

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, 2020
OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ___ to ___
Commission file number 0-24000

ERIE INDEMNITY COMPANY

(Exact name of registrant as specified in its charter)

Pennsylvania

(State or other jurisdiction of
incorporation or organization)

25-0466020

(IRS Employer
Identification No.)

100 Erie Insurance Place, Erie, Pennsylvania

(Address of principal executive offices)

16530

(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)

Securities registered pursuant to Section 12(b) of the Act:

Class A common stock, stated value \$0.0292 per share

(Title of each class)

ERIE

(Trading Symbol)

NASDAQ Stock Market, LLC

(Name of each exchange on which registered)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ 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 | <input checked="" type="checkbox"/> | Accelerated filer | <input type="checkbox"/> | Non-accelerated filer | <input type="checkbox"/> |
| Smaller reporting company | <input type="checkbox"/> | Emerging growth company | <input type="checkbox"/> | | |

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 ☒

The number of shares outstanding of the registrant's Class A Common Stock as of the latest practicable date was 46,189,068 at October 23, 2020.

The number of shares outstanding of the registrant's Class B Common Stock as of the latest practicable date was 2,542 at October 23, 2020.

[PART I.](#) [FINANCIAL INFORMATION](#)

[Item 1.](#) [Financial Statements \(Unaudited\)](#)

[Statements of Operations – Three and nine months ended September 30, 2020 and 2019](#)

[Statements of Comprehensive Income – Three and nine months ended September 30, 2020 and 2019](#)

[Statements of Financial Position – September 30, 2020 and December 31, 2019](#)

[Statements of Shareholders' Equity – Three and nine months ended September 30, 2020 and 2019](#)

[Statements of Cash Flows – Nine months ended September 30, 2020 and 2019](#)

[Notes to Financial Statements – September 30, 2020](#)

[Item 2.](#) [Management's Discussion and Analysis of Financial Condition and Results of Operations](#)

[Item 3.](#) [Quantitative and Qualitative Disclosures About Market Risk](#)

[Item 4.](#) [Controls and Procedures](#)

[PART II.](#) [OTHER INFORMATION](#)

[Item 1.](#) [Legal Proceedings](#)

[Item 1A.](#) [Risk Factors](#)

[Item 2.](#) [Unregistered Sales of Equity Securities and Use of Proceeds](#)

[Item 6.](#) [Exhibits](#)

[SIGNATURES](#)

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, | |
|--|-------------------------------------|------------------|------------------------------------|-------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Operating revenue | | | | |
| Management fee revenue - policy issuance and renewal services, net | \$ 484,551 | \$ 474,427 | \$ 1,412,096 | \$ 1,385,923 |
| Management fee revenue - administrative services, net | 14,910 | 14,430 | 44,494 | 42,576 |
| Administrative services reimbursement revenue | 147,710 | 142,730 | 451,229 | 431,305 |
| Service agreement revenue | 6,310 | 7,155 | 19,418 | 20,754 |
| Total operating revenue | 653,481 | 638,742 | 1,927,237 | 1,880,558 |
| Operating expenses | | | | |
| Cost of operations - policy issuance and renewal services | 409,546 | 390,105 | 1,202,903 | 1,160,614 |
| Cost of operations - administrative services | 147,710 | 142,730 | 451,229 | 431,305 |
| Total operating expenses | 557,256 | 532,835 | 1,654,132 | 1,591,919 |
| Operating income | 96,225 | 105,907 | 273,105 | 288,639 |
| Investment income | | | | |
| Net investment income | 7,030 | 8,652 | 22,772 | 25,199 |
| Net realized investment gains | 5,915 | 1,696 | 1,635 | 5,501 |
| Net impairment losses recognized in earnings | (122) | (31) | (3,192) | (193) |
| Equity in earnings (losses) of limited partnerships | 3,615 | 3,289 | (2,419) | 2,546 |
| Total investment income | 16,438 | 13,606 | 18,796 | 33,053 |
| Interest expense, net | 3 | 111 | 8 | 832 |
| Other (expense) income | (964) | 100 | (1,588) | 195 |
| Income before income taxes | 111,696 | 119,502 | 290,305 | 321,055 |
| Income tax expense | 22,480 | 25,333 | 59,786 | 63,821 |
| Net income | \$ 89,216 | \$ 94,169 | \$ 230,519 | \$ 257,234 |
| Net income per share | | | | |
| Class A common stock – basic | \$ 1.92 | \$ 2.02 | \$ 4.95 | \$ 5.52 |
| Class A common stock – diluted | \$ 1.71 | \$ 1.80 | \$ 4.41 | \$ 4.92 |
| Class B common stock – basic | \$ 287 | \$ 303 | \$ 742 | \$ 829 |
| Class B common stock – diluted | \$ 287 | \$ 303 | \$ 742 | \$ 828 |
| Weighted average shares outstanding – Basic | | | | |
| Class A common stock | 46,189,030 | 46,189,006 | 46,188,544 | 46,188,767 |
| Class B common stock | 2,542 | 2,542 | 2,542 | 2,542 |
| Weighted average shares outstanding – Diluted | | | | |
| Class A common stock | 52,310,429 | 52,325,125 | 52,312,588 | 52,317,275 |
| Class B common stock | 2,542 | 2,542 | 2,542 | 2,542 |
| Dividends declared per share | | | | |
| Class A common stock | \$ 0.965 | \$ 0.90 | \$ 2.895 | \$ 2.70 |
| Class B common stock | \$ 144.75 | \$ 135.00 | \$ 434.25 | \$ 405.00 |

See accompanying notes to Financial Statements. See Note 12, "Accumulated Other Comprehensive Income (Loss)", for amounts reclassified out of accumulated other comprehensive income (loss) into the Statements of Operations.

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|------------------|------------------------------------|-------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Net income | \$ 89,216 | \$ 94,169 | \$ 230,519 | \$ 257,234 |
| Other comprehensive income, net of tax | | | | |
| Change in unrealized holding gains on available-for-sale securities | 6,143 | 2,330 | 11,358 | 10,387 |
| Amortization of prior service costs and net actuarial loss on pension and other postretirement plans | 2,659 | 1,231 | 7,979 | 3,694 |
| Total other comprehensive income, net of tax | 8,802 | 3,561 | 19,337 | 14,081 |
| Comprehensive income | <u>\$ 98,018</u> | <u>\$ 97,730</u> | <u>\$ 249,856</u> | <u>\$ 271,315</u> |

See accompanying notes to Financial Statements. See Note 12, "Accumulated Other Comprehensive Income (Loss)", for amounts reclassified out of accumulated other comprehensive income (loss) into the Statements of Operations.

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

| | September 30, 2020 (Unaudited) | December 31, 2019 |
|--|--------------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 216,355 | \$ 336,739 |
| Available-for-sale securities | 13,429 | 32,810 |
| Equity securities | 0 | 2,381 |
| Receivables from Erie Insurance Exchange and affiliates, net | 501,192 | 468,636 |
| Prepaid expenses and other current assets | 52,008 | 44,943 |
| Federal income taxes recoverable | 3,965 | 462 |
| Accrued investment income | 5,973 | 5,433 |
| Total current assets | 792,922 | 891,404 |
| Available-for-sale securities, net | 894,625 | 697,891 |
| Equity securities | 94,435 | 64,752 |
| Limited partnership investments | 10,006 | 26,775 |
| Fixed assets, net | 254,908 | 221,379 |
| Agent loans, net | 58,339 | 60,978 |
| Deferred income taxes, net | 21,618 | 17,186 |
| Other assets | 32,489 | 35,875 |
| Total assets | \$ 2,159,342 | \$ 2,016,240 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Commissions payable | \$ 275,594 | \$ 262,963 |
| Agent bonuses | 85,709 | 96,053 |
| Accounts payable and accrued liabilities | 148,075 | 134,957 |
| Dividends payable | 44,940 | 44,940 |
| Contract liability | 37,420 | 35,938 |
| Deferred executive compensation | 12,701 | 10,882 |
| Current portion of long-term borrowings | 2,021 | 1,979 |
| Total current liabilities | 606,460 | 587,712 |
| Defined benefit pension plans | 169,358 | 145,659 |
| Long-term borrowings | 94,337 | 95,842 |
| Contract liability | 19,140 | 18,435 |
| Deferred executive compensation | 11,335 | 13,734 |
| Other long-term liabilities | 11,495 | 21,605 |
| Total liabilities | 912,125 | 882,987 |
| 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 | 16,487 | 16,483 |
| Accumulated other comprehensive loss | (97,531) | (116,868) |
| Retained earnings | 2,472,181 | 2,377,558 |
| Total contributed capital and retained earnings | 2,393,307 | 2,279,343 |
| Treasury stock, at cost; 22,110,132 shares held | (1,162,917) | (1,158,910) |
| Deferred compensation | 16,827 | 12,820 |
| Total shareholders' equity | 1,247,217 | 1,133,253 |
| Total liabilities and shareholders' equity | \$ 2,159,342 | \$ 2,016,240 |

See accompanying notes to Financial Statements.

ERIE INDEMNITY COMPANY
STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)
Three and nine months ended September 30, 2020
(dollars in thousands, except per share data)

| | Class A common stock | Class B common stock | Additional paid-in-capital | Accumulated other comprehensive (loss) income | Retained earnings | Treasury stock | Deferred compensation | Total shareholders' equity |
|---|-------------------------|-------------------------|-------------------------------|---|-------------------|----------------|--------------------------|-------------------------------|
| Balance, December 31, 2019 | \$ 1,992 | \$ 178 | \$ 16,483 | \$ (116,868) | \$ 2,377,558 | \$ (1,158,910) | \$ 12,820 | \$ 1,133,253 |
| Cumulative effect adjustment ⁽¹⁾ | | | | | (1,075) | | | (1,075) |
| Net income | | | | | 59,326 | | | 59,326 |
| Other comprehensive loss | | | | (29,576) | | | | (29,576) |
| Dividends declared: | | | | | | | | |
| Class A \$0.965 per share | | | | | (44,572) | | | (44,572) |
| Class B \$144.75 per share | | | | | (368) | | | (368) |
| Net purchase of treasury stock ⁽²⁾ | | | 4 | | | 0 | | 4 |
| Deferred compensation | | | | | | (772) | 772 | 0 |
| Balance, March 31, 2020 | \$ 1,992 | \$ 178 | \$ 16,487 | \$ (146,444) | \$ 2,390,869 | \$ (1,159,682) | \$ 13,592 | \$ 1,116,992 |
| Net income | | | | | 81,977 | | | 81,977 |
| Other comprehensive income | | | | 40,111 | | | | 40,111 |
| Dividends declared: | | | | | | | | |
| Class A \$0.965 per share | | | | | (44,573) | | | (44,573) |
| Class B \$144.75 per share | | | | | (368) | | | (368) |
| Net purchase of treasury stock ⁽²⁾ | | | 0 | | | 0 | | 0 |
| Deferred compensation | | | | | | (3,568) | 3,568 | 0 |
| Rabbi trust distribution ⁽³⁾ | | | | | | 704 | (704) | 0 |
| Balance, June 30, 2020 | \$ 1,992 | \$ 178 | \$ 16,487 | \$ (106,333) | \$ 2,427,905 | \$ (1,162,546) | \$ 16,456 | \$ 1,194,139 |
| Net income | | | | | 89,216 | | | 89,216 |
| Other comprehensive income | | | | 8,802 | | | | 8,802 |
| Dividends declared: | | | | | | | | |
| Class A \$0.965 per share | | | | | (44,572) | | | (44,572) |
| Class B \$144.75 per share | | | | | (368) | | | (368) |
| Net purchase of treasury stock ⁽²⁾ | | | 0 | | | 0 | | 0 |
| Deferred compensation | | | | | | (371) | 371 | 0 |
| Balance, September 30, 2020 | \$ 1,992 | \$ 178 | \$ 16,487 | \$ (97,531) | \$ 2,472,181 | \$ (1,162,917) | \$ 16,827 | \$ 1,247,217 |

(1) The cumulative effect adjustment is related to the implementation of new credit loss allowance accounting guidance effective January 1, 2020. See Note 2. "Significant Accounting Policies".

(2) Net purchases of treasury stock in 2020 include the repurchase of our Class A common stock in the open market that were subsequently distributed to satisfy stock based compensation awards.

(3) Distributions of our Class A shares were made from the rabbi trust to a retired director in 2020.

ERIE INDEMNITY COMPANY
STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)
Three and nine months ended September 30, 2019
(dollars in thousands, except per share data)

| | Class A common stock | Class B common stock | Additional paid-in-capital | Accumulated other comprehensive (loss) income | Retained earnings | Treasury stock | Deferred compensation | Total shareholders' equity |
|---|-------------------------|-------------------------|-------------------------------|---|-------------------|----------------|--------------------------|-------------------------------|
| Balance, December 31, 2018 | \$ 1,992 | \$ 178 | \$ 16,459 | \$ (130,284) | \$ 2,231,417 | \$ (1,157,625) | \$ 11,535 | \$ 973,672 |
| Net income | | | | | 75,311 | | | 75,311 |
| Other comprehensive income | | | | 6,710 | | | | 6,710 |
| Dividends declared: | | | | | | | | |
| Class A \$0.90 per share | | | | | (41,570) | | | (41,570) |
| Class B \$135.00 per share | | | | | (343) | | | (343) |
| Net purchase of treasury stock ⁽¹⁾ | | | 24 | | | 0 | | 24 |
| Deferred compensation | | | | | | (1,154) | 1,154 | 0 |
| Balance, March 31, 2019 | \$ 1,992 | \$ 178 | \$ 16,483 | \$ (123,574) | \$ 2,264,815 | \$ (1,158,779) | \$ 12,689 | \$ 1,013,804 |
| Net income | | | | | 87,754 | | | 87,754 |
| Other comprehensive income | | | | 3,810 | | | | 3,810 |
| Dividends declared: | | | | | | | | |
| Class A \$0.90 per share | | | | | (41,570) | | | (41,570) |
| Class B \$135.00 per share | | | | | (344) | | | (344) |
| Net purchase of treasury stock ⁽¹⁾ | | | 0 | | | 0 | | 0 |
| Deferred compensation | | | | | | (443) | 443 | 0 |
| Rabbi trust distribution ⁽²⁾ | | | | | | 922 | (922) | 0 |
| Balance, June 30, 2019 | \$ 1,992 | \$ 178 | \$ 16,483 | \$ (119,764) | \$ 2,310,655 | \$ (1,158,300) | \$ 12,210 | \$ 1,063,454 |
| Net income | | | | | 94,169 | | | 94,169 |
| Other comprehensive loss | | | | 3,561 | | | | 3,561 |
| Dividends declared: | | | | | | | | |
| Class A \$0.90 per share | | | | | (41,570) | | | (41,570) |
| Class B \$135.00 per share | | | | | (343) | | | (343) |
| Net purchase of treasury stock ⁽¹⁾ | | | 0 | | | 0 | | 0 |
| Deferred compensation | | | | | | (320) | 320 | 0 |
| Balance, September 30, 2019 | \$ 1,992 | \$ 178 | \$ 16,483 | \$ (116,203) | \$ 2,362,911 | \$ (1,158,620) | \$ 12,530 | \$ 1,119,271 |

⁽¹⁾ Net purchases of treasury stock in 2019 include the repurchase of our Class A common stock in the open market that were subsequently distributed to satisfy stock based compensation awards.

