ERIE INDEMNITY CO
Form 10-Q
October 26, 2017
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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, 2017

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 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [X]   Accelerated filer [ ]   Non-accelerated filer [ ]
(Do not check if a smaller reporting company)
Smaller reporting company [ ]   Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange
Act. [ ]

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 October 13, 2017.

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 13, 2017.

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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,	
	2017	2016	2017	2016
Operating revenue				
Management fee revenue, net	$435,214	$411,139	$1,268,591	$1,195,262
Service agreement revenue	7,278	7,267	21,781	21,756
Total operating revenue	442,492	418,406	1,290,372	1,217,018
Operating expenses				
Commissions	248,677	232,455	720,538	676,963
Salaries and employee benefits	60,499	53,265	181,013	161,579
All other operating expenses	52,480	50,431	158,407	142,797
Total operating expenses	361,656	336,151	1,059,958	981,339
Operating income	80,836	82,255	230,414	235,679
Investment income				
Net investment income	5,970	5,331	18,184	14,884
Net realized investment gains	899	718	1,539	29
Net impairment losses recognized in earnings	0	0	(182)	(345)
Equity in earnings (losses) of limited partnerships	1,537	(1,723)	1,899	(279)
Total investment income	8,406	4,326	21,440	14,289
Interest expense, net	377	—	800	—
Income before income taxes	88,865	86,581	251,054	249,968
Income tax expense	30,322	29,205	86,108	85,388
Net income	$58,543	$57,376	$164,946	$164,580
Earnings Per Share				
Net income per share				
Class A common stock – basic	$1.26	$1.23	$3.54	$3.53
Class A common stock – diluted	$1.12	$1.09	$3.15	$3.14
Class B common stock – basic	$189	$185	$531	$530
Class B common stock – diluted	$189	$185	$531	$529
Weighted average shares outstanding – Basic				
Class A common stock	46,188,949	46,188,980	46,186,109	46,188,971
Class B common stock	2,542	2,542	2,542	2,542
Weighted average shares outstanding – Diluted				
Class A common stock	52,316,876	52,411,303	52,342,450	52,442,697
Class B common stock	2,542	2,542	2,542	2,542

Dividends declared per share				
Class A common stock	$0.7825	$0.7300	$2.3475	$2.1900
Class B common stock	$117.375	$109.500	$352.125	$328.500

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		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Net income	$58,543	$57,376	$164,946	$164,580
Other comprehensive income, net of tax				
Change in unrealized holding (losses) gains on available-for-sale securities	(167)	355	2,446	6,846
Comprehensive income	$58,376	$57,731	$167,392	$171,426

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, 2017 (Unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 184,628	$ 189,072
Available-for-sale securities	65,318	56,138
Receivables from Erie Insurance Exchange and affiliates	428,500	378,540
Prepaid expenses and other current assets	35,797	30,169
Federal income taxes recoverable	0	5,260
Accrued investment income	6,435	6,337
Total current assets	720,678	665,516
Available-for-sale securities	683,948	657,153
Limited partnership investments	49,451	58,159
Fixed assets, net	75,370	69,142
Deferred income taxes, net	47,558	53,889
Note receivable from Erie Family Life Insurance Company	25,000	25,000
Other assets	29,424	20,096
Total assets	$ 1,631,429	$ 1,548,955
Liabilities and shareholders' equity		
Current liabilities:		
Commissions payable	$ 236,056	$ 210,559
Agent bonuses	93,448	114,772
Accounts payable and accrued liabilities	99,331	88,153
Dividends payable	36,441	36,441
Deferred executive compensation	12,794	19,675
Federal income taxes payable	5,331	0
Total current liabilities	483,401	469,600
Defined benefit pension plans	208,528	221,827
Employee benefit obligations	330	756
Deferred executive compensation	12,777	13,233
Long-term borrowings	49,734	24,766
Other long-term liabilities	1,509	1,863
Total liabilities	756,279	732,045
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	16,470	16,300

Accumulated other comprehensive loss	(118,935)	(121,381)
Retained earnings	2,121,535	2,065,911
Total contributed capital and retained earnings	2,021,240	1,963,000
Treasury stock, at cost; 22,110,132 shares held	(1,155,396)	(1,155,846)
Deferred compensation	9,306	9,756
Total shareholders’ equity	875,150	816,910
Total liabilities and shareholders’ equity	$ 1,631,429	$ 1,548,955

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, 2017	2016
Cash flows from operating activities		
Management fee received	$1,225,966	$1,155,234
Service agreement fee received	21,781	21,756
Net investment income received	23,593	19,643
Limited partnership distributions	2,993	7,222
Decrease in reimbursements collected from affiliates	(7,335)	(11,893)
Commissions paid to agents	(597,700)	(565,490)
Agents bonuses paid	(118,862)	(110,503)
Salaries and wages paid	(128,071)	(119,991)
Pension contribution and employee benefits paid	(62,837)	(37,341)
General operating expenses paid	(167,985)	(133,729)
Income taxes paid	(70,504)	(69,357)
Interest paid	(705)	—
Net cash provided by operating activities	120,334	155,551
Cash flows from investing activities		
Purchase of investments:		
Available-for-sale securities	(292,702)	(269,237)
Limited partnerships	(330)	(449)
Proceeds from investments:		
Available-for-sale securities sales	120,418	67,415
Available-for-sale securities maturities/calls	146,434	96,851
Trading securities	—	5,171
Limited partnerships	7,986	12,404
Net purchase of fixed assets	(18,036)	(10,415)
Net (distributions) collections on agent loans	(4,185)	1,622
Net cash used in investing activities	(40,415)	(96,638)
Cash flows from financing activities		
Dividends paid to shareholders	(109,324)	(101,989)
Net proceeds from long-term borrowings	24,961	—
Net cash used in financing activities	(84,363)	(101,989)
Net decrease in cash and cash equivalents	(4,444)	(43,076)
Cash and cash equivalents, beginning of period	189,072	182,889
Cash and cash equivalents, end of period	$184,628	$139,813

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. 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 and arranges for the provision of all claims handling services, investment management services, and certain other common overhead and service department functions and serves as the common pay agent. The amounts Indemnity incurs in this capacity are reimbursed to Indemnity from the Exchange at cost.

