
Commercial mortgage-backed securities	5	0	0	0	(1)	0	4
Collateralized debt obligations	14	1	(1)	0	(2)	0	12
Total fixed maturities	77	1	(2)	1	(5)	(23)	49
Nonredeemable preferred stock	12	2	(1)	0	(6)	0	7
Total available-for-sale securities	89	3	(3)	1	(11)	(23)	56
Trading securities:							
Common stock	7	0	0	0	0	0	7
Total trading securities	7	0	0	0	0	0	7
Other investments	112	2	0	0	(1)	0	113
Total Level 3 assets – Exchange	$208	$5	$ (3)	$ 1	$(12)	$(23)	$176
Total Level 3 assets – Erie Insurance Group	$231	$5	$ (3)	$ 1	$(13)	$(23)	$198

(1) These amounts are reported in the Consolidated Statement of Operations. There is $3 million included in net realized investment gains (losses) and $2 million included in equity in earnings of limited partnerships for the three months ended June 30, 2013 on Level 3 securities.

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

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.

For Indemnity, there were no transfers between Level 1 and Level 2 or between Level 2 and Level 3 for the three months ended June 30, 2013.

For the Exchange, there were no transfers between Level 1 and Level 2 or from Level 2 to Level 3 for the three months ended June 30, 2013. Level 3 to Level 2 transfers totaled $23 million for three fixed maturity holdings. These transfers out of Level 3 were primarily the result of using observable market data to determine the fair value at June 30, 2013.

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Level 3 Assets – Year-to-Date Change:

(in millions)	Erie Insurance Group Beginning balance at December 31, 2012	Included in earnings (1)	Included in other comprehensive income	Purchases	Sales	Transfers in and (out) of Level 3 (2)	Ending balance at June 30, 2013
Indemnity							
Available-for-sale securities:							
Corporate debt securities	$1	$0	$ 0	$ 0	$0	$0	$1
Collateralized debt obligations	3	0	0	0	(2)	0	1
Total fixed maturities	4	0	0	0	(2)	0	2
Total available-for-sale securities	4	0	0	0	(2)	0	2
Other investments	19	1	0	0	0	0	20
Total Level 3 assets – Indemnity	$23	$1	$ 0	$ 0	$(2)	$0	$22
Exchange							
Available-for-sale securities:							
Corporate debt securities	$43	$0	$ (1)	$ 1	$(2)	$(8)	$33
Commercial mortgage-backed securities	0	0	(1)	0	(1)	6	4
Collateralized debt obligations	16	1	0	0	(7)	2	12
Total fixed maturities	59	1	(2)	1	(10)	0	49
Nonredeemable preferred stock	0	0	3	4	0	0	7
Total available-for-sale securities	59	1	1	5	(10)	0	56
Trading securities:							
Common stock	15	(3)	0	0	(5)	0	7
Total trading securities	15	(3)	0	0	(5)	0	7
Other investments	109	7	0	0	(3)	0	113
Total Level 3 assets – Exchange	$183	$5	$ 1	$ 5	$(18)	$0	$176
Total Level 3 assets – Erie Insurance Group	$206	$6	$ 1	$ 5	$(20)	$0	$198

(1) These amounts are reported in the Consolidated Statement of Operations. There is $(2) million of losses included in net realized investment (losses) and $8 million included in equity in earnings of limited partnerships for the six months ended June 30, 2013 on Level 3 securities.

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

For Indemnity, there were no Level 1 to Level 2 transfers for the six months ended June 30, 2013. Level 2 to Level 1 transfers totaled $1 million, due to trading activity levels related to one preferred stock holding, and there were no transfers between Levels 2 and 3.

For the Exchange, Level 1 to Level 2 transfers totaled $5 million and Level 2 to Level 1 transfers totaled $44 million due to trading activity levels related to one preferred stock holding and five preferred stock holdings, respectively, for the six months ended June 30, 2013. Level 2 to Level 3 transfers totaled $18 million for five fixed maturity holdings and Level 3 to Level 2 transfers totaled $18 million for two fixed maturity holdings. These transfers in and out of Level 3 were primarily the result of using non-binding and binding broker quotes, respectively, to determine the fair value at June 30, 2013.