⁽²⁾ Distributions of our Class A shares were made from the rabbi trust to a retired director in 2019.

See accompanying notes to Financial Statements.

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

| | Nine months ended September 30, | |
|---|------------------------------------|-------------------|
| | 2020 | 2019 |
| Cash flows from operating activities | | |
| Management fee received | \$ 1,434,070 | \$ 1,387,877 |
| Administrative services reimbursements received | 432,133 | 420,697 |
| Service agreement fee received | 19,418 | 20,754 |
| Net investment income received | 26,066 | 25,461 |
| Limited partnership distributions | 751 | 1,596 |
| Commissions paid to agents | (696,447) | (669,618) |
| Agents bonuses paid | (104,301) | (112,262) |
| Salaries and wages paid | (146,420) | (138,279) |
| Employee benefits paid | (24,067) | (31,926) |
| General operating expenses paid | (193,613) | (179,799) |
| Administrative services expenses paid | (440,531) | (424,919) |
| Income taxes paid | (72,576) | (60,863) |
| Interest paid | (5) | (853) |
| Net cash provided by operating activities | 234,478 | 237,866 |
| Cash flows from investing activities | | |
| Purchase of investments: | | |
| Available-for-sale securities | (338,093) | (852,886) |
| Equity securities | (66,847) | (46,536) |
| Limited partnerships | (20) | (20) |
| Other investments | (768) | (252) |
| Proceeds from investments: | | |
| Available-for-sale securities sales | 89,264 | 655,519 |
| Available-for-sale securities maturities/calls | 92,731 | 282,846 |
| Equity securities | 55,000 | 4,505 |
| Limited partnerships | 589 | 3,600 |
| Purchase of fixed assets | (52,289) | (68,363) |
| Loans to agents | (3,773) | (16,458) |
| Collections on agent loans | 5,635 | 5,804 |
| Net cash used in investing activities | (218,571) | (32,241) |
| Cash flows from financing activities | | |
| Dividends paid to shareholders | (134,821) | (125,737) |
| Net payments on long-term borrowings | (1,470) | (1,433) |
| Net cash used in financing activities | (136,291) | (127,170) |
| Net (decrease) increase in cash and cash equivalents | (120,384) | 78,455 |
| Cash and cash equivalents, beginning of period | 336,739 | 266,417 |
| Cash and cash equivalents, end of period | \$ 216,355 | \$ 344,872 |
| Supplemental disclosure of noncash transactions | | |
| Transfer of investments from limited partnerships to equity securities | \$ 13,041 | \$ 0 |
| Operating lease assets obtained in exchange for new operating lease liabilities | \$ 4,107 | \$ 33,678 |
| Liability incurred to purchase fixed assets | \$ 496 | \$ 8,286 |

See accompanying notes to Financial Statements.

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.

Our primary function as attorney-in-fact is to perform policy issuance and renewal services on behalf of the subscribers at the Exchange. We also act as attorney-in-fact on behalf of the Exchange with respect to all claims handling and investment management services, as well as the service provider for all claims handling, life insurance, and investment management services for its insurance subsidiaries, collectively referred to as "administrative services". Acting as attorney-in-fact in these two capacities 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 for acting as attorney-in-fact in these two capacities, we earn a management fee calculated as a percentage of the direct and affiliated assumed premiums written by the Exchange.

The policy issuance and renewal 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. Included in these expenses are allocations of costs for departments that support these policy issuance and renewal functions.

By virtue of its legal structure as a reciprocal insurer, the Exchange does not have any employees or officers. Therefore, it enters into contractual relationships by and through an attorney-in-fact. Indemnity serves as the attorney-in-fact on behalf of the Exchange with respect to its administrative services. The Exchange's insurance subsidiaries also utilize Indemnity for these services in accordance with the service agreements between each of the subsidiaries and Indemnity. Claims handling services include costs incurred in the claims process, including the adjustment, investigation, defense, recording and payment functions. Life insurance management services include costs incurred in the management and processing of life insurance business. Investment management services are related to investment trading activity, accounting and all other functions attributable to the investment of funds. Included in these expenses are allocations of costs for departments that support these administrative functions. The amounts incurred for these services are reimbursed to Indemnity at cost in accordance with the subscriber's agreement and the service agreements. State insurance regulations require that intercompany service agreements and any material amendments be approved in advance by the state insurance department.

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 and cost reimbursements. See Note 13, "Concentrations of Credit Risk".

Coronavirus ("COVID-19").pandemic

On March 11, 2020, the outbreak of the coronavirus ("COVID-19") was declared a global pandemic. The significant volatility in the financial markets, economic disruption and uncertainty resulting from the COVID-19 pandemic that began in the first quarter of 2020 continues to evolve and the pandemic's ultimate impact and duration remain highly uncertain at this time. The Exchange's previously announced rate reductions that became effective in the second half of 2020, coupled with the uncertain economic conditions, will likely continue to constrain the Exchange's premium growth which will impact our management fee revenue. The Exchange's underwriting profitability has improved largely due to declines in claims frequency. The extent and duration of changes in consumer behavior and driving patterns and the resulting impact to the Exchange's growth and financial condition remain uncertain.

The economic conditions resulting from the COVID-19 pandemic may negatively impact the collectability of the Exchange's premiums receivable, however no significant impact has been noted through the date of this report. While our investment

portfolio was negatively impacted by the volatility in the financial markets in the first quarter of 2020, markets substantially recovered during the second and third quarters of 2020. We are unable to predict the duration or extent of the business disruption or the financial impact given the ongoing development of the pandemic and its impacts on the economy and financial markets.

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, 2020 are not necessarily indicative of the results that may be expected for the year ending December 31, 2020. For further information, refer to the financial statements and footnotes included in our Form 10-K for the year ended December 31, 2019 as filed with the Securities and Exchange Commission on February 27, 2020.

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 adopted accounting standards

In June 2016, the Financial Accounting Standards Board issued Accounting Standards Update ("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 current expected credit loss model and credit losses relating to available-for-sale debt securities to be recognized through an allowance for credit losses. We adopted this guidance, which applies to our receivable from Erie Insurance Exchange and affiliates, agent loans and investments, on January 1, 2020.

For assets measured at amortized cost for which a current expected credit loss allowance was required, we adopted the guidance using the modified-retrospective approach. At January 1, 2020, we recorded current expected credit loss allowances related to agent loans of \$0.8 million and receivables from Erie Insurance Exchange and affiliates of \$0.6 million. This resulted in the recording of a cumulative effect adjustment, net of taxes, to retained earnings of \$1.1 million. Our available-for-sale investments are not measured at amortized cost, and therefore do not require the use of a current expected credit loss model. Any credit losses, however, are required to be recorded as an allowance for credit losses rather than a reduction of the carrying value of the asset. For available-for-sale securities, we adopted the guidance using the prospective approach and recorded an initial allowance for credit losses of \$0.6 million at March 31, 2020. The adoption of this standard did not have a material impact on our Statements of Financial Position, net income or net cash flows.

Investments

Available-for-sale securities – Fixed maturity debt securities and redeemable preferred stock are classified as available-for-sale and reported at fair value with unrealized investment gains and losses, net of income taxes, recognized in other comprehensive income. Available-for-sale securities with a remaining maturity of 12 months or less and any security that we intend to sell as of the reporting date are classified as current assets.

Available-for-sale securities in an unrealized loss position are evaluated to determine whether the impairment is a result of credit loss or other factors. If we have the intent to sell or it's more likely than not that we would be required to sell the security before recovery of the amortized cost basis, the entire impairment is recognized in earnings. Securities that have experienced a decline in fair value that we do not intend to sell, and that we will not be required to sell before recovery, are evaluated to determine if the decline in fair value is credit related. Impairment resulting from a credit loss is recognized in earnings with a corresponding allowance on the balance sheet. Future recoveries of credit loss result in an adjustment to the allowance and earnings in the period the credit conditions improve. Factors considered in the evaluation of credit loss include the extent to which fair value is less than cost and fundamental factors specific to the issuer such as financial condition, changes in credit ratings, near and long-term business prospects and other factors, as well as the likelihood of recovery of the amortized cost of the security. If the qualitative review indicates credit impairment, the allowance for credit loss is measured as the amount that the security's amortized cost exceeds the present value of cash flows expected to be collected and is limited to the amount that fair value is below amortized cost.

Realized gains and losses and investment income – Realized gains and losses on sales of available-for-sale and equity securities are recognized in income based upon the specific identification method and reported as net realized investment gains (losses). Interest income is recognized as earned and includes amortization of premium and accretion of discount. Income is recognized based on the constant effective yield method, which includes periodically updated prepayment assumptions obtained from third party data sources on our prepaying securities. The effective yield for prepaying securities is recalculated on a retrospective basis. Dividend income is recognized at the ex-dividend date. Both interest and dividend income are reported as net investment income. We do not record an allowance for credit losses on accrued investment income as any amount deemed uncollectible is reversed from interest income in the period the expected payment defaults.

Agent loans

Agent loans, the majority of which are senior secured, are carried at unpaid principal balance with interest recorded in investment income as earned. The current portion of agent loans is recorded in prepaid expenses and other current assets. The adoption of ASU 2016-13 on January 1, 2020 requires the recording of a current expected credit loss allowance on these loans. The allowance is estimated using available loss history and/or external loss rates based on comparable loan losses and considers current conditions and forecasted information. When establishing the expected credit loss allowance upon implementation of ASU 2016-13, a cumulative effect adjustment was recorded to beginning retained earnings. Future changes to the allowance will be recognized in earnings as adjustments to net impairment losses. Prior to the adoption of ASU 2016-13, we did not record an allowance for credit losses as the majority of these loans are senior secured and have had insignificant default amounts. In the second quarter of 2020, we entered into an agreement with a bank for the establishment of a loan participation program for agent loans. The maximum amount of loans to be funded through this program is \$100 million. We have committed to fund a minimum of 30% of each loan executed through this program. Additionally, we have agreed to guarantee a portion of the funding provided by the other participants in the program upon execution of each loan. In the third quarter of 2020, loans executed under the agreement totaled \$3.1 million, of which our portion of the loans is \$0.9 million, and the related guarantee is \$0.7 million. Our portion of these loans and the related current expected credit loss allowance are recorded in the same manner as our direct agent loans.

Other assets

Other assets include operating lease assets and other long-term prepaid assets. The determination of whether an arrangement is a lease, and the related lease classification, is made at inception of a contract. Our leases are classified as operating leases. Operating lease assets and liabilities are recorded at inception based on the present value of the future minimum lease payments over the lease term at commencement date. When an implicit rate for the lease is not available, we use our incremental borrowing rate based on the information available at commencement date to determine the present value of future payments. Lease terms include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Most of our lease contracts contain lease and non-lease components. Non-lease components are expensed as incurred. Operating lease assets are included in other assets, and the current and noncurrent portions of the operating lease liabilities are included in accounts payable and accrued expenses and other long-term liabilities, respectively.

Note 3. Revenue

The majority of our revenue is derived from the subscriber's agreement between us and the subscribers (policyholders) at the Exchange. Pursuant to the subscriber's agreement, we earn a management fee calculated as a percentage, not to exceed 25%, of all direct and affiliated assumed written premiums of the Exchange.

We allocate a portion of our management fee revenue, currently 25% of the direct and affiliated assumed written premiums of the Exchange, between the two performance obligations we have under the subscriber's agreement. The first performance obligation is to provide policy issuance and renewal services to the subscribers (policyholders) at the Exchange, and the second is to act as attorney-in-fact on behalf of the Exchange, as well as the service provider for its insurance subsidiaries, with respect to all administrative services. The transaction price, including management fee revenue and administrative service reimbursement revenue, is allocated based on the estimated standalone selling prices developed using industry information and other available information for similar services. We update the transaction price allocation annually based upon the most recent information available or more frequently if there have been significant changes in any components considered in the transaction price. In 2020, we are reviewing our transaction price allocation quarterly to consider the most current economic conditions related to the COVID-19 pandemic. These reviews have resulted in no material change to the allocation.

The first performance obligation is to provide policy issuance and renewal services that result in executed insurance policies between the Exchange or one of its insurance subsidiaries and the subscriber (policyholder). Our customer, the subscriber (policyholder), receives economic benefits when substantially all the policy issuance or renewal services are complete and an insurance policy is issued or renewed by the Exchange or one of its insurance subsidiaries. It is at the time of policy issuance or renewal that the allocated portion of revenue is recognized.

The Exchange, by virtue of its legal structure as a reciprocal insurer, does not have any employees or officers. Therefore, it enters into contractual relationships by and through an attorney-in-fact. Indemnity serves as the attorney-in-fact on behalf of the Exchange with respect to its administrative services in accordance with the subscriber's agreement. The Exchange's insurance subsidiaries also utilize Indemnity for these services in accordance with the service agreements between each of the subsidiaries and Indemnity. Collectively, these services represent a second performance obligation under the subscriber's agreement and the service agreements. The revenue allocated to this performance obligation is recognized over time as these services are provided. The portion of revenue not yet earned is recorded as a contract liability in the Statements of Financial Position. The administrative services expenses we incur and the related reimbursements we receive are recorded gross in the Statements of Operations.

Indemnity records a receivable from the Exchange for management fee revenue when the premium is written or assumed by the Exchange. Indemnity collects the management fee from the Exchange when the Exchange collects the premiums from the subscribers (policyholders). As the Exchange issues policies with annual terms only, cash collections generally occur within one year.

A constraining estimate exists around the management fee received as consideration related to the potential for management fee to be returned if a policy were to be cancelled mid-term. Management fees are returned to the Exchange when policyholders cancel their insurance coverage mid-term and unearned premiums are refunded to them. We maintain an estimated allowance to reduce the management fee to its estimated net realizable value to account for the potential of mid-term policy cancellations based on historical cancellation rates. In 2020, our historical cancellation rates were adjusted to include the potential for increased cancellations given the current economic conditions related to the COVID-19 pandemic. The result was a decrease to the allowance of \$0.8 million for the three months ended September 30, 2020 and an increase to the allowance of \$3.6 million for the nine months ended September 30, 2020. There was no change to the allowance for the three months ended September 30, 2019 and an increase of \$2.9 million for the nine months ended September 30, 2019 primarily driven by premium growth.

This estimated allowance has been allocated between the two performance obligations consistent with the revenue allocation proportions.