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, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. For further information, refer to the financial statements and footnotes included in our Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on February 23, 2017.

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.

Recently issued accounting standards
In March 2017, the FASB issued ASU 2017-07, "Compensation-Retirement Benefits", which requires the service cost component of net benefit costs to be reported with other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit costs are required to be presented separately from the service cost component and outside of income from operations. This amendment also allows only the service cost component to be eligible for capitalization when applicable. The guidance is effective for interim and annual periods beginning after December 15, 2017. While the presentation of the costs within the Statements of Operations will change, we do not expect a material impact on our financial statements or related disclosures.

In March 2017, the FASB issued ASU 2017-08, "Receivables-Nonrefundable Fees and Other Costs", which shortens the amortization period for certain purchased callable debt securities held at a premium from maturity date to the earliest call date. ASU 2017-08 is effective for interim and annual reporting periods beginning after December 31, 2018. The guidance should be applied using a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. 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 have evaluated the impact of this guidance on our invested assets. Our investments are not measured at amortized cost, which are the investments that require the use of a new expected loss model. Our available-for-sale debt securities will continue to be monitored for credit losses which would be reflected as an allowance for credit losses rather than a reduction of the carrying value of the asset. The other material financial assets subject to this guidance include our receivables from Erie Insurance Exchange and affiliates. Given the financial strength of the Exchange, demonstrated by its strong surplus position and industry ratings, it is unlikely these receivables would have significant, if any, credit loss exposure. We do not expect a material impact on our financial statements or related disclosures as a result of this guidance.

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. Leases are required to be recognized and measured at the beginning of the earliest period presented using a modified retrospective approach. Early adoption is permitted. We expect to adopt ASU 2016-02 as of January 1, 2019 using the modified retrospective method. Under existing guidance, we recognize lease expense as a component of operating expenses in the Statements of Operations. We are in the process of evaluating our existing lease contracts to determine the impact to our financial statements and disclosures.

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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. As of September 30, 2017, we do not own any equity security investments, therefore the adoption of this guidance would have no impact to our financial statements. We will continue to monitor our investment portfolio as we may enter into investments in equity securities; however, at this time we do not expect that recognizing the change in fair value of future equity investments through net income instead of accumulated other comprehensive income would be material.

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 with early application permitted beginning in the first interim period in 2017. We expect to adopt the ASU 2014-09 as of January 1, 2018 under the modified retrospective method where the cumulative effect is recognized at the date of initial application. Our evaluation is ongoing and not complete. We performed an analysis in accordance with the steps identified in the new guidance around the recognition, measurement, and presentation of management fee revenue. We determined that service fee revenue is not within the scope of the new guidance. We have preliminarily concluded that adoption of this guidance will not have a material impact on our management fee revenue recognition pattern or our financial statements. We are also reviewing agreements related to the amounts we receive as reimbursements from the Exchange and its subsidiaries, such as claims-related expenses, investment and other overhead expenses. While the expenses are reimbursed to us at actual cost, we are evaluating if there is a performance obligation that would require allocation of revenue under this guidance. Additionally, we are evaluating the impact of the new disclosure requirements.

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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:

	Three months ended September 30,					
	2017			2016		
(dollars in thousands, except per share data)	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	$58,064	46,188,949	$ 1.26	$56,906	46,188,980	$ 1.23
Dilutive effect of stock-based awards	0	27,127	—	0	121,523	—
Assumed conversion of Class B shares	479	6,100,800	—	470	6,100,800	—
Class A – Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	$58,543	52,316,876	$ 1.12	$57,376	52,411,303	$ 1.09
Class B – Basic EPS:						
Income available to Class B stockholders	$479	2,542	$ 189	$470	2,542	$ 185
Class B – Diluted EPS:						
Income available to Class B stockholders	$479	2,542	$ 189	$469	2,542	$ 185

	Nine months ended September 30,					
	2017			2016		
(dollars in thousands, except per share data)	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	$163,596	46,186,109	$ 3.54	$163,233	46,188,971	$ 3.53
Dilutive effect of stock-based awards	0	55,541	—	0	152,926	—
Assumed conversion of Class B shares	1,350	6,100,800	—	1,347	6,100,800	—
Class A – Diluted EPS:						
Income available to Class A stockholders on Class A equivalent shares	$164,946	52,342,450	$ 3.15	$164,580	52,442,697	$ 3.14
Class B – Basic EPS:						
Income available to Class B stockholders	$1,350	2,542	$ 531	$1,347	2,542	$ 530
Class B – Diluted EPS:						
Income available to Class B stockholders	$1,350	2,542	$ 531	$1,346	2,542	$ 529

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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 virtually all of our prices are obtained from third party sources, we also perform an internal pricing review on outliers, which include securities with price changes inconsistent with 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.

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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, 2017 Fair value measurements using:			
(in thousands)	Total	Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3
Available-for-sale securities:				
U.S. treasury	$11,834	$ 0	$11,834	$ 0
States & political subdivisions	261,966	0	261,966	0
Foreign government securities	507	0	507	0
Corporate debt securities	346,372	0	338,457	7,915
Residential mortgage-backed securities	25,719	0	25,719	0
Commercial mortgage-backed securities	34,331	0	34,331	0
Collateralized debt obligations	62,381	0	62,381	0
Other debt securities	6,156	0	6,156	0
Total fixed maturities	749,266	0	741,351	7,915
Total available-for-sale securities	749,266	0	741,351	7,915
Other investments (1)	4,338	—	—	—
Total	$753,604	$ 0	$741,351	$ 7,915

	At December 31, 2016 Fair value measurements using:			
(in thousands)	Total	Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3
Available-for-sale securities:				
U.S. treasury	$5,031	$ 0	$5,031	$ 0
Government sponsored entities	2,026	0	2,026	0
States & political subdivisions	253,132	0	253,132	0
Corporate debt securities	322,948	0	313,596	9,352
Residential mortgage-backed securities	16,102	0	16,102	0
Commercial mortgage-backed securities	36,849	0	36,849	0
Collateralized debt obligations	69,253	0	69,253	0
Other debt securities	2,000	0	2,000	0
Total fixed maturities	707,341	0	697,989	9,352
Common stock	5,950	5,950	0	0
Total available-for-sale securities	713,291	5,950	697,989	9,352
Other investments (1)	4,412	—	—	—

Total	$717,703	$ 5,950	$697,989	$ 9,352

(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, 2017 and December 31, 2016. During the nine months ended September 30, 2017, no contributions were made and distributions totaling $0.3 million were received from these investments. During the year ended December 31, 2016, no contributions were made and distributions totaling $0.9 million were received from these investments. There were no unfunded commitments related to the investments as of September 30, 2017, and $0.3 million as of December 31, 2016.