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The following table presents our consolidated fair value measurements on a recurring basis by pricing source at June 30, 2014:

(in millions)	Erie Insurance Group June 30, 2014			
	Total	Level 1	Level 2	Level 3
Indemnity				
Fixed maturities:				
Priced via pricing services	$496	$0	$496	$0
Priced via market comparables/broker quotes (1)	1	0	0	1
Priced via internal modeling	0	0	0	0
Total fixed maturities	497	0	496	1
Nonredeemable preferred stock:				
Priced via pricing services	12	2	10	0
Priced via market comparables/broker quotes (1)	2	0	2	0
Total nonredeemable preferred stock	14	2	12	0
Common stock:				
Priced via pricing services	12	12	0	0
Total common stock	12	12	0	0
Other investments:				
Priced via unobservable inputs (2)	18	0	0	18
Total other investments	18	0	0	18
Total – Indemnity	$541	$14	$508	$19
Exchange				
Fixed maturities:				
Priced via pricing services	$8,646	$0	$8,646	$0
Priced via market comparables/broker quotes (1)	48	0	30	18
Priced via internal modeling	7	0	0	7
Total fixed maturities	8,701	0	8,676	25
Nonredeemable preferred stock:				
Priced via pricing services	679	303	376	0
Priced via market comparables/broker quotes (1)	37	0	37	0
Priced via internal modeling	1	0	0	1
Total nonredeemable preferred stock	717	303	413	1
Common stock:				
Priced via pricing services	3,559	3,559	0	0
Priced via internal modeling	15	0	0	15
Total common stock	3,574	3,559	0	15
Other investments:				
Priced via unobservable inputs (2)	102	0	0	102
Total other investments	102	0	0	102
Total – Exchange	$13,094	$3,862	$9,089	$143
Total – Erie Insurance Group	$13,635	$3,876	$9,597	$162

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

(2) 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. 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 six months ended June 30, 2014.

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Note 7. Investments

Available-for-sale securities
The following table summarizes the cost and fair value of our available-for-sale securities at June 30, 2014:

	Erie Insurance Group June 30, 2014			
(in millions)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Indemnity				
Available-for-sale securities:				
States & political subdivisions	$230	$ 11	$ 0	$241
Corporate debt securities	254	2	0	256
Collateralized debt obligations	0	0	0	0
Total fixed maturities	484	13	0	497
Nonredeemable preferred stock	12	2	0	14
Common stock	13	0	1	12
Total available-for-sale securities – Indemnity	$509	$ 15	$ 1	$523
Exchange				
Available-for-sale securities:				
U.S. treasury	$31	$ 0	$ 0	$31
Government sponsored enterprises	3	1	0	4
States & political subdivisions	1,438	83	2	1,519
Foreign government securities	15	0	0	15
Corporate debt securities	6,409	465	8	6,866
Residential mortgage-backed securities	145	3	2	146
Commercial mortgage-backed securities	32	2	0	34
Collateralized debt obligations	7	7	0	14
Other debt securities	69	3	0	72
Total fixed maturities	8,149	564	12	8,701
Nonredeemable preferred stock	646	73	2	717
Common stock	196	2	1	197
Total available-for-sale securities – Exchange	$8,991	$ 639	$ 15	$9,615
Total available-for-sale securities – Erie Insurance Group	$9,500	$ 654	$ 16	$10,138

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

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

The amortized cost and estimated fair value of fixed maturities at June 30, 2014 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.

	Erie Insurance Group June 30, 2014	
(in millions)	Amortized cost	Estimated fair value
Indemnity		
Due in one year or less	$69	$69
Due after one year through five years	229	232
Due after five years through ten years	113	118
Due after ten years	73	78
Total fixed maturities – Indemnity	$484	$497
Exchange		

Due in one year or less	377	384
Due after one year through five years	3,155	3,365
Due after five years through ten years	3,094	3,303
Due after ten years	1,523	1,649
Total fixed maturities – Exchange	$8,149	$8,701
Total fixed maturities – Erie Insurance Group	$8,633	$9,198

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Available-for-sale securities in a gross unrealized loss position at June 30, 2014 are as follows. Data is provided by length of time for securities in a gross unrealized loss position.

	Erie Insurance Group						
	June 30, 2014						
(dollars in millions)	Less than 12 months		12 months or longer		Total		
Indemnity	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	No. of holdings
Available-for-sale securities:							
States & political subdivisions	$3	$0	$7	$0	$10	$0	4
Corporate debt securities	49	0	6	0	55	0	172
Total fixed maturities	52	0	13	0	65	0	176
Nonredeemable preferred stock	0	0	2	0	2	0	2
Common stock	0	0	12	1	12	1	1
Total available-for-sale securities – Indemnity	$52	$0	$27	$1	$79	$1	179
Quality breakdown of fixed maturities:							