The following table disaggregates revenue by our two performance obligations:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|--|----------------------------------|------------|---------------------------------|--------------|
| | 2020 | 2019 | 2020 | 2019 |
| Management fee revenue - policy issuance and renewal services, net | \$ 484,551 | \$ 474,427 | \$ 1,412,096 | \$ 1,385,923 |
| Management fee revenue - administrative services, net | 14,910 | 14,430 | 44,494 | 42,576 |
| Administrative services reimbursement revenue | 147,710 | 142,730 | 451,229 | 431,305 |
| Total administrative services | \$ 162,620 | \$ 157,160 | \$ 495,723 | \$ 473,881 |

Note 4. Earnings Per Share

Class A and Class B basic earnings per share and Class B diluted earnings per share are calculated under the two-class method. The two-class method allocates earnings to each class of stock based upon its dividend rights. Class B shares are convertible into Class A shares at a conversion ratio of 2,400 to 1. See Note 11, "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, | | | | | |
|--|-------------------------------------|----------------------------------|------------------|-------------------------------------|----------------------------------|------------------|
| | 2020 | | | 2019 | | |
| | Allocated net income (numerator) | Weighted shares (denominator) | Per-share amount | Allocated net income (numerator) | Weighted shares (denominator) | Per-share amount |
| <i>(dollars in thousands, except per share data)</i> | | | | | | |
| Class A – Basic EPS: | | | | | | |
| Income available to Class A stockholders | \$ 88,486 | 46,189,030 | \$ 1.92 | \$ 93,398 | 46,189,006 | \$ 2.02 |
| Dilutive effect of stock-based awards | 0 | 20,599 | — | 0 | 35,319 | — |
| Assumed conversion of Class B shares | 730 | 6,100,800 | — | 771 | 6,100,800 | — |
| Class A – Diluted EPS: | | | | | | |
| Income available to Class A stockholders on Class A equivalent shares | \$ 89,216 | 52,310,429 | \$ 1.71 | \$ 94,169 | 52,325,125 | \$ 1.80 |
| Class B – Basic EPS: | | | | | | |
| Income available to Class B stockholders | \$ 730 | 2,542 | \$ 287 | \$ 771 | 2,542 | \$ 303 |
| Class B – Diluted EPS: | | | | | | |
| Income available to Class B stockholders | \$ 730 | 2,542 | \$ 287 | \$ 770 | 2,542 | \$ 303 |

| | Nine months ended September 30, | | | | | |
|--|-------------------------------------|----------------------------------|------------------|-------------------------------------|----------------------------------|------------------|
| | 2020 | | | 2019 | | |
| | Allocated net income (numerator) | Weighted shares (denominator) | Per-share amount | Allocated net income (numerator) | Weighted shares (denominator) | Per-share amount |
| <i>(dollars in thousands, except per share data)</i> | | | | | | |
| Class A – Basic EPS: | | | | | | |
| Income available to Class A stockholders | \$ 228,632 | 46,188,544 | \$ 4.95 | \$ 255,128 | 46,188,767 | \$ 5.52 |
| Dilutive effect of stock-based awards | 0 | 23,244 | — | 0 | 27,708 | — |
| Assumed conversion of Class B shares | 1,887 | 6,100,800 | — | 2,106 | 6,100,800 | — |
| Class A – Diluted EPS: | | | | | | |
| Income available to Class A stockholders on Class A equivalent shares | \$ 230,519 | 52,312,588 | \$ 4.41 | \$ 257,234 | 52,317,275 | \$ 4.92 |
| Class B – Basic EPS: | | | | | | |
| Income available to Class B stockholders | \$ 1,887 | 2,542 | \$ 742 | \$ 2,106 | 2,542 | \$ 829 |
| Class B – Diluted EPS: | | | | | | |
| Income available to Class B stockholders | \$ 1,887 | 2,542 | \$ 742 | \$ 2,105 | 2,542 | \$ 828 |

Note 5. Fair Value

Financial instruments carried at fair value

Our available-for-sale and equity 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 equity 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. 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 securities are valued using an exchange traded price provided by the pricing service. Pricing service valuations for Level 2 securities 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.

Although virtually all of our prices are obtained from third party sources, we also perform internal pricing reviews, including evaluating the methodology and inputs used to ensure that we determine the proper classification level of the financial instrument and reviewing securities with price changes that vary significantly from current market conditions or independent price sources. Price variances are investigated and corroborated by market data and transaction volumes. We have reviewed the pricing methodologies of our pricing service as well as other observable inputs and believe that the prices adequately consider market activity in determining fair value.

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.

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. As of September 30, 2020, nearly all of our available-for-sale and equity securities were priced using a third party pricing service.

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

| (in thousands) | September 30, 2020 | | | |
|--|--------------------|-----------|------------|-----------|
| | Total | Level 1 | Level 2 | Level 3 |
| Available-for-sale securities: | | | | |
| Corporate debt securities | \$ 547,877 | \$ 2,689 | \$ 538,158 | \$ 7,030 |
| Residential mortgage-backed securities | 123,726 | 0 | 112,880 | 10,846 |
| Commercial mortgage-backed securities | 113,214 | 0 | 62,981 | 50,233 |
| Collateralized debt obligations | 106,921 | 0 | 106,921 | 0 |
| Other debt securities | 16,316 | 0 | 16,316 | 0 |
| Total available-for-sale securities | 908,054 | 2,689 | 837,256 | 68,109 |
| Equity securities - nonredeemable preferred stock: | | | | |
| Financial services sector | 78,453 | 23,770 | 52,543 | 2,140 |
| Utilities sector | 9,250 | 4,639 | 4,611 | 0 |
| Communications sector | 2,623 | 2,623 | 0 | 0 |
| Consumer sector | 2,269 | 419 | 985 | 865 |
| Energy sector | 1,067 | 0 | 1,067 | 0 |
| Industrial sector | 773 | 773 | 0 | 0 |
| Total equity securities | 94,435 | 32,224 | 59,206 | 3,005 |
| Total | \$ 1,002,489 | \$ 34,913 | \$ 896,462 | \$ 71,114 |

| (in thousands) | December 31, 2019 | | | |
|---|-------------------|-----------|------------|-----------|
| | Total | Level 1 | Level 2 | Level 3 |
| Available-for-sale securities: | | | | |
| Corporate debt securities | \$ 454,880 | \$ 2,683 | \$ 443,873 | \$ 8,324 |
| Residential mortgage-backed securities | 125,343 | 0 | 125,343 | 0 |
| Commercial mortgage-backed securities | 67,541 | 0 | 64,220 | 3,321 |
| Collateralized debt obligations | 77,856 | 0 | 77,856 | 0 |
| Other debt securities | 5,081 | 0 | 5,081 | 0 |
| Total available-for-sale securities | 730,701 | 2,683 | 716,373 | 11,645 |
| Equity securities - nonredeemable preferred and common stock: | | | | |
| Financial services sector | 53,513 | 14,927 | 38,586 | 0 |
| Utilities sector | 6,818 | 3,190 | 3,628 | 0 |
| Communications sector | 3,433 | 3,433 | 0 | 0 |
| Energy sector | 1,881 | 0 | 1,881 | 0 |
| Industrial sector | 980 | 0 | 980 | 0 |
| Consumer sector | 508 | 0 | 508 | 0 |
| Total equity securities | 67,133 | 21,550 | 45,583 | 0 |
| Total | \$ 797,834 | \$ 24,233 | \$ 761,956 | \$ 11,645 |

We review the fair value hierarchy classifications each reporting period. Transfers between hierarchy levels may occur due to changes in available market observable inputs.

Level 3 Assets – 2020 Quarterly Change:

| <i>(in thousands)</i> | Beginning balance at June 30, 2020 | 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, 2020 |
|--|--|--|---|-----------|----------|--|--|--|
| Available-for-sale securities: | | | | | | | | |
| Corporate debt securities | \$ 4,916 | \$ 4 | \$ 157 | \$ 2,258 | \$ (198) | \$ 1,644 | \$ (1,751) | \$ 7,030 |
| Residential mortgage-backed securities | 0 | 0 | 0 | 287 | 0 | 10,559 | 0 | 10,846 |
| Commercial mortgage-backed securities | 18,066 | (47) | 351 | 2,077 | 0 | 29,786 | 0 | 50,233 |
| Collateralized debt obligations | 259 | 0 | (9) | 0 | 0 | 0 | (250) | 0 |
| Total available-for-sale securities | 23,241 | (43) | 499 | 4,622 | (198) | 41,989 | (2,001) | 68,109 |
| Nonredeemable preferred stock | 795 | 194 | 0 | 2,016 | 0 | 0 | 0 | 3,005 |
| Total Level 3 securities | \$ 24,036 | \$ 151 | \$ 499 | \$ 6,638 | \$ (198) | \$ 41,989 | \$ (2,001) | \$ 71,114 |

Level 3 Assets – 2020 Year-to-Date Change:

| <i>(in thousands)</i> | Beginning balance at December 31, 2019 | 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, 2020 |
|--|---|--|---|-----------|------------|--|--|--|
| Available-for-sale securities: | | | | | | | | |
| Corporate debt securities | \$ 8,324 | \$ 9 | \$ (354) | \$ 4,759 | \$ (740) | \$ 9,681 | \$ (14,649) | \$ 7,030 |
| Residential mortgage-backed securities | 0 | 0 | 0 | 287 | 0 | 10,559 | 0 | 10,846 |
| Commercial mortgage-backed securities | 3,321 | (89) | 471 | 9,281 | (287) | 38,677 | (1,141) | 50,233 |
| Collateralized debt obligations | 0 | 0 | 3 | 247 | 0 | 0 | (250) | 0 |
| Total available-for-sale securities | 11,645 | (80) | 120 | 14,574 | (1,027) | 58,917 | (16,040) | 68,109 |
| Nonredeemable preferred stock | 0 | 169 | 0 | 2,836 | 0 | 0 | 0 | 3,005 |
| Total Level 3 securities | \$ 11,645 | \$ 89 | \$ 120 | \$ 17,410 | \$ (1,027) | \$ 58,917 | \$ (16,040) | \$ 71,114 |

Level 3 Assets – 2019 Quarterly Change:

| <i>(in thousands)</i> | Beginning balance at June 30, 2019 | 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, 2019 |
|---|--|--|---|-----------|----------|--|--|--|
| Available-for-sale securities: | | | | | | | | |
| Corporate debt securities | \$ 6,373 | \$ 16 | \$ (92) | \$ 549 | \$ (507) | \$ 1,850 | \$ (1,131) | \$ 7,058 |
| Commercial mortgage-backed securities | 2,551 | (6) | 2 | 0 | (3) | 2,846 | (683) | 4,707 |
| Collateralized debt obligations | 0 | 0 | 0 | 2,300 | 0 | 0 | 0 | 2,300 |
| Total Level 3 available-for-sale securities | \$ 8,924 | \$ 10 | \$ (90) | \$ 2,849 | \$ (510) | \$ 4,696 | \$ (1,814) | \$ 14,065 |

Level 3 Assets – 2019 Year-to-Date Change:

| (in thousands) | Beginning balance at December 31, 2018 | 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, 2019 |
|---|--|-------------------------------------|--|-----------|------------|---------------------------------------|---|--------------------------------------|
| Available-for-sale securities: | | | | | | | | |
| Corporate debt securities | \$ 12,577 | \$ 7 | \$ 199 | \$ 1,283 | \$ (6,779) | \$ 9,244 | \$ (9,473) | \$ 7,058 |
| Residential mortgage-backed securities | 0 | 4 | 15 | 921 | (32) | 0 | (908) | 0 |
| Commercial mortgage-backed securities | 0 | 7 | (6) | 478 | (1,068) | 6,103 | (807) | 4,707 |
| Collateralized debt obligations | 0 | 0 | 0 | 2,300 | 0 | 0 | 0 | 2,300 |
| Total Level 3 available-for-sale securities | \$ 12,577 | \$ 18 | \$ 208 | \$ 4,982 | \$ (7,879) | \$ 15,347 | \$ (11,188) | \$ 14,065 |

(1) These amounts are reported as net investment income and net realized investment gains (losses) for 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.

Quantitative and Qualitative Disclosures about Unobservable Inputs

Investments totaling \$12.0 million and \$1.3 million at September 30, 2020 and December 31, 2019, respectively, were priced using a non-binding broker quote as the only pricing input and were classified within Level 3. The quantitative detail of the unobservable inputs supporting these quotes is neither provided nor reasonably available to us.

Financial instruments not carried at fair value

The following table presents the carrying values and fair values of financial instruments categorized as Level 3 in the fair value hierarchy that are recorded at carrying value as of:

| (in thousands) | September 30, 2020 | | December 31, 2019 | |
|-------------------------------------|--------------------|------------|-------------------|------------|
| | Carrying value | Fair value | Carrying value | Fair value |
| Agent loans ⁽¹⁾ | \$ 64,852 | \$ 66,345 | \$ 67,696 | \$ 71,602 |
| Long-term borrowings ⁽²⁾ | 96,610 | 116,865 | 98,080 | 101,888 |

(1) The discount rate used to calculate fair value at September 30, 2020 is reflective of an increase in the BB+ financial yield curve due to the market volatility resulting from the COVID-19 pandemic.

(2) The discount rate used to calculate fair value at September 30, 2020 is reflective of a decline in U.S. Treasury bond yields due to the market volatility resulting from the COVID-19 pandemic.

Note 6. Investments

Available-for-sale securities

See Note 5, "Fair Value" for additional fair value disclosures. The following tables summarize the cost and fair value, net of credit loss allowance, of our available-for-sale securities as of:

| (in thousands) | September 30, 2020 | | | |
|--|--------------------|------------------------|-------------------------|----------------------|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| Corporate debt securities | \$ 534,902 | \$ 16,904 | \$ 3,929 | \$ 547,877 |
| Residential mortgage-backed securities | 120,268 | 3,470 | 12 | 123,726 |
| Commercial mortgage-backed securities | 109,187 | 4,420 | 393 | 113,214 |
| Collateralized debt obligations | 107,787 | 373 | 1,239 | 106,921 |
| Other debt securities | 15,792 | 542 | 18 | 16,316 |
| Total available-for-sale securities, net | <u>\$ 887,936</u> | <u>\$ 25,709</u> | <u>\$ 5,591</u> | <u>\$ 908,054</u> |

| (in thousands) | December 31, 2019 | | | |
|--|-------------------|------------------------|-------------------------|----------------------|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| Corporate debt securities | \$ 450,295 | \$ 6,289 | \$ 1,704 | \$ 454,880 |
| Residential mortgage-backed securities | 124,337 | 1,056 | 50 | 125,343 |
| Commercial mortgage-backed securities | 67,210 | 479 | 148 | 67,541 |
| Collateralized debt obligations | 78,059 | 44 | 247 | 77,856 |
| Other debt securities | 5,049 | 71 | 39 | 5,081 |
| Total available-for-sale securities, net | <u>\$ 724,950</u> | <u>\$ 7,939</u> | <u>\$ 2,188</u> | <u>\$ 730,701</u> |

The amortized cost and estimated fair value of available-for-sale securities at September 30, 2020 are shown below by remaining contractual term to maturity. 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) | September 30, 2020 | |
|--|--------------------|----------------------|
| | Amortized cost | Estimated fair value |
| Due in one year or less | \$ 13,157 | \$ 13,229 |
| Due after one year through five years | 419,336 | 431,758 |
| Due after five years through ten years | 160,245 | 161,148 |
| Due after ten years | 295,198 | 301,919 |
| Total available-for-sale securities ⁽¹⁾ | <u>\$ 887,936</u> | <u>\$ 908,054</u> |

(1) The contractual maturities of our available-for-sale securities are included in the table. However, given our intent to sell certain impaired securities, these securities are classified as current assets in our Statements of Financial Position at September 30, 2020.