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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 and nine months ended September 30, 2017 and 2016, respectively.

Level 3 Assets – Quarterly Change:

(in thousands)	Beginning balance at June 30, 2017	Included in earnings(1)	Included in other comprehensive income	Purchases	Sales	Transfers into Level 3(2)	Transfers out of Level 3(2)	Ending balance at September 30, 2017
Available-for-sale securities:								
Corporate debt securities	$ 9,295	$ 24	$ (60)	$ 539	$ (1,240)	$ 2,633	$ (3,276)	$ 7,915
Total fixed maturities	9,295	24	(60)	539	(1,240)	2,633	(3,276)	7,915
Total available-for-sale securities	9,295	24	(60)	539	(1,240)	2,633	(3,276)	7,915
Total Level 3 assets	$ 9,295	$ 24	$ (60)	$ 539	$ (1,240)	$ 2,633	$ (3,276)	$ 7,915

Level 3 Assets – Year-to-Date Change:

(in thousands)	Beginning balance at December 31, 2016	Included in earnings(1)	Included in other comprehensive income	Purchases	Sales	Transfers into Level 3(2)	Transfers out of Level 3(2)	Ending balance at September 30, 2017
Available-for-sale securities:								
Corporate debt securities	$ 9,352	$ 3	$ (108)	$ 4,520	$ (4,372)	$ 8,444	$ (9,924)	$ 7,915
Total fixed maturities	9,352	3	(108)	4,520	(4,372)	8,444	(9,924)	7,915
Total available-for-sale securities	9,352	3	(108)	4,520	(4,372)	8,444	(9,924)	7,915
Total Level 3 assets	$ 9,352	$ 3	$ (108)	$ 4,520	$ (4,372)	$ 8,444	$ (9,924)	$ 7,915

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 into Level 3(2)	Transfers out of Level 3(2)	Ending balance at September 30, 2016
Available-for-sale securities:								
Corporate debt securities	$ 8,851	$ 22	$ 38	$ 3,217	$ (318)	$ 2,514	$ (4,135)	$ 10,189
Commercial mortgage-backed securities	1,003	0	0	0	0	0	(1,003)	0
Collateralized debt obligations	1,200	0	7	3,000	0	2,114	(1,200)	5,121
Total fixed maturities	11,054	22	45	6,217	(318)	4,628	(6,338)	15,310
Total available-for-sale securities	11,054	22	45	6,217	(318)	4,628	(6,338)	15,310
Total Level 3 assets	$ 11,054	$ 22	$ 45	$ 6,217	$ (318)	$ 4,628	$ (6,338)	$ 15,310

Level 3 Assets – Year-to-Date Change:

(in thousands)	Beginning balance at	Included in earnings(1)	Included in other comprehensive	Purchases	Sales	Transfers into Level	Transfers out of Level 3(2)	Ending balance at September

	December 31, 2015		income			3(2)		30, 2016
Available-for-sale securities:								
Corporate debt securities	$ 69	$ 67	$ 119	$ 11,887	$ (924)	$ 5,470	$ (6,499)	$ 10,189
Commercial mortgage-backed securities	0	0	3	1,000	0	0	(1,003)	0
Collateralized debt obligations	8,577	4	(5)	7,722	(54)	2,114	(13,237)	5,121
Total fixed maturities	8,646	71	117	20,609	(978)	7,584	(20,739)	15,310
Total available-for-sale securities	8,646	71	117	20,609	(978)	7,584	(20,739)	15,310
Total Level 3 assets	$ 8,646	$ 71	$ 117	$ 20,609	$ (978)	$ 7,584	$ (20,739)	$ 15,310

(1) These amounts are reported in the Statements of Operations as net investment income and net realized investment gains (losses) for the each of the periods presented above.

(2) Transfers into and/or (out) of Level 3 are primarily attributable to the availability of market observable information and the re-evaluation of the observability of pricing inputs.

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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 broker quotes totaled $7.9 million at September 30, 2017. 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, 2017			
	Total	Level 1	Level 2	Level 3
Fixed maturities:				
Priced via pricing services	$749,266	$ 0	$741,351	$7,915
Total fixed maturities	749,266	0	741,351	7,915
Other investments:				
Priced via unobservable inputs [(1)]	4,338	—	—	—
Total other investments	4,338	—	—	—
Total	$753,604	$ 0	$741,351	$7,915

(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 fair value of these investments is based on the 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, 2017.

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Note 5. Investments

Available-for-sale securities
The following tables summarize the cost and fair value of our available-for-sale securities:

(in thousands)	At September 30, 2017 Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available-for-sale securities:				
U.S. treasury	$11,878	$ 0	$ 44	$11,834
States & political subdivisions	254,835	7,809	678	261,966
Foreign government securities	501	6	0	507
Corporate debt securities	345,003	2,201	832	346,372
Residential mortgage-backed securities	25,388	404	73	25,719
Commercial mortgage-backed securities	34,892	73	634	34,331
Collateralized debt obligations	62,193	207	19	62,381
Other debt securities	6,119	37	0	6,156
Total fixed maturities	740,809	10,737	2,280	749,266
Total available-for-sale securities	$740,809	$ 10,737	$ 2,280	$749,266

(in thousands)	At December 31, 2016 Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available-for-sale securities:				
U.S. treasury	$5,093	$ 0	$ 62	$5,031
Government sponsored entities	2,004	22	0	2,026
States & political subdivisions	249,312	6,113	2,293	253,132
Corporate debt securities	321,041	3,293	1,386	322,948
Residential mortgage-backed securities	16,232	61	191	16,102
Commercial mortgage-backed securities	37,723	59	933	36,849
Collateralized debt obligations	68,998	351	96	69,253
Other debt securities	2,000	0	0	2,000
Total fixed maturities	702,403	9,899	4,961	707,341
Common stock	6,152	0	202	5,950
Total available-for-sale securities	$708,555	$ 9,899	$ 5,163	$713,291

The amortized cost and estimated fair value of fixed maturities at September 30, 2017 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, 2017 Amortized cost	Estimated fair value
Due in one year or less	$65,085	$65,208
Due after one year through five years	332,904	337,986

Due after five years through ten years	239,042	242,425
Due after ten years	103,778	103,647
Total fixed maturities	$740,809	$749,266

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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.

	At September 30, 2017						
(in thousands)	Less than 12 months		12 months or longer		Total		
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	No. of holdings
Available-for-sale securities:							
U.S. treasury	$11,835	$ 44	$ 0	$ 0	$11,835	$ 44	4
States & political subdivisions	49,278	449	7,280	229	56,558	678	26
Corporate debt securities	108,828	619	19,951	213	128,779	832	255
Residential mortgage-backed securities	5,553	19	5,771	54	11,324	73	10
Commercial mortgage-backed securities	12,793	106	11,019	528	23,812	634	21
Collateralized debt obligations	16,426	19	0	0	16,426	19	8
Total fixed maturities	204,713	1,256	44,021	1,024	248,734	2,280	324
Total available-for-sale securities	$204,713	$ 1,256	$ 44,021	$ 1,024	$248,734	$ 2,280	324
Quality breakdown of fixed maturities:							
Investment grade	$152,341	$ 745	$ 42,020	$ 533	$194,361	$ 1,278	113
Non-investment grade	52,372	511	2,001	491	54,373	1,002	211
Total fixed maturities	$204,713	$ 1,256	$ 44,021	$ 1,024	$248,734	$ 2,280	324

	At December 31, 2016						
(in thousands)	Less than 12 months		12 months or longer		Total		
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	No. of holdings
Available-for-sale securities:							
U.S. treasury	$5,031	$ 62	$ 0	$ 0	$5,031	$ 62	1
States & political subdivisions	84,611	2,293	0	0	84,611	2,293	40
Corporate debt securities	112,453	987	8,692	399	121,145	1,386	155
Residential mortgage-backed securities	7,451	60	4,974	131	12,425	191	13
Commercial mortgage-backed securities	26,509	437	4,319	496	30,828	933	28
Collateralized debt obligations	27,470	75	4,208	21	31,678	96	15
Total fixed maturities	263,525	3,914	22,193	1,047	285,718	4,961	252
Common stock	5,950	202	0	0	5,950	202	1
Total available-for-sale securities	$269,475	$ 4,116	$ 22,193	$ 1,047	$291,668	$ 5,163	253
Quality breakdown of fixed maturities:							
Investment grade	$239,041	$ 3,605	$ 16,061	$ 399	$255,102	$ 4,004	136
Non-investment grade	24,484	309	6,132	648	30,616	957	116
Total fixed maturities	$263,525	$ 3,914	$ 22,193	$ 1,047	$285,718	$ 4,961	252

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 September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Fixed maturities	$4,234	$5,245	$16,358	$14,629
Equity securities	0	50	49	132
Cash equivalents and other	1,936	366	2,852	1,011
Total investment income	6,170	5,661	19,259	15,772
Less: investment expenses	200	330	1,075	888
Net investment income	$5,970	$5,331	$18,184	$14,884

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 September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Available-for-sale securities:				
Fixed maturities:				
Gross realized gains	$1,621	$603	$2,708	$1,175
Gross realized losses	(722)	(27)	(1,116)	(1,819)
Net realized gains (losses)	899	576	1,592	(644)
Equity securities:				
Gross realized losses	0	0	(145)	(34)
Net realized losses	0	0	(145)	(34)
Trading securities:				
Common stock:				
Gross realized gains	0	121	0	707
Increases in fair value[1]	0	21	0	0
Net realized gains	0	142	0	707
Miscellaneous:				
Gross realized gains	0	0	94	0
Gross realized losses	0	0	(2)	0
Net realized gains	0	0	92	0
Net realized investment gains	$899	$718	$1,539	$29

(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	Nine months ended

	ended September 30,		September 30,	
	2017	2016	2017	2016
Fixed maturities	$ 0	$ 0	$(182)	$(345)
Total other-than-temporary impairments	0	0	(182)	(345)
Portion recognized in other comprehensive income	0	0	0	0
Net impairment losses recognized in earnings	$ 0	$ 0	$(182)	$(345)

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
The majority of our limited partnership holdings are considered investment companies where the general partners record assets at fair value. These limited partnerships are recorded using the equity method of accounting and are generally reported on a one-quarter lag; therefore, our year-to-date limited partnership results through September 30, 2017 are comprised of partnership financial results for the fourth quarter of 2016 and the first two quarters of 2017. Given the lag in reporting, our limited partnership results do not reflect the market conditions of the third quarter of 2017. We also own some real estate limited partnerships that do not meet the criteria of an investment company. These partnerships prepare audited financial statements on a cost basis. We have elected to report these limited partnerships under the fair value option, which is based on the NAV from our partner's capital statement reflecting the general partner's estimate of fair value for the fund's underlying assets. Fair value provides consistency in the evaluation and financial reporting for these limited partnerships and limited partnerships accounted for under the equity method. Cash contributions made to and distributions received from the partnerships are recorded in the period in which the transaction occurs.