The below securities have been evaluated and determined to be temporary declines in fair value for which we expect to recover our entire principal plus interest. The following table presents available-for-sale securities based on length of time in a gross unrealized loss position as of:

| | September 30, 2020 | | | | | |
|---|---------------------|-------------------|---------------------|-------------------|-------------------|-----------------|
| | Less than 12 months | | 12 months or longer | | Total | |
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | No. of holdings |
| <i>(dollars in thousands)</i> | | | | | | |
| Corporate debt securities | \$ 116,649 | \$ 2,493 | \$ 8,236 | \$ 1,436 | \$ 124,885 | 437 |
| Residential mortgage-backed securities | 17,274 | 12 | 0 | 0 | 17,274 | 11 |
| Commercial mortgage-backed securities | 19,076 | 393 | 0 | 0 | 19,076 | 29 |
| Collateralized debt obligations | 78,166 | 998 | 11,992 | 241 | 90,158 | 97 |
| Other debt securities | 1,057 | 18 | 0 | 0 | 1,057 | 4 |
| Total available-for-sale securities | <u>\$ 232,222</u> | <u>\$ 3,914</u> | <u>\$ 20,228</u> | <u>\$ 1,677</u> | <u>\$ 252,450</u> | <u>578</u> |
| Quality breakdown of available-for-sale securities: | | | | | | |
| Investment grade | \$ 184,738 | \$ 1,916 | \$ 11,992 | \$ 241 | \$ 196,730 | 178 |
| Non-investment grade | 47,484 | 1,998 | 8,236 | 1,436 | 55,720 | 400 |
| Total available-for-sale securities | <u>\$ 232,222</u> | <u>\$ 3,914</u> | <u>\$ 20,228</u> | <u>\$ 1,677</u> | <u>\$ 252,450</u> | <u>578</u> |

| | December 31, 2019 | | | | | |
|---|---------------------|-------------------|---------------------|-------------------|-------------------|-----------------|
| | Less than 12 months | | 12 months or longer | | Total | |
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | No. of holdings |
| <i>(dollars in thousands)</i> | | | | | | |
| Corporate debt securities | \$ 25,804 | \$ 342 | \$ 15,699 | \$ 1,362 | \$ 41,503 | 158 |
| Residential mortgage-backed securities | 16,712 | 50 | 0 | 0 | 16,712 | 7 |
| Commercial mortgage-backed securities | 21,981 | 147 | 372 | 1 | 22,353 | 30 |
| Collateralized debt obligations | 20,889 | 33 | 41,010 | 214 | 61,899 | 49 |
| Other debt securities | 2,350 | 39 | 0 | 0 | 2,350 | 2 |
| Total available-for-sale securities | <u>\$ 87,736</u> | <u>\$ 611</u> | <u>\$ 57,081</u> | <u>\$ 1,577</u> | <u>\$ 144,817</u> | <u>246</u> |
| Quality breakdown of available-for-sale securities: | | | | | | |
| Investment grade | \$ 76,315 | \$ 287 | \$ 46,390 | \$ 218 | \$ 122,705 | 100 |
| Non-investment grade | 11,421 | 324 | 10,691 | 1,359 | 22,112 | 146 |
| Total available-for-sale securities | <u>\$ 87,736</u> | <u>\$ 611</u> | <u>\$ 57,081</u> | <u>\$ 1,577</u> | <u>\$ 144,817</u> | <u>246</u> |

Credit loss allowance on investments

As of September 30, 2020, the current expected credit loss allowance on agent loans is \$1.0 million and the credit loss allowance on available-for-sale securities is \$0.4 million.

Net investment income

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|------------------------------------|----------------------------------|-----------------|---------------------------------|------------------|
| | 2020 | 2019 | 2020 | 2019 |
| <i>(in thousands)</i> | | | | |
| Available-for sale securities | \$ 5,353 | \$ 5,449 | \$ 16,811 | \$ 17,098 |
| Equity securities | 1,178 | 452 | 2,935 | 734 |
| Cash equivalents and other | 1,009 | 2,900 | 4,098 | 8,025 |
| Total investment income | 7,540 | 8,801 | 23,844 | 25,857 |
| Less: investment expenses | 510 | 149 | 1,072 | 658 |
| Investment income, net of expenses | <u>\$ 7,030</u> | <u>\$ 8,652</u> | <u>\$ 22,772</u> | <u>\$ 25,199</u> |

Realized investment gains (losses)

Realized gains (losses) on investments were as follows:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|----------------------------------|----------|---------------------------------|----------|
| | 2020 | 2019 | 2020 | 2019 |
| Available-for-sale securities: | | | | |
| Gross realized gains | \$ 604 | \$ 1,320 | \$ 3,399 | \$ 5,640 |
| Gross realized losses | (467) | (248) | (2,292) | (1,411) |
| Net realized gains on available-for-sale securities | 137 | 1,072 | 1,107 | 4,229 |
| Equity securities | 5,777 | 624 | 525 | 1,272 |
| Miscellaneous | 1 | 0 | 3 | 0 |
| Net realized investment gains | \$ 5,915 | \$ 1,696 | \$ 1,635 | \$ 5,501 |

The portion of net unrealized gains and losses recognized during the reporting period related to equity securities held at the reporting date is calculated as follows:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|--|----------------------------------|--------|---------------------------------|----------|
| | 2020 | 2019 | 2020 | 2019 |
| Equity securities: | | | | |
| Net gains recognized during the period | \$ 5,777 | \$ 624 | \$ 525 | \$ 1,272 |
| Less: net gains (losses) recognized on securities sold | 1,796 | 47 | (1,009) | 47 |
| Net unrealized gains recognized on securities held at reporting date | \$ 3,981 | \$ 577 | \$ 1,534 | \$ 1,225 |

Net impairment losses recognized in earnings

Upon adoption of ASU 2016-13 on January 1, 2020, impairments on available-for-sale securities that are deemed to be credit related are recognized in earnings with a corresponding available-for-sale security allowance. All unrealized losses related to factors other than credit are recorded in other comprehensive income. Prior to January 1, 2020, we had the intent to sell all credit-impaired available-for-sale securities; therefore, the entire amount of the impairment charges was included in earnings and no impairments were recognized in other comprehensive income. See also Note 2, "Significant Accounting Policies".

Impairments on available-for-sale securities and agent loans were as follows:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|--|----------------------------------|-------|---------------------------------|--------|
| | 2020 | 2019 | 2020 | 2019 |
| Available-for-sale securities: | | | | |
| Intent to sell | \$ 37 | \$ 31 | \$ 2,279 | \$ 193 |
| Credit impaired | 85 | — | 743 | — |
| Total available-for-sale securities | 122 | 31 | 3,022 | 193 |
| Agent loans - expected credit losses | 0 | — | 170 | — |
| Net impairment losses recognized in earnings | \$ 122 | \$ 31 | \$ 3,192 | \$ 193 |

Note 7. Leases

The following table summarizes our lease assets and liabilities as of:

| <i>(in thousands)</i> | September 30, 2020 | December 31, 2019 |
|---|--------------------|-------------------|
| Operating lease assets | \$ 16,844 | \$ 22,401 |
| Operating lease liabilities - current | \$ 10,735 | \$ 11,289 |
| Operating lease liabilities - long-term | 5,766 | 10,665 |
| Total operating lease liabilities | \$ 16,501 | \$ 21,954 |

We currently have leases for real estate, technology equipment, copiers, and vehicles. Our largest operating lease asset at September 30, 2020 of \$7.8 million is for office space leased from the Exchange, including the home office. Under this lease, rent is based on rental rates of like property and all operating expenses are the responsibility of the tenant (Indemnity). The lease agreement expires December 31, 2021.

Operating lease costs for the three months ended September 30, 2020 and 2019 were \$3.2 million and \$3.5 million, respectively, and \$9.9 million and \$10.7 million for the nine months ended September 30, 2020 and 2019, respectively. Of this amount, the Exchange and its subsidiaries reimbursed us \$1.3 million and \$1.5 million for the three months ended September 30, 2020 and 2019, respectively, and \$4.1 million and \$4.6 million for the nine months ended September 30, 2020 and 2019, respectively, which represents the allocated share of lease costs supporting administrative services activities.

Note 8. Borrowing Arrangements**Bank line of credit**

As of September 30, 2020, we have access to a \$100 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on October 30, 2023. As of September 30, 2020, 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, 2020.

Investments with a fair value of \$124.6 million were pledged as collateral on the line at September 30, 2020. The investments pledged as collateral have no trading restrictions and are reported as available-for-sale securities and cash and cash equivalents as of September 30, 2020. The banks require compliance with certain covenants, which include leverage ratios and debt restrictions, for our line of credit. We are in compliance with all covenants at September 30, 2020.

Term loan credit facility

In 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. On January 1, 2019, the Credit Facility converted to a fully-amortized term loan with monthly payments of principal and interest at a fixed rate of 4.35% over a period of 28 years. Investments with a fair value of \$126.2 million were pledged as collateral for the facility and are reported as available-for-sale securities and cash and cash equivalents as of September 30, 2020. 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, 2020.

The remaining unpaid balance from the Credit Facility is reported at carrying value on our Statements of Financial Position, net of unamortized loan origination and commitment fees. See Note 5, "Fair Value" for the estimated fair value of these borrowings.

Annual principal payments

The following table sets forth future principal payments:

| <i>(in thousands)</i> | |
|-----------------------|--------------------|
| Year | Principal payments |
| 2020 | \$ 520 |
| 2021 | 2,020 |
| 2022 | 2,110 |
| 2023 | 2,226 |
| 2024 | 2,303 |
| Thereafter | 87,431 |

Note 9. 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 and its subsidiaries reimburse us for approximately 58% of the annual benefit expense of these plans, which represents pension benefits for employees performing administrative services and their allocated share of costs for employees in departments that support the administrative functions.

The cost of our pension plans are as follows:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|--------------------------------------|----------------------------------|-----------------|---------------------------------|------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Service cost for benefits earned | \$ 10,873 | \$ 8,463 | \$ 32,620 | \$ 25,390 |
| Interest cost on benefits obligation | 9,395 | 9,827 | 28,184 | 29,480 |
| Expected return on plan assets | (12,353) | (11,872) | (37,059) | (35,614) |
| Prior service cost amortization | 336 | 349 | 1,007 | 1,046 |
| Net actuarial loss amortization | 3,031 | 1,279 | 9,093 | 3,835 |
| Pension plan cost ⁽¹⁾ | <u>\$ 11,282</u> | <u>\$ 8,046</u> | <u>\$ 33,845</u> | <u>\$ 24,137</u> |

(1) The components of pension plan costs other than the service cost component are included in the line item "Other (expense) income" in the Statements of Operations after reimbursements from the Exchange and its subsidiaries.

Note 10. Income Taxes

Income tax expense is provided on an interim basis based upon our estimate of the annual effective income tax rate, adjusted each quarter for discrete items. For the three months ended September 30, 2020 and 2019, our effective tax rate was 20.1% and 21.2%, respectively, and for the nine months ended September 30, 2020 and 2019 our effective tax rate was 20.6% and 19.9%, respectively. Impacting our effective tax rate in the nine months ended September 30, 2019 was the settlement of an uncertain tax position, which reduced our effective tax rate by 1.3%.

Note 11. 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, 2020 and the year ended December 31, 2019. 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 2011, our Board of Directors approved a continuation of the current stock repurchase program of \$150 million, with no time limitation. There were no shares repurchased under this program during the nine months ended September 30, 2020 and the year ended December 31, 2019. We had approximately \$17.8 million of repurchase authority remaining under this program at September 30, 2020.

Note 12. 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:

| | Three months ended September 30, 2020 | | | Three months ended September 30, 2019 | | |
|--|--|-------------|--------------|--|-------------|--------------|
| | Before Tax | Income Tax | Net | Before Tax | Income Tax | Net |
| <i>(in thousands)</i> | | | | | | |
| Investment securities: | | | | | | |
| AOCI, beginning of period | \$ 12,265 | \$ 2,575 | \$ 9,690 | \$ 1,030 | \$ 216 | \$ 814 |
| OCI before reclassifications | 7,792 | 1,636 | 6,156 | 3,991 | 838 | 3,153 |
| Realized investment gains | (137) | (28) | (109) | (1,072) | (225) | (847) |
| Impairment losses | 122 | 26 | 96 | 31 | 7 | 24 |
| OCI | 7,777 | 1,634 | 6,143 | 2,950 | 620 | 2,330 |
| AOCI, end of period | \$ 20,042 | \$ 4,209 | \$ 15,833 | \$ 3,980 | \$ 836 | \$ 3,144 |
| Pension and other postretirement plans: | | | | | | |
| AOCI (loss), beginning of period | \$ (146,866) | \$ (30,843) | \$ (116,023) | \$ (152,632) | \$ (32,054) | \$ (120,578) |
| Amortization of prior service costs | 335 | 70 | 265 | 349 | 74 | 275 |
| Amortization of net actuarial loss | 3,031 | 637 | 2,394 | 1,210 | 254 | 956 |
| OCI | 3,366 | 707 | 2,659 | 1,559 | 328 | 1,231 |
| AOCI (loss), end of period | \$ (143,500) | \$ (30,136) | \$ (113,364) | \$ (151,073) | \$ (31,726) | \$ (119,347) |
| Total | | | | | | |
| AOCI (loss), beginning of period | \$ (134,601) | \$ (28,268) | \$ (106,333) | \$ (151,602) | \$ (31,838) | \$ (119,764) |
| Investment securities | 7,777 | 1,634 | 6,143 | 2,950 | 620 | 2,330 |
| Pension and other postretirement plans | 3,366 | 707 | 2,659 | 1,559 | 328 | 1,231 |
| OCI | 11,143 | 2,341 | 8,802 | 4,509 | 948 | 3,561 |
| AOCI (loss), end of period | \$ (123,458) | \$ (25,927) | \$ (97,531) | \$ (147,093) | \$ (30,890) | \$ (116,203) |
| | | | | | | |
| | Nine months ended September 30, 2020 | | | Nine months ended September 30, 2019 | | |
| | Before Tax | Income Tax | Net | Before Tax | Income Tax | Net |
| <i>(in thousands)</i> | | | | | | |
| Investment securities: | | | | | | |
| AOCI (loss), beginning of period | \$ 5,664 | \$ 1,189 | \$ 4,475 | \$ (9,169) | \$ (1,926) | \$ (7,243) |
| OCI before reclassifications | 12,463 | 2,617 | 9,846 | 17,185 | 3,609 | 13,576 |
| Realized investment gains | (1,107) | (232) | (875) | (4,229) | (888) | (3,341) |
| Impairment losses | 3,022 | 635 | 2,387 | 193 | 41 | 152 |
| OCI | 14,378 | 3,020 | 11,358 | 13,149 | 2,762 | 10,387 |
| AOCI, end of period | \$ 20,042 | \$ 4,209 | \$ 15,833 | \$ 3,980 | \$ 836 | \$ 3,144 |
| Pension and other postretirement plans: | | | | | | |
| AOCI (loss), beginning of period | \$ (153,600) | \$ (32,257) | \$ (121,343) | \$ (155,749) | \$ (32,708) | \$ (123,041) |
| Amortization of prior service costs | 1,007 | 211 | 796 | 1,046 | 220 | 826 |
| Amortization of net actuarial loss | 9,093 | 1,910 | 7,183 | 3,630 | 762 | 2,868 |
| OCI | 10,100 | 2,121 | 7,979 | 4,676 | 982 | 3,694 |
| AOCI (loss), end of period | \$ (143,500) | \$ (30,136) | \$ (113,364) | \$ (151,073) | \$ (31,726) | \$ (119,347) |
| Total | | | | | | |
| AOCI (loss), beginning of period | \$ (147,936) | \$ (31,068) | \$ (116,868) | \$ (164,918) | \$ (34,634) | \$ (130,284) |
| Investment securities | 14,378 | 3,020 | 11,358 | 13,149 | 2,762 | 10,387 |
| Pension and other postretirement plans | 10,100 | 2,121 | 7,979 | 4,676 | 982 | 3,694 |
| OCI | 24,478 | 5,141 | 19,337 | 17,825 | 3,744 | 14,081 |
| AOCI (loss), end of period | \$ (123,458) | \$ (25,927) | \$ (97,531) | \$ (147,093) | \$ (30,890) | \$ (116,203) |

Note 13. 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 its affiliates. See also Note 1, "Nature of Operations". Net management fee amounts and other reimbursements due from the Exchange and its affiliates were \$501.2 million and \$468.6 million at September 30, 2020 and December 31, 2019, respectively. Given the financial strength of the Exchange and historical experience of no credit losses, we previously did not record a credit loss allowance to these receivables. Upon adoption of ASU 2016-13, we recorded an allowance for current expected credit losses of \$0.6 million related to the receivables from the Exchange and affiliates. See also Note 2, "Significant Accounting Policies". There was no change to this allowance for the three and nine months ended September 30, 2020.