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

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Equity in earnings (losses) of limited partnerships accounted for under the equity method	$1,305	$(1,778)	$1,704	$(436)
Change in fair value of limited partnerships accounted for under the fair value option	232	55	195	157
Equity in earnings (losses) of limited partnerships	$1,537	$(1,723)	$1,899	$(279)

The following table summarizes limited partnership investments by sector:

(in thousands)	At September 30, 2017	At December 31, 2016
Private equity	$ 33,478	$ 35,228
Mezzanine debt	4,797	6,010
Real estate	6,838	12,509
Real estate - fair value option	4,338	4,412
Total limited partnership investments	$ 49,451	$ 58,159

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

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Note 6. Borrowing Arrangements

Bank line of credit

As of September 30, 2017, 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, 2017, a total of $99.1 million remains available under the facility due to $0.9 million outstanding letters of credit, which reduce the availability for letters of credit to $24.1 million. We had no borrowings outstanding on our line of credit as of September 30, 2017. Bonds with a fair value of $109.5 million were pledged as collateral on the line at September 30, 2017. 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, 2017. The bank requires compliance with certain covenants, which include leverage ratios and debt restrictions, for our line of credit. We are in compliance with all bank covenants at September 30, 2017.

Term loan credit facility

On November 7, 2016, we entered into a credit agreement for a $100 million senior secured draw term loan credit facility ("Credit Facility") for the acquisition of real property and construction of an office building that will serve as part of our principal headquarters. Under the agreement, $25 million will be drawn on December 1, 2016, June 1, 2017, December 1, 2017, and June 1, 2018 ("Draw Period"). During the Draw Period, we will make monthly interest only payments under the Credit Facility and thereafter the Credit Facility converts to a fully-amortized term loan with monthly payments of principal and interest over a period of 28 years. Borrowings under the Credit Facility will bear interest at a fixed rate of 4.35%. In addition, we are required to pay a quarterly commitment fee of 0.08% on the unused portion of the Credit Facility during the Draw Period. Total draws against the facility are $50 million as of September 30, 2017. Bonds with a fair value of $109.7 million were pledged as collateral for the facility and are reported as available-for-sale securities in the Statements of Financial Position as of September 30, 2017. The bank requires compliance with certain covenants, which include leverage ratios, debt restrictions and minimum net worth, for our Credit Facility. We are in compliance with all covenants at September 30, 2017.

Amounts drawn from the Credit Facility are reported at carrying value on our Statements of Financial Position, net of unamortized loan origination and commitment fees. The estimated fair value of this borrowing at September 30, 2017 was $47.9 million. The estimated fair value was determined using estimates based upon interest rates and credit spreads and are classified as Level 3 in the fair value hierarchy as of September 30, 2017.

The scheduled maturity of the $100 million Credit Facility begins on January 1, 2019 with annual principal payments of $1.9 million in 2019, $2.0 million in 2020, $2.0 million in 2021, $2.1 million in 2022 and $92.0 million thereafter.

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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 and their share of service department costs.

A $19.0 million contribution was made to the defined benefit pension plan in the first quarter of 2017. An additional $20.0 million contribution was made to the plan in the third quarter of 2017.

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 $19.7 million at September 30, 2017 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,	
	2017	2016	2017	2016
Service cost for benefits earned	$7,777	$7,050	$23,330	$21,150
Interest cost on benefits obligation	8,569	8,281	25,706	24,844
Expected return on plan assets	(10,317)	(9,880)	(30,950)	(29,640)
Prior service cost amortization	218	174	654	522
Net actuarial loss amortization	2,325	2,029	6,975	6,084
Pension plan cost [1]	$8,572	$7,654	$25,715	$22,960

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

Note 8. Income Taxes

The effective tax rates differ from the statutory federal tax rate of 35% primarily due to permanent differences for tax exempt interest income.

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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, 2017 and the year ended December 31, 2016. There is no provision for conversion of Class A shares to Class B shares, and Class B shares surrendered for conversion cannot be reissued.

Stock repurchases
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, 2017 and the year ended December 31, 2016. We had approximately $17.8 million of repurchase authority remaining under this program at September 30, 2017.

During the nine months ended September 30, 2017, we purchased 58,129 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of $7.0 million. Of this amount, we purchased 3,785 shares for $0.4 million, or $111.55 per share, for stock-based awards in conjunction with our equity compensation plan. We purchased 7,460 shares for $0.9 million, or $121.46 per share, to fund the rabbi trust for the outside director deferred compensation plan. The remaining 46,884 shares were purchased at a total cost of $5.7 million, or $122.40 per share, for the vesting of stock-based awards in the long-term incentive plan.

In 2016, we purchased 15,093 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of $1.5 million. Of this amount, we purchased 7,432 shares for $0.7 million, or $99.23 per share, to fund the rabbi trust for the outside director deferred compensation plan. The remaining 7,661 shares were purchased at a total cost of $0.8 million, or $98.20 per share, for the vesting of stock-based awards in the long-term incentive plan.

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Note 10. Accumulated Other Comprehensive Income (Loss)

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

(in thousands)	Three months ended September 30, 2017			Three months ended September 30, 2016		
	Before Tax	Income Tax	Net	Before Tax	Income Tax	Net
Investment securities:						
AOCI, beginning of period	$7,974	$2,791	$5,183	$13,875	$4,857	$9,018
OCI before reclassifications	643	225	418	1,121	392	729
Realized investment gains	(899)	(314)	(585)	(576)	(202)	(374)
OCI (loss)	(256)	(89)	(167)	545	190	355
AOCI, end of period	$7,718	$2,702	$5,016	$14,420	$5,047	$9,373
Pension and other postretirement plans: (1)						
AOCI (loss), beginning of period	$(190,695)	$(66,744)	$(123,951)	$(152,910)	$(53,519)	$(99,391)
AOCI (loss), end of period	$(190,695)	$(66,744)	$(123,951)	$(152,910)	$(53,519)	$(99,391)
Total						
AOCI (loss), beginning of period	$(182,721)	$(63,953)	$(118,768)	$(139,035)	$(48,662)	$(90,373)
Investment securities	(256)	(89)	(167)	545	190	355
Pension and other postretirement plans	0	0	0	0	0	0
OCI (loss)	(256)	(89)	(167)	545	190	355
AOCI (loss), end of period	$(182,977)	$(64,042)	$(118,935)	$(138,490)	$(48,472)	$(90,018)

(in thousands)	Nine months ended September 30, 2017			Nine months ended September 30, 2016		
	Before Tax	Income Tax	Net	Before Tax	Income Tax	Net
Investment securities:						
AOCI, beginning of period	$3,954	$1,384	$2,570	$3,888	$1,361	$2,527
OCI before reclassifications	5,029	1,760	3,269	9,509	3,328	6,181
Realized investment (gains) losses	(1,447)	(506)	(941)	678	237	441
Impairment losses	182	64	118	345	121	224
OCI	3,764	1,318	2,446	10,532	3,686	6,846
AOCI, end of period	$7,718	$2,702	$5,016	$14,420	$5,047	$9,373
Pension and other postretirement plans: (1)						
AOCI (loss), beginning of period	$(190,695)	$(66,744)	$(123,951)	$(152,910)	$(53,519)	$(99,391)
AOCI (loss), end of period	$(190,695)	$(66,744)	$(123,951)	$(152,910)	$(53,519)	$(99,391)
Total						
AOCI (loss), beginning of period	$(186,741)	$(65,360)	$(121,381)	$(149,022)	$(52,158)	$(96,864)
Investment securities	3,764	1,318	2,446	10,532	3,686	6,846
Pension and other postretirement plans	0	0	0	0	0	0
OCI	3,764	1,318	2,446	10,532	3,686	6,846
AOCI (loss), end of period	$(182,977)	$(64,042)	$(118,935)	$(138,490)	$(48,472)	$(90,018)

(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

Office lease

We lease certain office space from the Exchange including the home office and three field office facilities. On April 28, 2017, after securing approval from the Pennsylvania Insurance Department, a new home office lease was executed between the Exchange and Indemnity, which was retroactive to January 1, 2017, when the prior lease expired. Under the new lease, rent is based on rental rates of like property in Erie, Pennsylvania and all operating expenses including utilities, cleaning, repairs, real estate taxes, property insurance and leasehold improvements will be the responsibility of the tenant (Indemnity). This lease agreement expires December 31, 2021. Under the previous lease, rents were determined considering returns on invested capital and included building operating and overhead costs. Rent costs and related operating expenses of shared facilities are allocated between Indemnity, Exchange and EFL based upon usage or square footage occupied. Total rent and operating expenses are estimated at $17.4 million for 2017 and totaled $14.3 million in 2016. In 2016, reimbursements from the Exchange and EFL related to the use of this space totaled $4.9 million.

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 $428.5 million and $378.5 million at September 30, 2017 and December 31, 2016, respectively.

Note 13. Commitments and Contingencies

We have contractual commitments to invest up to $16.4 million related to our limited partnership investments at September 30, 2017. These commitments are split among private equity securities of $6.6 million, mezzanine debt securities of $8.2 million, and real estate activities of $1.6 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.

Note 14. Subsequent Events

No items were identified in this period subsequent to the financial statement date that required adjustment or additional disclosure.

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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, 2016, as contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 23, 2017.

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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 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 and investments in new technology and systems;
- 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 and difficulties with technology or data security breaches, including cyber attacks;
- factors affecting the quality and liquidity of our investment portfolio;

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- our ability to meet liquidity needs and access capital; and
- outcome of pending and potential litigation.

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

RECENT ACCOUNTING STANDARDS

See Part I, Item 1. "Financial Statements - Note 2, Significant Accounting Policies, of Notes to Financial Statements" contained within this report for a discussion of recently adopted 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.

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 and arranges for the provision of all claims handling services, investment management services, and certain other common overhead and service department functions and serves as the common pay agent. The amounts Indemnity incurs in this capacity are reimbursed to Indemnity from the Exchange at cost.

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 71% of the 2016 direct and assumed written premiums and commercial lines comprising the remaining 29%. The principal personal lines products are private passenger automobile and homeowners. The principal commercial lines products are commercial multi-peril, commercial automobile and workers compensation.

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Financial Overview

	Three months ended September 30,			Nine months ended September 30,		
(dollars in thousands, except per share data)	2017	2016	% Change	2017	2016	% Change
	(Unaudited)			(Unaudited)		
Total operating revenue	$442,492	$418,406	5.8 %	$1,290,372	$1,217,018	6.0 %
Total operating expenses	361,656	336,151	7.6	1,059,958	981,339	8.0
Operating income	80,836	82,255	(1.7)	230,414	235,679	(2.2)
Total investment income	8,406	4,326	94.3	21,440	14,289	50.0
Interest expense, net	377	—	NM	800	—	NM
Income before income taxes	88,865	86,581	2.6	251,054	249,968	0.4
Income tax expense	30,322	29,205	3.8	86,108	85,388	0.8
Net income	$58,543	$57,376	2.0 %	$164,946	$164,580	0.2 %
Net income per share - diluted	$1.12	$1.09	2.2 %	$3.15	$3.14	0.4 %

NM = not meaningful

Total operating revenue increased in both the third quarter and nine months ended September 30, 2017 compared to the same periods in 2016, driven by management fee revenue growth. The two components of 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 2017 and 2016. The direct and assumed premiums written by the Exchange increased 5.8% to $1.7 billion in the third quarter of 2017, compared to the third quarter of 2016, and increased 6.0% to $5.1 billion for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016.

Total operating expenses increased 7.6% in the third quarter of 2017, compared to the third quarter of 2016, driven by higher commissions and personnel costs. Total operating expenses increased 8.0% for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, driven by higher commissions, personnel costs and information technology-related professional fees.

Gross margin from operations was 18.3% and 19.7% in the third quarters of 2017 and 2016, respectively, and 17.9% and 19.4% for the nine months ended September 30, 2017 and 2016, respectively.

Total investment income increased $4.1 million in the third quarter of 2017, compared to the third quarter of 2016, driven by higher earnings from limited partnerships. Total investment income increased $7.2 million for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, driven by higher net investment income, as well as higher earnings from limited partnerships and realized investment gains.