Note 14. Commitments and Contingencies

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 15. Subsequent Events

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

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

The following discussion of financial condition and results of operations highlights significant factors influencing 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, 2019, as contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2020.

INDEX

| | <u>Page Number</u> |
|--|--------------------|
| Cautionary Statement Regarding Forward-Looking Information | 26 |
| Recent Accounting Standards | 27 |
| Operating Overview | 27 |
| Results of Operations | 30 |
| Financial Condition | 36 |
| Liquidity and Capital Resources | 38 |
| Critical Accounting Estimates | 40 |

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:

- potential impacts of the COVID-19 pandemic on the growth and financial condition of the Erie Insurance Exchange ("Exchange");
- potential impacts of the COVID-19 pandemic on our operations, the business operations of our customers and/or independent agents, or our third-party vendor operations;
- dependence upon our relationship with the Exchange and the management fee under the agreement with the subscribers at 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;
- costs of providing policy issuance and renewal services to the Exchange under the subscriber's agreement;
- ability to attract and retain talented management and employees;
- ability to ensure system availability and effectively manage technology initiatives;
- difficulties with technology or data security breaches, including cyber attacks;
- ability to maintain uninterrupted business operations;

- factors affecting the quality and liquidity of our investment portfolio;
- our ability to meet liquidity needs and access capital; and
- outcome of pending and potential litigation.

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 property and casualty insurance. Our primary function as attorney-in-fact is to perform policy issuance and renewal services on behalf of the subscribers at the Exchange. We also act as attorney-in-fact on behalf of the Exchange, as well as the service provider for its insurance subsidiaries, with respect to all administrative services.

The Exchange is a reciprocal insurance exchange, which is an unincorporated association of individuals, partnerships and corporations that agree to insure one another. Each applicant for insurance to the Exchange signs a subscriber's agreement, which contains an appointment of Indemnity as their attorney-in-fact to transact the business of the Exchange on their behalf. Pursuant to the subscriber's agreement for acting as attorney-in-fact in these two capacities, we earn a management fee calculated as a percentage of the direct and affiliated assumed premiums written by the Exchange.

Our earnings are primarily driven by the management fee revenue generated for the services we provide to the Exchange. The policy issuance and renewal 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. Agent compensation generally comprises approximately two-thirds of our policy issuance and renewal 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. Included in these expenses are allocations of costs for departments that support these policy issuance and renewal functions.

By virtue of its legal structure as a reciprocal insurer, the Exchange does not have any employees or officers. Therefore, it enters into contractual relationships by and through an attorney-in-fact. Indemnity serves as the attorney-in-fact on behalf of the Exchange with respect to its administrative services. The Exchange's insurance subsidiaries also utilize Indemnity for these services in accordance with the service agreements between each of the subsidiaries and Indemnity. Claims handling services include costs incurred in the claims process, including the adjustment, investigation, defense, recording and payment functions. Life insurance management services include costs incurred in the management and processing of life insurance business. Investment management services are related to investment trading activity, accounting and all other functions attributable to the investment of funds. Included in these expenses are allocations of costs for departments that support these administrative functions. The amounts incurred for these services are reimbursed to Indemnity at cost in accordance with the subscriber's agreement and the service agreements. State insurance regulations require that intercompany service agreements and any material amendments be approved in advance by the state insurance department.

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 affiliated assumed premiums written by the Exchange. The Exchange generates revenue by insuring preferred and standard risks, with personal lines comprising 71% of the 2019 direct and affiliated 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.

Coronavirus ("COVID-19") pandemic

On March 11, 2020, the outbreak of the coronavirus ("COVID-19") was declared a global pandemic. The significant volatility in the financial markets, economic disruption and uncertainty resulting from the COVID-19 pandemic that began in the first quarter of 2020 continues to evolve and the pandemic's ultimate impact and duration remain highly uncertain at this time.

The impact the COVID-19 pandemic has on the premiums written by the Exchange, our sole customer, affects our management fee revenue. While the Exchange experienced declines in new business premiums in the second quarter of 2020 due to business disruptions and recessionary conditions, new business premiums grew 10.4% in the third quarter of 2020 compared to the same period in 2019, primarily driven by growth in the personal auto and homeowners lines of business. The uncertainty of the ongoing impacts of the COVID-19 pandemic will likely continue in the fourth quarter of 2020 and may continue until such time as the spread of the virus is contained. The Exchange previously announced rate reductions that reduced its premiums and our management fee revenue, which became effective in the third quarter of 2020. There may also be other market and/or regulatory pressures that could impact the Exchange's operations. In the first nine months of 2020, within our cost of operations, we incurred increased agent incentive costs as lower claim frequency resulted in improved agent profitability. We have incurred additional technology costs in support of remote working conditions for our employees. These expenses, among others, could continue to increase as the full extent and duration of the pandemic's impacts remain uncertain. While the financial market volatility had a negative impact on our investment portfolio in the first quarter of 2020, markets substantially recovered during the second and third quarters of 2020, contributing to realized and unrealized gains during these periods. We could experience future losses and/or impairments to the portfolio given the pandemic's impact on market conditions. We have provided additional disclosure of these impacted areas throughout our Management's Discussion and Analysis that follows. A broader discussion of the potential future impacts has also been disclosed in the Financial Condition, Liquidity and Capital Resources, and Part II. Item 1A. "Risk Factors" related to COVID-19 contained within this report.

We have a dedicated internal committee comprised of management from various finance disciplines reviewing our risk positions on an ongoing basis as circumstances are evolving. The committee is reviewing risk scenarios and performing stress tests, including the review of cash flow trends, liquidity requirements and other forms of risk quantification. This provides tools for management, as well as our Risk Committee of the Board of Directors, to assess risks and prioritize key issues.

While we were not required to close our physical locations under the state mandated closure of nonessential services, out of concern for the health and safety of our employees, over 90% of our workforce has been working remote since about March 12, 2020. We have had no significant interruption to our core business processes or systems to date. We have had no significant changes to our financial close or reporting processes or related internal controls, nor do we anticipate any significant future challenges at this time. We have a separate dedicated committee developing a return to the office plan that will be implemented when it becomes feasible and safe.

Financial Overview

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|--------------------------------|----------------------------------|------------|----------|---------------------------------|------------|----------|
| | 2020 | 2019 | % Change | 2020 | 2019 | % Change |
| | (Unaudited) | | | (Unaudited) | | |
| Operating income | \$ 96,225 | \$ 105,907 | (9.1) % | \$ 273,105 | \$ 288,639 | (5.4) % |
| Total investment income | 16,438 | 13,606 | 20.8 | 18,796 | 33,053 | (43.1) |
| Interest expense, net | 3 | 111 | NM | 8 | 832 | NM |
| Other (expense) income | (964) | 100 | NM | (1,588) | 195 | NM |
| Income before income taxes | 111,696 | 119,502 | (6.5) | 290,305 | 321,055 | (9.6) |
| Income tax expense | 22,480 | 25,333 | (11.3) | 59,786 | 63,821 | (6.3) |
| Net income | \$ 89,216 | \$ 94,169 | (5.3) % | \$ 230,519 | \$ 257,234 | (10.4) % |
| Net income per share – diluted | \$ 1.71 | \$ 1.80 | (5.2) % | \$ 4.41 | \$ 4.92 | (10.4) % |

NM = not meaningful

Operating income decreased in both the third quarter and nine months ended September 30, 2020, compared to the same periods in 2019, as growth in operating expenses outpaced the growth in operating revenues. Management fee revenue for policy issuance and renewal services increased 2.1% to \$484.6 million in the third quarter and 1.9% to \$1.4 billion for the nine months ended September 30, 2020, respectively. Management fee revenue is based upon the management fee rate we charge, and the direct and affiliated assumed premiums written by the Exchange. The management fee rate was 25% for both 2020 and 2019. The direct and affiliated assumed premiums written by the Exchange increased 2.0% to \$2.0 billion in the third quarter of 2020 and increased 1.9% to \$5.8 billion for the nine months ended September 30, 2020, compared to the same periods in 2019.

Cost of operations for policy issuance and renewal services increased 5.0% to \$409.5 million and 3.6% to \$1.2 billion in the third quarter and nine months ended September 30, 2020, compared to the same periods in 2019, primarily due to higher commissions driven by direct and affiliated assumed written premium growth and personnel costs.

Management fee revenue for administrative services increased 3.3% to \$14.9 million in the third quarter of 2020 and increased 4.5% to \$44.5 million for the nine months ended September 30, 2020, compared to the same periods in 2019. The administrative services reimbursement revenue and corresponding cost of operations increased both total operating revenue and total operating expenses by \$147.7 million in the third quarter of 2020 and \$451.2 million for the nine months ended September 30, 2020, but had no net impact on operating income.

While our investment portfolio was negatively impacted by the significant disruption to financial markets in the first quarter of 2020, market conditions have substantially recovered during the second and third quarters of 2020. Total investment income increased \$2.8 million in the third quarter of 2020 compared to the third quarter of 2019 primarily driven by increased net realized gains of \$4.2 million, partially offset by decreased net investment income of \$1.6 million. Total investment income decreased \$14.3 million during the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019 driven by decreased limited partnership results of \$5.0 million, decreased net realized gains of \$3.9 million, increased impairment losses of \$3.0 million, and decreased net investment income of \$2.4 million.

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. The extent to which economic conditions could impact the Exchange's operations and our management fee was exacerbated with the COVID-19 pandemic. The extent and duration of the impacts to economic conditions remain uncertain as the pandemic continues to evolve. See Financial Condition, Liquidity and Capital Resources, and Part II, Item 1A. "Risk Factors" contained within this report for a discussion of the potential impacts of the COVID-19 pandemic on our operations.

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. Significant volatility has been seen in the global financial markets since the outbreak of the COVID-19 pandemic. The extent of the impact on our invested assets cannot be estimated with a high degree of certainty at this time given the ongoing developments of this pandemic and the related impacts on the financial markets.

RESULTS OF OPERATIONS

Management fee revenue

We have two performance obligations in the subscriber's agreement, providing policy issuance and renewal services and acting as attorney-in-fact for the Exchange, as well as the service provider for its insurance subsidiaries, with respect to all administrative services. We earn management fees for acting as the attorney-in-fact for the subscribers at the Exchange in these two capacities, and allocate our revenues between our performance obligations.

The management fee is calculated by multiplying all direct and affiliated assumed premiums written by the Exchange by 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 2020 and 2019. Changes in the management fee rate can affect our revenue and net income significantly. The transaction price, including management fee revenue and administrative service reimbursement revenue, is allocated based on the estimated standalone selling prices developed using industry information and other available information for similar services. We update the transaction price allocation annually based upon the most recent information available or more frequently if there have been significant changes in any components considered in the transaction price. In 2020, we are reviewing our transaction price allocation quarterly to consider the most current economic conditions related to the COVID-19 pandemic. These reviews have resulted in no material change to the allocation.

The following table presents the allocation and disaggregation of revenue for our two performance obligations:

| (dollars in thousands) | Three months ended September 30, | | | Nine months ended September 30, | | |
|--|----------------------------------|-------------------|----------|---------------------------------|---------------------|----------|
| | 2020 | 2019 | % Change | 2020 | 2019 | % Change |
| | (Unaudited) | | | (Unaudited) | | |
| Policy issuance and renewal services | | | | | | |
| Direct and affiliated assumed premiums written by the Exchange | \$ 1,999,074 | \$ 1,960,441 | 2.0 % | \$ 5,849,505 | \$ 5,738,554 | 1.9 % |
| Management fee rate | 24.2% | 24.2% | | 24.2% | 24.2% | |
| Management fee revenue | 483,776 | 474,427 | 2.0 | 1,415,580 | 1,388,730 | 1.9 |
| Change in allowance for management fee returned on cancelled policies ⁽¹⁾ | 775 | 0 | NM | (3,484) | (2,807) | (24.1) |
| Management fee revenue - policy issuance and renewal services, net | <u>\$ 484,551</u> | <u>\$ 474,427</u> | 2.1 % | <u>\$ 1,412,096</u> | <u>\$ 1,385,923</u> | 1.9 % |
| Administrative services | | | | | | |
| Direct and affiliated assumed premiums written by the Exchange | \$ 1,999,074 | \$ 1,960,441 | 2.0 % | \$ 5,849,505 | \$ 5,738,554 | 1.9 % |
| Management fee rate | 0.8% | 0.8% | | 0.8% | 0.8% | |
| Management fee revenue | 15,993 | 15,683 | 2.0 | 46,796 | 45,908 | 1.9 |
| Change in contract liability ⁽²⁾ | (1,064) | (1,241) | 14.3 | (2,247) | (3,293) | 31.8 |
| Change in allowance for management fee returned on cancelled policies ⁽¹⁾ | (19) | (12) | (65.0) | (55) | (39) | (41.6) |
| Management fee revenue - administrative services, net | 14,910 | 14,430 | 3.3 | 44,494 | 42,576 | 4.5 |
| Administrative services reimbursement revenue | 147,710 | 142,730 | 3.5 | 451,229 | 431,305 | 4.6 |
| Total revenue from administrative services | <u>\$ 162,620</u> | <u>\$ 157,160</u> | 3.5 % | <u>\$ 495,723</u> | <u>\$ 473,881</u> | 4.6 % |

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. This estimated allowance has been allocated between the two performance obligations consistent with the revenue allocation proportion. The potential for a greater number of mid-term cancellations as a result of the COVID-19 pandemic was taken into consideration in the determination of this allowance in the 2020 periods presented.
- (2) Management fee revenue - administrative services is recognized over time as the services are performed. See Part I, Item 1. "Financial Statements - Note 3, Revenue, of Notes to Financial Statements" contained within this report.