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:

	Three months ended September 30,			Nine months ended September 30,		
(dollars in thousands)	2017	2016	% Change	2017	2016	% Change
	(Unaudited)			(Unaudited)		
Management fee revenue, net	$435,214	$411,139	5.9 %	$1,268,591	$1,195,262	6.1 %
Service agreement revenue	7,278	7,267	0.2	21,781	21,756	0.1
Total operating revenue	442,492	418,406	5.8	1,290,372	1,217,018	6.0
Total operating expenses	361,656	336,151	7.6	1,059,958	981,339	8.0
Operating income	$80,836	$82,255	(1.7)%	$230,414	$235,679	(2.2)%
Gross margin	18.3 %	19.7 %	(1.4) pts.	17.9 %	19.4 %	(1.5) 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 2017 and 2016. 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:

	Three months ended September 30,			Nine months ended September 30,		
(dollars in thousands)	2017	2016	% Change	2017	2016	% Change
	(Unaudited)			(Unaudited)		
Direct and assumed premiums written by the Exchange	$1,739,654	$1,643,755	5.8 %	$5,085,562	$4,795,446	6.0 %
Management fee rate	25 %	25 %		25 %	25 %	
Management fee revenue, gross	434,914	410,939	5.8	1,271,391	1,198,862	6.0
Change in allowance for management fee returned on cancelled policies[1]	300	200	NM	(2,800)	(3,600)	NM
Management fee revenue, net of allowance	$435,214	$411,139	5.9 %	$1,268,591	$1,195,262	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 5.8% to $1.7 billion in the third quarter of 2017 compared to the third quarter of 2016, 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 3.4% in the third quarter of 2017 as the result of continuing strong policyholder retention and an increase in new policies written, compared to 3.3% in the third quarter of 2016. The year-over-year average premium per policy for all lines of business increased 2.6% at September 30, 2017, compared to 2.7% at September 30, 2016.

Premiums generated from new business increased 14.2% to $222 million in the third quarter of 2017, compared to an increase of 3.9% to $194 million in the third quarter of 2016. Underlying the trend in new business premiums was a 9.2% increase in new business policies written in the third quarter of 2017, compared to a 1.1% increase in the third quarter of 2016, while the year-over-year average premium per policy on new business increased 4.6% at September 30, 2017, compared to 1.9% at September 30, 2016. Premiums generated from renewal business increased 4.7% to $1.5 billion in the third quarter of 2017, compared to an increase of 5.7% to $1.4 billion in the third quarter of 2016. Underlying the trend in renewal business premiums was an increase in year-over-year average premium per policy of 2.4% at September 30, 2017, compared to 2.8% at September 30, 2016, and steady policy retention ratios.

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Personal lines – Total personal lines premiums written increased 6.5% to $1.3 billion in the third quarter of 2017, from $1.2 billion in the third quarter of 2016, driven by an increase of 3.5% in total personal lines policies in force and an increase of 3.2% in the total personal lines year-over-year average premium per policy.

Commercial lines – Total commercial lines premiums written increased 4.0% to $457 million in the third quarter of 2017, from $440 million in the third quarter of 2016, driven by a 2.7% increase in total commercial lines policies in force and a 1.6% 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. Our continued focus on underwriting discipline and the maturing of pricing sophistication models has contributed to the Exchange's 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 in both the third quarter of 2017 and 2016, and $21.8 million for both the nine months ended September 30, 2017 and 2016. While policies in force continue to grow, service agreement revenue remains flat. This 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 for certain payment methods. 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 operations

	Three months ended September 30,			Nine months ended September 30,		
(in thousands)	2017	2016	% Change	2017	2016	% Change
	(Unaudited)			(Unaudited)		
Commissions:						
Total commissions	$248,677	$232,455	7.0 %	$720,538	$676,963	6.4 %
Non-commission expense:						
Underwriting and policy processing	$36,060	$33,946	6.2 %	$108,115	$102,108	5.9 %
Information technology	32,688	31,114	5.1	102,850	87,714	17.3
Sales and advertising	15,722	14,869	5.7	46,375	46,872	(1.1)
Customer service	7,083	5,381	31.6	20,661	18,689	10.5
Administrative and other	21,426	18,386	16.5	61,419	48,993	25.4
Total non-commission expense	112,979	103,696	9.0	339,420	304,376	11.5
Total cost of operations	$361,656	$336,151	7.6 %	$1,059,958	$981,339	8.0 %

Commissions – Commissions increased $16.2 million in the third quarter of 2017 and $43.6 million for the nine months ended September 30, 2017, compared to the same respective periods in 2016. The increases were primarily driven by the 5.8% and 6.0% increases in direct and assumed premiums written by the Exchange for the third quarter and nine months ended September 30, 2017, respectively. The remaining portion of the increases were due to higher agent incentive costs related to profitable growth, compared to the same respective periods in 2016. The estimated agent incentive payout at September 30, 2017 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 2017. 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 increased $9.3 million in the third quarter of 2017 compared to the same period in 2016. Underwriting and policy processing costs increased $2.1 million primarily due to increased personnel costs and underwriting report costs. Information technology costs increased $1.6 million primarily due to increased personnel costs and hardware and software costs, somewhat offset by lower professional fees. Customer service costs increased $1.7 million

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primarily due to increased credit card processing fees. Administrative and other expenses increased $3.0 million driven by increased personnel costs.

Non-commission expense increased $35.0 million for the nine months ended September 30, 2017 compared to the same period in 2016. Underwriting and policy processing costs increased $6.0 million primarily due to increased personnel costs and underwriting report costs. Information technology costs increased $15.1 million primarily due to increased professional fees, personnel costs and hardware and software costs. Customer service costs increased $2.0 million primarily due to increased personnel costs and credit card processing fees. Administrative and other expenses increased $12.4 million primarily driven by increased personnel costs, including higher incentive plan costs and pension expenses. The incentive plan cost increase was driven by the long-term incentive plan due to the increase in the company stock price during the first nine months of 2017. Additionally, the employee incentive plan program was expanded to additional employee groups beginning in 2017.

Gross margin

The gross margin in the third quarter of 2017 was 18.3% compared to 19.7% in the third quarter of 2016, and was 17.9% for the nine months ended September 30, 2017, compared to 19.4% for the nine months ended September 30, 2016.

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,		
	2017	2016	% Change	2017	2016	% Change
	(Unaudited)			(Unaudited)		
Net investment income	$5,970	$5,331	12.0 %	$18,184	$14,884	22.2 %
Net realized investment gains	899	718	25.4	1,539	29	NM
Net impairment losses recognized in earnings	0	0	0.0	(182)	(345)	47.3
Equity in earnings (losses) of limited partnerships	1,537	(1,723)	NM	1,899	(279)	NM
Total investment income	$8,406	$4,326	94.3 %	$21,440	$14,289	50.0 %

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 by $0.6 million in the third quarter of 2017, compared to the third quarter of 2016, and increased by $3.3 million for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016. The increase in net investment income in both periods was primarily due to an increase in the invested balances and yields of fixed maturity securities.

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,	
	2017	2016	2017	2016

Securities sold:	(Unaudited)		(Unaudited)	
Fixed maturities	$899	$576	$1,592	$(644)
Equity securities	0	0	(145)	(34)
Common stock trading securities	0	121	0	707
Common stock increases in fair value[1]	0	21	0	0
Miscellaneous	0	0	92	0
Net realized investment gains [2]	$899	$718	$1,539	$29

(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.

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 of $0.9 million during the third quarter of 2017 reflected gains from sales of fixed maturity securities, while net realized gains of $0.7 million during the third quarter 2016 resulted from gains on sales of fixed maturity securities and common stock. Net realized gains of $1.5 million for the nine months ended September 30, 2017 primarily reflected gains from sales of fixed maturity securities, partially offset by losses from sales of equity securities, while net realized gains for the nine months ended September 30, 2016 primarily reflected gains from the sale of common stock, partially offset by losses from sales of fixed maturity securities.

Net impairment losses recognized in earnings
There were no impairment losses in the third quarter of 2017 or 2016. Net impairment losses were $0.2 million and $0.3 million for the nine months ended September 30, 2017 and 2016, respectively. Impairments were primarily related to securities in an unrealized loss position where we determined the loss was other-than-temporary based on credit factors. In 2017, impairments also included securities in an unrealized loss position that we intended to sell prior to expected recovery of our amortized cost basis.

Equity in earnings (losses) of limited partnerships
The components of equity in earnings of limited partnerships are as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(Unaudited)		(Unaudited)	
Private equity	$594	$(443)	$822	$(2,240)
Mezzanine debt	387	(120)	274	(26)
Real estate	556	(1,160)	803	1,987
Total equity in earnings (losses) of limited partnerships	$1,537	$(1,723)	$1,899	$(279)

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, 2017 reflect investment valuation changes resulting from the financial markets and the economy in the fourth quarter of 2016 and the first two quarters of 2017.

Equity in earnings of limited partnerships increased by $3.3 million in the third quarter of 2017, compared to the third quarter of 2016, and increased by $2.2 million for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016. The increase in earnings during both periods was primarily due to higher earnings across all sectors, except for real estate for the nine months ended September 30, 2017, which decreased compared to the nine months ended September 30, 2016.

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". On July 12, 2017, 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 standards established by A.M. Best and have a superior ability to meet obligations to policyholders over the long term. As of December 31, 2016, only approximately 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

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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 6.0% to $5.1 billion for the nine months ended September 30, 2017 from $4.8 billion for the nine months ended September 30, 2016. 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 $8.4 billion at September 30, 2017, $7.7 billion at December 31, 2016, and $7.6 billion at September 30, 2016. The Exchange and its wholly owned property and casualty subsidiaries' year-over-year policy retention ratio continues to be high at 89.6% at September 30, 2017, and 89.8% at December 31, 2016 and September 30, 2016.

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, 2017	% to total		Carrying value at December 31, 2016	% to total	
	(Unaudited)					
Fixed maturities	$749,266	94	%	$ 707,341	90	%
Common stock	0	0		5,950	1	
Limited partnerships:						
Private equity	33,478	4		35,228	5	
Mezzanine debt	4,797	1		6,010	1	
Real estate	11,176	1		16,921	3	
Real estate mortgage loans [1]	156	0		213	0	
Total investments	$798,873	100	%	$ 771,663	100	%

(1) Real estate mortgage loans are included with Other assets in the Statements of Financial Position.

We continually review our investment portfolio to evaluate positions that might incur other-than-temporary declines in value. We record impairment write-downs on investments in instances where the fair value of the investment is substantially below cost, and we conclude that the decline in fair value is other-than-temporary, which includes consideration for intent to sell. For all investment holdings, general economic conditions and/or conditions specifically affecting the underlying issuer or its industry, including downgrades by the major rating agencies, are considered in evaluating impairment in value. In addition to specific factors, other factors considered in our review of investment valuation are the length of time the fair value is below cost and the amount the fair value is below cost.

We individually analyze all positions with emphasis on those that have, in 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 $262.0 million, or 35%, of the total fixed maturity portfolio at September 30, 2017. 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 $5.5 million at September 30, 2017, compared to $3.2 million at December 31, 2016.

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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, 2017 (Unaudited)					
Industry Sector	AAA	AA	A	BBB	Non-investment grade	Fair value
Basic materials	$0	$0	$0	$0	$ 15,558	$15,558
Communications	0	0	4,018	7,683	24,777	36,478
Consumer	0	1,064	4,651	33,576	48,210	87,501
Diversified	0	0	0	0	347	347
Energy	0	1,006	3,002	12,035	17,221	33,264
Financial	0	3,996	24,981	57,283	17,968	104,228
Government-municipal	105,004	148,164	8,798	0	0	261,966
Industrial	0	0	7,035	3,388	22,671	33,094
Structured securities(2)	70,879	32,202	12,073	5,415	8,018	128,587
Technology	0	3,987	0	6,056	14,814	24,857
U.S. treasury	0	11,834	0	0	0	11,834
Utilities	0	0	3,995	4,997	2,560	11,552
Total	$175,883	$202,253	$68,553	$130,433	$ 172,144	$749,266

(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
At December 31, 2016,