Direct and affiliated assumed premiums written by the Exchange

Direct and affiliated assumed premiums include premiums written directly by the Exchange and premiums assumed from its wholly owned property and casualty subsidiaries. Direct and affiliated assumed premiums written by the Exchange increased 2.0% to \$2.0 billion in the third quarter of 2020 compared to the third quarter of 2019, primarily driven by an increase in new personal lines premiums written. Year-over-year policies in force for all lines of business increased 1.7% in the third quarter of 2020 compared to 2.2% in the third quarter of 2019. The year-over-year average premium per policy for all lines of business increased 0.8% at September 30, 2020 compared to 3.4% at September 30, 2019. The year-over-year average premium per policy at September 30, 2020 was impacted by the previously announced rate reductions for our personal and commercial auto policies as a result of the COVID-19 pandemic.

Premiums generated from new business increased 10.4% to \$244 million in the third quarter of 2020 primarily driven by increases in personal auto and homeowners premiums written compared to the same period in 2019. While year-over-year average premium per policy on new business decreased 4.6% at September 30, 2020, new business policies written increased 19.7% in the third quarter of 2020. Premiums generated from new business decreased 3.7% to \$221 million in the third quarter of 2019. While year-over-year average premium per policy on new business increased 6.6% at September 30, 2019, new business policies written decreased 8.9% in the third quarter of 2019. Premiums generated from renewal business increased 0.9% to \$1.8 billion in the third quarter of 2020 compared to the third quarter of 2019. Underlying the trend in renewal business premiums was an increase in year-over-year average premium per policy of 1.5% at September 30, 2020, driven by continuing strong policyholder retention, compared to 2.9% at September 30, 2019.

Personal lines – Total personal lines premiums written increased 1.8% to \$1.5 billion in the third quarter of 2020, primarily driven by increases in new premiums written of 19.7% compared to the third quarter of 2019. Total personal lines policies in force increased 1.8% in the third quarter of 2020 and total personal lines year-over-year average premium per policy increased 0.3% compared to the same period last year. While the impacts of the COVID-19 pandemic, including changes in consumer behavior and driving patterns, among others, significantly reduced new personal policies written in the second quarter of 2020, new personal policies written increased 22.3% in the third quarter of 2020, compared to the same period last year. In the third quarter of 2019, new personal policies written decreased by 9.3%.

Commercial lines – Total commercial lines premiums written increased 2.5% to \$543 million in the third quarter of 2020 compared to the third quarter of 2019, driven by a 1.4% increase in total commercial lines policies in force and a 2.1% increase in total commercial lines year-over-year average premium per policy. While there was a significant reduction in new commercial policies written in the second quarter of 2020 as a result of the business disruptions and unfavorable economic conditions related to the COVID-19 pandemic, new commercial policies written increased 4.0% in the third quarter of 2020 compared to the same period last year. This third quarter activity was primarily driven by an increase in commercial auto policies written that was partially offset by a decrease in workers' compensation policies written. In the third quarter of 2019, new commercial policies written decreased 5.9%.

Future trends-premium revenue – Changes in premium levels attributable to the growth in policies in force and rate changes directly affect the profitability of the Exchange and have a direct bearing on our management fee. The COVID-19 pandemic may have a negative impact on the Exchange's premiums, and therefore our management fees, given recessionary economic conditions and related declines in consumer activity and demand for certain services, as well as the potential for sustained changes in driving patterns. In response to reduced exposure given lower driving activity, and to provide financial relief to policyholders as a result of the COVID-19 pandemic, the Exchange previously announced \$200 million in personal and commercial auto rate reductions that take effect at the time of policy initiations or renewal, beginning July 1, 2020. Through the third quarter of 2020, the rate reductions resulted in an estimated decrease of \$41 million in Exchange written premiums and a corresponding decrease of \$10 million in our management fee revenue. An estimated \$49 million decrease in written premium and \$12 million in corresponding management fee revenue related to the rate reductions is expected in the fourth quarter of 2020. The remaining reduction will impact both the Exchange's written premium and our management fee revenue in 2021. Future premiums could also be impacted by potential regulatory changes resulting from the COVID-19 pandemic.

Through a careful agency selection process, the Exchange plans to continue its effort to expand the size of its agency force to increase market penetration in existing operating territories to contribute to future growth. While our agents initially experienced business declines resulting from disruptions created by the COVID-19 pandemic, there have been no significant disruptions in their operations. The continued impacts of the COVID-19 pandemic could make it difficult for our independent agents to write new business and retain existing business and/or constrain our ability to recruit new agents.

The extent of the impact to the Exchange's premiums and our management fee cannot be estimated with a high degree of certainty at this time given the ongoing developments related to this pandemic. See also Part II. Item 1A. "Risk Factors" contained within this report.

Policy issuance and renewal services

| (dollars in thousands) | Three months ended September 30, | | | Nine months ended September 30, | | |
|--|----------------------------------|------------|----------|---------------------------------|--------------|----------|
| | 2020 | 2019 | % Change | 2020 | 2019 | % Change |
| | (Unaudited) | | | (Unaudited) | | |
| Management fee revenue - policy issuance and renewal services, net | \$ 484,551 | \$ 474,427 | 2.1 % | \$ 1,412,096 | \$ 1,385,923 | 1.9 % |
| Service agreement revenue | 6,310 | 7,155 | (11.8) | 19,418 | 20,754 | (6.4) |
| | 490,861 | 481,582 | 1.9 | 1,431,514 | 1,406,677 | 1.8 |
| Cost of policy issuance and renewal services | 409,546 | 390,105 | 5.0 | 1,202,903 | 1,160,614 | 3.6 |
| Operating income - policy issuance and renewal services | \$ 81,315 | \$ 91,477 | (11.1) % | \$ 228,611 | \$ 246,063 | (7.1) % |

Policy issuance and renewal services

We allocate a portion of the management fee, which currently equates to 24.2% of the direct and affiliated assumed premiums written by the Exchange, for providing policy issuance and renewal services. This portion of the management fee is recognized as revenue when the policy is issued or renewed because it is at that time that the services we provide are substantially complete and the executed insurance policy is transferred to the customer. The increase in management fee revenue for policy issuance and renewal services was driven by the increase in the direct and affiliated assumed premiums written by the Exchange discussed previously.

Service agreement revenue

Service agreement revenue includes service charges we collect from subscribers/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. The decrease in service agreement revenue for the three and nine months ended 2020 reflects the continued shift to payment plans that do not incur service charges or offer a premium discount for certain payment methods.

Cost of policy issuance and renewal services

| (dollars in thousands) | Three months ended September 30, | | | Nine months ended September 30, | | |
|--|----------------------------------|------------|----------|---------------------------------|--------------|----------|
| | 2020 | 2019 | % Change | 2020 | 2019 | % Change |
| | (Unaudited) | | | (Unaudited) | | |
| <i>Commissions:</i> | | | | | | |
| Total commissions | \$ 273,184 | \$ 266,983 | 2.3 % | \$ 803,658 | \$ 783,221 | 2.6 % |
| <i>Non-commission expense:</i> | | | | | | |
| Underwriting and policy processing | \$ 40,674 | \$ 37,497 | 8.5 % | \$ 121,917 | \$ 115,942 | 5.2 % |
| Information technology | 42,940 | 41,891 | 2.5 | 128,253 | 121,885 | 5.2 |
| Sales and advertising | 12,111 | 12,501 | (3.1) | 39,356 | 37,703 | 4.4 |
| Customer service | 8,650 | 8,006 | 8.0 | 25,860 | 24,342 | 6.2 |
| Administrative and other | 31,987 | 23,227 | 37.7 | 83,859 | 77,521 | 8.2 |
| Total non-commission expense | 136,362 | 123,122 | 10.8 | 399,245 | 377,393 | 5.8 |
| Total cost of policy issuance and renewal services | \$ 409,546 | \$ 390,105 | 5.0 % | \$ 1,202,903 | \$ 1,160,614 | 3.6 % |

Commissions – Commissions increased \$6.2 million in the third quarter of 2020 and \$20.4 million for the nine months ended September 30, 2020 compared to the same periods in 2019, primarily resulting from higher commissions driven by direct and affiliated assumed written premium growth. Increases in agent incentive compensation in the nine months ended September 30, 2020 also contributed to the increase in commission expenses compared to the same periods in 2019. The estimated agent incentive payouts at September 30, 2020 are based on actual underwriting results for the two prior years and current year-to-date actual results and forecasted results for the remainder of 2020. Therefore, fluctuations in the current quarter underwriting results can impact the estimated incentive payout on a quarter-to-quarter basis. The Exchange experienced a significant decrease in automobile claims frequency and related loss expense beginning in March 2020 that continued through May 2020 driven by the impacts of the COVID-19 pandemic. Claims frequency increased in June 2020 and maintained consistent levels

through September 2020. If a sustained period of lower claims frequency and loss expenses occurs, our agent compensation could increase related to the profitability component of the agent incentive bonuses.

Non-commission expense – Non-commission expense increased \$13.2 million in the third quarter of 2020 compared to the third quarter of 2019. Underwriting and policy processing expense increased \$3.2 million primarily due to increased personnel costs and underwriting report costs. Administrative and other costs increased \$8.8 million primarily driven by higher incentive plan award accruals due to the Exchange's lower combined ratio and the change in the company stock price, which experienced an increase in the third quarter of 2020 compared to a decrease in the same period in 2019. Increased professional fees also contributed to the increase in administrative and other costs compared to the same period in 2019.

Non-commission expense increased \$21.9 million in the nine months ended September 30, 2020 compared to the same period in 2019. Information technology costs increased \$6.4 million primarily due to increases in hardware and software costs, personnel costs, and professional fees. Underwriting and policy processing expense increased \$6.0 million primarily due to increases in personnel costs and underwriting report costs. Administrative and other costs increased \$6.3 million primarily driven by increases in personnel costs and professional fees. Increased personnel costs in all categories included higher incentive plan award accruals due to the Exchange's lower combined ratio and higher vacation accruals as employees took less vacation in the first nine months of 2020 as a result of the COVID-19 pandemic.

Administrative services

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---|----------------------------------|-----------|----------|---------------------------------|-----------|----------|
| | 2020 | 2019 | % Change | 2020 | 2019 | % Change |
| (dollars in thousands) | (Unaudited) | | | (Unaudited) | | |
| Management fee revenue - administrative services, net | \$ 14,910 | \$ 14,430 | 3.3 % | \$ 44,494 | \$ 42,576 | 4.5 % |
| Administrative services reimbursement revenue | 147,710 | 142,730 | 3.5 | 451,229 | 431,305 | 4.6 |
| Total revenue allocated to administrative services | 162,620 | 157,160 | 3.5 | 495,723 | 473,881 | 4.6 |
| Administrative services expenses | | | | | | |
| Claims handling services | 127,055 | 124,566 | 2.0 | 390,832 | 376,061 | 3.9 |
| Investment management services | 9,373 | 8,088 | 15.9 | 26,783 | 25,273 | 6.0 |
| Life management services | 11,282 | 10,076 | 12.0 | 33,614 | 29,971 | 12.2 |
| Operating income - administrative services | \$ 14,910 | \$ 14,430 | 3.3 % | \$ 44,494 | \$ 42,576 | 4.5 % |

Administrative services

We allocate a portion of the management fee, which currently equates to 0.8% of the direct and affiliated assumed premiums written by the Exchange, to the administrative services. This portion of the management fee is recognized as revenue over a four-year period representing the time over which the services are provided. We also report reimbursed costs as revenues, which are recognized monthly as services are provided. The administrative services expenses we incur and the related reimbursements we receive are recorded gross in the Statements of Operations.

Cost of administrative services

By virtue of its legal structure as a reciprocal insurer, the Exchange does not have any employees or officers. Therefore, it enters into contractual relationships by and through an attorney-in-fact. Indemnity serves as the attorney-in-fact on behalf of the Exchange with respect to its administrative services in accordance with the subscriber's agreement. The Exchange's insurance subsidiaries also utilize Indemnity for these services in accordance with the service agreements between each of the subsidiaries and Indemnity. The amounts incurred for these services are reimbursed to Indemnity at cost in accordance with the subscriber's agreement and the service agreements. We record these reimbursements due from the Exchange and its insurance subsidiaries as a receivable.

Total investment income

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

| (dollars in thousands) | Three months ended September 30, | | | Nine months ended September 30, | | |
|---|----------------------------------|------------------|----------|---------------------------------|------------------|----------|
| | 2020 | 2019 | % Change | 2020 | 2019 | % Change |
| | (Unaudited) | | | (Unaudited) | | |
| Net investment income | \$ 7,030 | \$ 8,652 | (18.7) % | \$ 22,772 | \$ 25,199 | (9.6) % |
| Net realized investment gains | 5,915 | 1,696 | NM | 1,635 | 5,501 | (70.3) |
| Net impairment losses recognized in earnings | (122) | (31) | NM | (3,192) | (193) | NM |
| Equity in earnings (losses) of limited partnerships | 3,615 | 3,289 | 9.9 | (2,419) | 2,546 | NM |
| Total investment income | <u>\$ 16,438</u> | <u>\$ 13,606</u> | 20.8 % | <u>\$ 18,796</u> | <u>\$ 33,053</u> | (43.1) % |

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 decreased \$1.6 million in the third quarter of 2020 and \$2.4 million for the nine months ended September 30, 2020, compared to the same periods in 2019. The results from both periods were primarily due to decreased income generated from cash and cash equivalents driven by lower rates and invested balances, somewhat offset by increased preferred stock dividends resulting from higher invested balances.

Net realized investment 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, | |
|--|----------------------------------|-----------------|---------------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| | (Unaudited) | | (Unaudited) | |
| Securities sold: | | | | |
| Available-for-sale securities | \$ 137 | \$ 1,072 | \$ 1,107 | \$ 4,229 |
| Equity securities | 1,194 | (37) | (1,334) | (37) |
| Equity securities change in fair value | 4,583 | 661 | 1,859 | 1,309 |
| Miscellaneous | 1 | 0 | 3 | 0 |
| Net realized investment gains | <u>\$ 5,915</u> | <u>\$ 1,696</u> | <u>\$ 1,635</u> | <u>\$ 5,501</u> |

Net realized gains during the third quarter and nine months ended September 30, 2020 were primarily due to market value adjustments on equity securities. Net realized gains during the third quarter and nine months ended September 30, 2019 were primarily driven by gains from sales of available-for-sale securities and market value adjustments on equity securities.

Net impairment losses recognized in earnings

Net impairment losses recognized on available-for-sale securities during the nine months ended September 30, 2020 include \$2.3 million of securities in an unrealized loss position where we had intent to sell prior to recovery of our amortized cost basis and \$0.7 million of credit impairment losses. The remaining impairments include the change in the current expected credit loss allowance related to our agent loans. The COVID-19 pandemic's impact on financial markets contributed to higher impairment losses on our available-for-sale securities during the first nine months of 2020 compared to the same period in 2019.

Equity in earnings (losses) of limited partnerships

Limited partnership results for both the third quarter and nine months ended September 30, 2020 compared to the same periods in 2019 were primarily due to activity in the private equity sector.

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 through assessing its financial stability and 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", the second highest financial strength rating, which is assigned to companies that 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. On July 8, 2020, the outlook for the financial strength rating was affirmed as stable. As of December 31, 2019, only approximately 12% of insurance groups, in which the Exchange is included, are rated A+ or higher.

The financial statements of the Exchange are prepared in accordance with statutory accounting principles prescribed by the Commonwealth of Pennsylvania. Financial statements prepared under statutory accounting principles focus on the solvency of the insurer and generally provide a more conservative approach than under U.S. generally accepted accounting principles. Statutory direct written premiums of the Exchange and its wholly owned property and casualty subsidiaries grew 1.9% to \$5.8 billion for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019. 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 \$10.0 billion at September 30, 2020, \$9.5 billion at December 31, 2019, and \$9.1 billion at September 30, 2019. The Exchange and its wholly owned property and casualty subsidiaries' year-over-year policy retention ratio continues to be high at 89.9% at September 30, 2020, 90.0% at December 31, 2019, and 90.1% at September 30, 2019.

We have prepared our financial statements considering the financial strength of the Exchange based on its A.M. Best rating and strong level of surplus. We are monitoring risks related to the COVID-19 pandemic on an ongoing basis and believe that the Exchange falls within defined risk tolerances. However, see Part II. Item 1A. "Risk Factors" for possible outcomes that could impact that determination.

FINANCIAL CONDITION

The financial market conditions resulting from the COVID-19 pandemic substantially recovered during the second and third quarters of 2020, which resulted in a favorable impact on our investment portfolio; however, we could experience further reductions in the market value of our investment portfolio as long as market conditions remain volatile in response to the developments of this pandemic and the related economic impacts.

Investments

Our investment portfolio is managed with the objective of maximizing after-tax returns on a risk-adjusted basis. The following table presents the carrying value of our investments as of:

| <i>(dollars in thousands)</i> | September 30, 2020 | % to total | December 31, 2019 | % to total |
|-------------------------------|--------------------|------------|-------------------|------------|
| | (Unaudited) | | | |
| Fixed maturities | \$ 908,054 | 84 % | \$ 730,701 | 82 % |
| Equity securities: | | | | |
| Preferred stock | 94,435 | 9 | 64,752 | 7 |
| Common stock | 0 | 0 | 2,381 | 0 |
| Limited partnerships | 10,006 | 1 | 26,775 | 3 |
| Agent loans ⁽¹⁾ | 64,852 | 6 | 67,696 | 8 |
| Other investments | 2,223 | 0 | 1,430 | 0 |
| Total investments | \$ 1,079,570 | 100 % | \$ 893,735 | 100 % |

(1) The current portion of agent loans is included with prepaid expenses and other current assets in the Statements of Financial Position.

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.

Fixed maturities 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, totaled \$15.9 million at September 30, 2020, compared to net unrealized gains of \$4.5 million at December 31, 2019.

The following table presents a breakdown of the fair value of our fixed maturity portfolio by industry sector and rating as of:

| <i>(in thousands)</i> | September 30, 2020 ⁽¹⁾ | | | | | |
|--------------------------------------|-----------------------------------|------------|------------|------------|----------------------|------------|
| | AAA | AA | A | BBB | Non-investment grade | Fair value |
| | (Unaudited) | | | | | |
| Basic materials | \$ 0 | \$ 0 | \$ 3,287 | \$ 4,037 | \$ 8,081 | \$ 15,405 |
| Communications | 0 | 8,913 | 12,005 | 19,372 | 15,358 | 55,648 |
| Consumer | 0 | 3,257 | 25,204 | 69,764 | 37,708 | 135,933 |
| Diversified | 0 | 0 | 0 | 1,070 | 730 | 1,800 |
| Energy | 0 | 7,547 | 4,714 | 17,888 | 10,213 | 40,362 |
| Financial | 0 | 1,031 | 58,676 | 113,931 | 10,548 | 184,186 |
| Industrial | 0 | 0 | 10,207 | 11,980 | 14,545 | 36,732 |
| Structured securities ⁽²⁾ | 142,196 | 178,866 | 29,097 | 10,018 | 0 | 360,177 |
| Technology | 0 | 5,311 | 12,319 | 18,594 | 12,610 | 48,834 |
| Utilities | 0 | 0 | 3,943 | 19,430 | 5,604 | 28,977 |
| Total | \$ 142,196 | \$ 204,925 | \$ 159,452 | \$ 286,084 | \$ 115,397 | \$ 908,054 |

(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 and commercial mortgage-backed securities, collateralized debt obligations, and asset-backed securities.

Equity securities

Equity securities consist of nonredeemable preferred and common stock and are carried at fair value in the Statements of Financial Position with all changes in unrealized gains and losses reflected in the Statements of Operations.

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

| (in thousands) | September 30, 2020 | | December 31, 2019 | |
|--------------------|--------------------|--------------|-------------------|-----------------|
| | Preferred stock | Common stock | Preferred stock | Common stock |
| | (Unaudited) | | | |
| Communication | \$ 2,623 | \$ 0 | \$ 1,052 | \$ 2,381 |
| Consumer | 2,269 | 0 | 508 | 0 |
| Energy | 1,067 | 0 | 1,881 | 0 |
| Financial services | 78,453 | 0 | 53,513 | 0 |
| Industrial | 773 | 0 | 980 | 0 |
| Utilities | 9,250 | 0 | 6,818 | 0 |
| Total | <u>\$ 94,435</u> | <u>\$ 0</u> | <u>\$ 64,752</u> | <u>\$ 2,381</u> |

LIQUIDITY AND CAPITAL RESOURCES

We continue to monitor the sufficiency of our liquidity and capital resources given the potential impact of the COVID-19 pandemic. We did not see a significant impact on our sources or uses of cash in the first nine months of 2020. However, we may experience future reductions in our management fee revenue if the Exchange's premium growth is constrained. Also, future disruptions in the markets could occur which may affect our liquidity position. There is potential that the funding requirements for our costs of operations will increase related to agent compensation and technology costs, among others. If our normal operating and investing cash activities were to become insufficient to meet future funding requirements, we believe we have sufficient access to liquidity through our cash position, liquid marketable securities and our \$100 million line of credit that does not expire until October 2023. See broader discussions of potential risks to our operations in the Operating Overview and Part II. Item 1A. "Risk Factors" contained within this report.

Sources and Uses of Cash

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

Volatility in the financial markets presents challenges to us as we do occasionally access our investment portfolio as a source of cash. Some of our fixed income investments, despite being publicly traded, may be illiquid. Volatility in these markets could impair our ability to sell certain fixed income securities or cause such securities to sell at deep discounts. We believe we have sufficient liquidity to meet our needs from sources other than the liquidation of securities, even if market volatility persists throughout 2020 and beyond.

Cash flow activities

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

| | 2020 (Unaudited) | 2019 (Unaudited) |
|--|---------------------|---------------------|
| Net cash provided by operating activities | \$ 234,478 | \$ 237,866 |
| Net cash used in investing activities | (218,571) | (32,241) |
| Net cash used in financing activities | (136,291) | (127,170) |
| Net (decrease) increase in cash and cash equivalents | <u>\$ (120,384)</u> | <u>\$ 78,455</u> |

Net cash provided by operating activities was \$234.5 million in the first nine months of 2020, compared to \$237.9 million in the first nine months of 2019. Decreased cash provided by operating activities in the nine months of 2020 was primarily due to an increase in cash paid for agent commissions of \$26.8 million due to higher scheduled commissions driven by premium growth, increased administrative services expenses paid of \$15.6 million, and increased income taxes paid of \$11.7 million. Offsetting the decrease in cash provided by operating activities was an increase of \$46.2 million in management fee received driven by growth in direct and affiliated assumed premiums written by the Exchange in the nine months of 2020 compared to the same period in 2019.

Net cash used in investing activities was \$218.6 million in the first nine months of 2020, compared to \$32.2 million in the same period in 2019. In the first nine months of 2020, net cash used in investing activities was primarily driven by purchases of available-for-sale and equity securities \$404.9 million, offset by proceeds generated from investment sales and maturities/calls of \$182.0 million. In the first nine months of 2019, net cash used in investing activities was primarily driven by purchases of available-for-sale and equity securities \$899.4 million, offset by proceeds generated from investment sales and maturities/calls of \$938.4 million due to portfolio rebalancing. Fixed asset purchases decreased \$16.1 million over the prior year driven primarily by decreased costs related to the home office expansion as the project is nearing completion. We have a commitment for the remaining costs related to the construction of the building that will serve as part of our principal headquarters. Of the total expected cost of \$115 million, which was funded primarily by the senior secured draw term loan credit facility, \$104.8 million of costs have been paid as of September 30, 2020.

Net cash used in financing activities totaled \$136.3 million in the first nine months of 2020, compared to \$127.2 million in the first nine months of 2019. The increase in cash used was due to dividends paid to shareholders. Dividends paid to shareholders totaled \$134.8 million in the first nine months of 2020 and \$125.7 million in the first nine months of 2019. We increased both

our Class A and Class B shareholder regular quarterly dividends by 7.2% for 2020, compared to 2019. There are no regulatory restrictions on the payment of dividends to our shareholders. Future financing activities also include the principal payments due annually over the term of the senior secured draw term loan credit facility, of which \$0.5 million will be paid during the remainder of 2020.

There were no repurchases of our Class A nonvoting common stock in the first nine months of 2020 and 2019 in conjunction with our stock repurchase program. In 2011, our Board of Directors approved a continuation of the current stock repurchase program of \$150 million with no time limitation. This repurchase authority includes, and is not in addition to, any unspent amounts remaining under the prior authorization. We had approximately \$17.8 million of repurchase authority remaining under this program at September 30, 2020, based upon trade date.

During the nine months ended September 30, 2020, we purchased 28,155 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$5.0 million. Of this amount, we purchased 1,787 shares for \$0.3 million, or \$165.82 per share, for stock-based awards in conjunction with our equity compensation plan. We purchased 4,785 shares for \$0.9 million, or \$178.98 per share, to fund the rabbi trust for the outside director deferred stock compensation plan. The remaining 21,583 shares were purchased at a total cost of \$3.8 million, or \$178.62 per share, to fund the rabbi trust for the incentive compensation deferral plan. All shares were delivered as of September 30, 2020.

During the nine months ended September 30, 2019, we purchased 13,399 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$2.4 million. Of this amount, we purchased 3,246 shares for \$0.4 million, or \$132.35 per share, for stock-based awards in conjunction with our equity compensation plan. We purchased 5,844 shares for \$1.2 million, or \$198.17 per share, to fund the rabbi trust for the outside director deferred stock compensation plan. The remaining 4,309 shares were purchased at a total cost of \$0.8 million, or \$176.26 per share, to fund the rabbi trust for the incentive compensation deferral plan. All shares were delivered as of September 30, 2019.

Capital Outlook

We regularly prepare forecasts evaluating the current and future cash requirements for both normal and extreme risk events, including the current COVID-19 pandemic. Should an extreme risk event result in a cash requirement exceeding normal cash flows, we have the ability to meet our future funding requirements through various alternatives available to us.

Outside of our normal operating and investing cash activities, future funding requirements could be met through: 1) cash and cash equivalents, which total approximately \$216.4 million at September 30, 2020, 2) a \$100 million bank revolving line of credit, and 3) liquidation of unpledged assets held in our investment portfolio, including preferred stock and investment grade bonds, which totaled approximately \$644.8 million at September 30, 2020. Volatility in the financial markets could impair our ability to sell certain fixed income securities or cause such securities to sell at deep discounts. Additionally, we have the ability to curtail or modify discretionary cash outlays such as those related to shareholder dividends and share repurchase activities.

As of September 30, 2020, we have access to a \$100 million bank revolving line of credit with a \$25 million letter of credit sublimit that expires on October 30, 2023. As of September 30, 2020, 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, 2020. Investments with a fair value of \$124.6 million were pledged as collateral on the line at September 30, 2020. The investments pledged as collateral have no trading restrictions and are reported as available-for-sale securities and cash and cash equivalents in the Statements of Financial Position. The banks require compliance with certain covenants, which include leverage ratios and debt restrictions. We were in compliance with our bank covenants at September 30, 2020.

Off-Balance Sheet Arrangements and Contractual Obligations

Off-balance sheet arrangements include those with unconsolidated entities that may have a material current or future effect on our financial condition or results of operations, including material variable interests in unconsolidated entities that conduct certain activities. We have no material off-balance sheet obligations. As of September 30, 2020, there were no material changes to our future contractual obligations as previously reported in our Annual Report on Form 10-K for the year ended December 31, 2019.

CRITICAL ACCOUNTING ESTIMATES

We make estimates and assumptions that have a significant effect on the amounts and disclosures reported in the financial statements. The most significant estimates relate to investment valuation and retirement benefit plans for employees. While management believes its estimates are appropriate, the ultimate amounts may differ from estimates provided. Our most critical accounting estimates are described in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for the year ended December 31, 2019 of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 27, 2020. See Part I, Item 1. "Financial Statements - Note 5, Fair Value, of Notes to Financial Statements" contained within this report for additional information on our valuation of investments.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is primarily related to fluctuations in prices and interest rates. Quantitative and qualitative disclosures about market risk resulting from changes in prices, interest rates, and other risk exposures for the year ended December 31, 2019 are included in Item 7A. "Quantitative and Qualitative Disclosures About Market Risk", of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 27, 2020.

While there were no material changes to our reported market risks during the nine months ended September 30, 2020, there were significant disruptions in the financial markets during the first quarter of 2020 that have affected prices for many securities due to increased economic uncertainty resulting from the COVID-19 pandemic. While increased economic uncertainty remains, market conditions substantially recovered during the second and third quarters of 2020, including improved liquidity and tightening of credit spreads.

For a recent discussion of conditions surrounding our investment portfolio, see the "Operating Overview", "Results of Operations", and "Financial Condition" discussions contained in Part I, Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained within this report.

ITEM 4. CONTROLS AND PROCEDURES

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

Our management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, any change in our internal control over financial reporting and determined there has been no change in our internal control over financial reporting during the nine months ended September 30, 2020 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

State Court Lawsuit Against Erie Indemnity Company

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

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

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

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

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

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

On September 12, 2016, Plaintiffs filed a motion to stay the Sullivan lawsuit pending the outcome of the Federal Court Lawsuit they filed against Indemnity and former and current Directors of Indemnity on July 8, 2016. (See below.) Indemnity filed an opposition to Plaintiff's motion to stay on September 19, 2016; and filed amended preliminary objections seeking dismissal of the Sullivan lawsuit on September 20, 2016. The motion to stay and the amended preliminary objections remain pending. On June 27, 2018, Plaintiffs filed a motion for a status conference in the Sullivan lawsuit.

On July 30, 2018, the Court held a status conference and thereafter lifted the stay of proceedings. On September 28, 2018, Indemnity filed a Motion to Enforce the Federal Judgment in the Beltz II lawsuit, seeking dismissal of the Sullivan lawsuit with prejudice. On October 26, 2018, Plaintiffs filed an opposition to that Motion; and Indemnity filed a reply in further support on November 5, 2018. Oral argument was held on Indemnity's Motion to Enforce the Federal Judgment on November 20, 2018 and on July 30, 2019. The Motion to Enforce the Federal Judgment remains pending.

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

Federal Court Lawsuit Against Erie Indemnity Company and Directors

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

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

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

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

The allegations of the Beltz II lawsuit arise from the same fundamental, underlying claims as the Sullivan and prior Beltz litigation, i.e., that Indemnity improperly retained Service Charges and Added Service Charges. The Beltz II lawsuit alleges that the retention of the Service Charges and Added Service Charges was improper because, for among other reasons, that retention constituted a breach of the Subscriber's Agreement and an Implied Covenant of Good Faith and Fair Dealing by Indemnity, breaches of fiduciary duty by Indemnity and the other defendants, conversion by Indemnity, and unjust enrichment by defendants Jonathan Hirt Hagen, Thomas B. Hagen, and Elizabeth A. Hirt Vorsheck, at the expense of Exchange. The Beltz II lawsuit requests, among other things, that a judgment be entered against the Defendants certifying the action as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure; declaring Plaintiffs as representatives of the Class and Plaintiffs' counsel as counsel for the Class; declaring the conduct alleged as unlawful, including, but not limited to, Defendants' retention of the Service Charges and Added Service Charges; enjoining Defendants from continuing to retain the Service Charges and Added Service Charges; and awarding compensatory and punitive damages and interest.

On September 23, 2016, Indemnity filed a motion to dismiss the Beltz II lawsuit. On September 30, 2016, the Directors filed their own motions to dismiss the Beltz II lawsuit. On July 17, 2017, the Court granted Indemnity's and the Directors' motions to dismiss the Beltz II lawsuit, dismissing the case in its entirety. The Court ruled that "the Subscriber's Agreement does not govern the separate and additional charges at issue in the Complaint" and, therefore, dismissed the breach of contract claim against Indemnity for failure to state a claim. The Court also ruled that the remaining claims, including the claims for breach of fiduciary duty against Indemnity and the Directors, are barred by the applicable statutes of limitation or fail to state legally cognizable claims. On August 14, 2017, Plaintiffs filed a notice of appeal to the United States Court of Appeals for the Third Circuit.

On May 10, 2018, the United States Court of Appeals for the Third Circuit affirmed the District Court's dismissal of the Beltz II lawsuit. On May 24, 2018, Plaintiffs filed a petition seeking rehearing of their appeal before the Third Circuit. The Third Circuit denied that petition on June 14, 2018.

For additional information on contingencies, see Part I, Item 1. "Financial Statements - Note 14, Commitments and Contingencies, of Notes to Financial Statements".

ITEM 1A. RISK FACTORS

Our business involves various risks and uncertainties, including, but not limited to those discussed in this section. The risks and uncertainties described in the risk factors below, or any additional risk outside of those discussed below, could have a material adverse effect on our business, financial condition, operating results, cash flows, or liquidity if they were to develop into actual events. This information should be considered carefully together with the other information contained in this report and in other reports and materials we file periodically with the Securities and Exchange Commission ("SEC").

The risk factors listed below should be read in conjunction with the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019 as filed with the SEC on February 27, 2020. These risk factors address risks specific to the COVID-19 pandemic and related economic conditions. While we believe the risk factors in our Form 10-K filed with the SEC on February 27, 2020 generally address the risks of a pandemic on our business, we have included these disclosures to provide additional details specific to the COVID-19 pandemic.

Serving as the attorney-in-fact in the reciprocal insurance exchange structure results in the Exchange being our sole customer. We have an interest in the growth and financial condition of the Exchange as our earnings are largely generated from management fees based on the direct and affiliated assumed premiums written by the Exchange. If the impacts of the COVID-19 pandemic impair the Exchange's ability to grow or its financial condition, it could have a material adverse effect on our business, financial condition, results of operations, or cash flows.

On March 11, 2020, the World Health Organization declared the outbreak of COVID-19 a global pandemic. The significant volatility in the financial markets, economic disruption and uncertainty resulting from the COVID-19 pandemic that began in the first quarter of 2020 continues to evolve and the pandemic's ultimate impact and duration remain highly uncertain at this time. Initial efforts to contain the spread of the virus included the closure of nonessential businesses and stay at home orders. As businesses and communities start to re-open, current efforts have shifted the focus to the establishment and enforcement of safety protocols. If a second wave of the virus occurs or effective medical treatments are not identified, future restrictions and a prolonged recession remain a possibility. The resulting effects, including a decline in consumer activity, lower demand for certain services, high unemployment, payroll declines, and reduced personal income may cause customers to modify coverages, not renew or cancel policies, which may have a negative impact on the Exchange's written premiums, and therefore our management fees. While certain coverage modifications were experienced through the third quarter of 2020, primarily related to reduced usage/mileage in the private passenger automobile line of business, the modifications did not result in a material impact to the Exchange's written premiums, however, the extent and duration of the effects on future customer demand and buying practices remains uncertain. A specific action taken by the Exchange both in response to changes in exposure as less driving occurs and to provide financial relief to the policyholders has resulted in a certain reduction to the Exchange's written premiums. In a Form 8-K filed with the SEC on April 9, 2020, the Exchange and its subsidiaries announced an estimated \$200 million in personal and commercial auto rate reductions effective beginning July 1, 2020 at the time of new policy issuance or policy renewal. Through the third quarter of 2020, the rate reductions resulted in an estimated decrease of \$41 million in Exchange written premiums and a corresponding decrease of \$10 million in our management fee revenue. An estimated \$49 million decrease in written premium and \$12 million in corresponding management fee revenue related to the rate reductions is expected in the fourth quarter of 2020. The remaining reduction will impact both the Exchanges' written premium and our management fee revenue in 2021. An additional action taken by the Exchange that does not impact Indemnity was the payment of a policyholder dividend directly to personal and commercial auto policyholders equal to approximately 30% of their premium for two months. Longer term, there could be sustained changes in driving patterns if working remotely becomes more common and accepted, potentially having a negative impact on premium revenues. Further declines in economic conditions, potential regulatory actions, or competitive pressure could also impact Exchange's rates and written premium, and therefore our management fees.

The Exchange is represented by independent agencies that serve as its sole distribution channel. The economic impact of the pandemic on independent agents' business operations or systems capabilities could make it difficult for independent agents to write new business and retain existing business and/or constrain the ability to recruit new agents, thereby impeding premium growth. While independent agents have been able to work remotely or safely in their offices, a second wave of the virus could adversely impact their operations and their ability to write new business and provide service to existing policyholders. More broadly, independent agents may face challenges sustaining their own business operations and financial conditions that could result in the sale or closure of their businesses, thereby reducing the agency force of the Exchange. Further, the COVID-19 pandemic could be an accelerant to shifting consumer behaviors toward increased digital interactions.

The unknown risks related to the COVID-19 pandemic may cause additional uncertainty in the process of estimating loss and loss adjustment expense reserves. For example, the behavior of claimants and policyholders may change in unexpected ways, the disruption to the court system may impact the timing and amounts of claims settlements, and the actions taken by

governmental bodies, both legislative and regulatory, in reaction to COVID-19 and their related impacts are hard to predict. As a result, the Exchange's estimated level of loss and loss adjustment expense reserves may change.

The Exchange's financial condition could be impacted by defaults or delays in collecting premiums from customers due to economic hardships. Regulatory actions including temporary suspension of policy cancellations for the nonpayment of premiums and relaxing due dates for premium payments could also have a negative impact to the Exchange. If there were legislative action to retroactively mandate coverage irrespective of terms, exclusions or other conditions included in business interruption policies that would otherwise preclude coverage, this would have a significant impact on the financial condition, results of operations and cash flows of the Exchange.

The Exchange and its subsidiaries have been named as defendants in a number of pandemic-related lawsuits and, therefore, are subject to the risks and uncertainties of such litigation. There is also a risk that the Exchange could suffer reputational harm if any actions taken are not viewed as sufficient responses to the pandemic by customers or consumer organizations

While the Exchange's investment portfolio was negatively impacted by the significant disruption to financial markets in the first quarter of 2020 as a result of the COVID-19 pandemic, market conditions have substantially recovered during the second and third quarters of 2020. The value of the Exchange's invested assets could be adversely impacted and there is potential for further impairments on its investment portfolio as long as market conditions remain volatile in response to the developments of this pandemic and the related economic impacts.

The duration and extent of the impact on the Exchange's business, strategy, financial condition, results of operations and cash flows cannot be estimated with a high degree of certainty at this time given the ongoing developments of this pandemic and the related impacts on the economy and financial markets.

The effect of the COVID-19 pandemic on our operations, the business operations of our customers and/or independent agents, or our third-party vendor operations, could have a material adverse effect on our business, financial condition, results of operations, or cash flows.

If the COVID-19 pandemic results in conditions that constrain the Exchange's ability to grow its written premiums, our management fee revenue could be negatively impacted. We expect that certain expenses within our cost of operations will increase as a result of the pandemic, including but not limited to agent compensation, technology costs, and potentially healthcare costs, among others. Our agent incentive bonuses include a profitability component. If claims frequency and loss expenses continue to decline, the profitability component of our agent incentive bonuses will continue to improve, increasing our agent compensation costs. Technology costs may increase as a result of supporting remote work capabilities for our employees. There is a potential for increased healthcare costs for treatments of the COVID-19 virus if a significant number of our employees and/or their dependents were to become infected. Also, future pension costs could increase as a result of a lower discount rate or investment returns related to the adverse market conditions caused by the COVID-19 pandemic.

Our business continuity plans were implemented upon the outbreak of this pandemic, including transitioning the vast majority of our employees and third-party contractors to remote work capabilities. We have had no significant interruption to our core business processes or systems to date. We have processes in place with our critical third-party vendors to understand impacts on their business and their business continuity plans. We have had no significant interruption to any third-party vendor relationships, business processes or systems to date. No significant challenges have been identified in our, or our third-party vendor's ongoing business continuity plans, however if future challenges were to arise, this could result in an adverse effect on our business, financial condition, results of operations or cash flows. Also, while we have not experienced any delays in internal initiatives to date, future challenges could arise that impact the timing and execution of certain initiatives. Having shifted to remote working arrangements, we also face a heightened risk of cybersecurity attacks or data security incidents. Through the third quarter, cyber threats have remained at a constant level, however, new cybersecurity tactics, techniques, and practices continue to evolve. Additionally, we are more dependent on internet and telecommunications access and capabilities. If we experience difficulties with technology, data and network security, telecommunications access, outsourcing relationships or cloud-based technology, our ability to conduct our business could be negatively impacted.

Indemnity's workforce providing services for the Exchange are largely concentrated in Erie, Pennsylvania. If a significant outbreak affects the labor force in this area, or if a significant operating function had a high level of infections at one time, it could impact the policy acquisition, underwriting, claims and/or support services provided to the policyholders of the Exchange and/or our independent agents.

With the increasing number of COVID-19 related disputes, there is a risk that Indemnity could become subject to pandemic related litigation. It is also possible that changes in economic conditions and steps taken by federal, state and local governments

in response to COVID-19 could require an increase in taxes at the federal, state and local levels, which would adversely impact our results of operations.

While Indemnity's investment portfolio was negatively impacted by the significant disruption to financial markets in the first quarter of 2020 as a result of the COVID-19 pandemic, market conditions have substantially recovered during the second and third quarters of 2020. The value of our invested assets could be adversely impacted and there is potential for further impairments in our investment portfolio as long as market conditions remain volatile in response to the developments of this pandemic and the related economic impacts.

The duration and extent of the impact on our business, strategy, financial condition, results of operations and cash flows cannot be estimated with a high degree of certainty at this time given the ongoing developments of this pandemic and the related impacts on the economy and financial markets.

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

Issuer Purchases of Equity Securities

In 2011, our Board of Directors approved a continuation of the current stock repurchase program, authorizing repurchases for a total of \$150 million with no time limitation. This repurchase authority included, and was not in addition to, any unspent amounts remaining under the prior authorization. There were no repurchases of our Class A common stock under this program during the nine months ending September 30, 2020. We had approximately \$17.8 million of repurchase authority remaining under this program at September 30, 2020.

During the quarter ending September 30, 2020, we purchased 1,745 shares of our outstanding Class A nonvoting common stock outside of our publicly announced share repurchase program at a total cost of \$0.4 million. We purchased 176 shares for \$37 thousand, or \$212.71 per share, in August 2020 to fund the rabbi trust for the incentive compensation deferral plan. The remaining 1,569 shares were purchased in August 2020 at a total cost of \$0.3 million, or \$212.71 per share, to fund the rabbi trust for the outside director deferred stock compensation plan. The shares for both plans were transferred to the rabbi trust in August 2020.

ITEM 6. EXHIBITS

| <u>Exhibit Number</u> | <u>Description of Exhibit</u> |
|---------------------------|--|
| 31.1* | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32* | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS* | Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document. |
| 101.SCH* | Inline XBRL Taxonomy Extension Schema Document. |
| 101.CAL* | Inline XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF* | Inline XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB* | Inline XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE* | Inline XBRL Taxonomy Extension Presentation Linkbase Document. |
| 104* | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101). |

* Filed herewith.

SIGNATURES

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

Erie Indemnity Company

(Registrant)

Date: October 29, 2020

By: /s/ Timothy G. NeCastro

Timothy G. NeCastro, President & CEO

By: /s/ Gregory J. Gutting

Gregory J. Gutting, Executive Vice President & CFO

Exhibit 31.1

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Timothy G. NeCastro, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Erie Indemnity Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 29, 2020

/s/ Timothy G. NeCastro

Timothy G. NeCastro
President & CEO

Exhibit 31.2

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Gregory J. Gutting, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Erie Indemnity Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 29, 2020

/s/ Gregory J. Gutting

Gregory J. Gutting

Executive Vice President & CFO

Exhibit 32

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

We, Timothy G. NeCastro, Chief Executive Officer of the Erie Indemnity Company (the "Company"), and Gregory J. Gutting, Chief Financial Officer of the Company, certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. § 1350, that:

- (1) The Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2020 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Timothy G. NeCastro

Timothy G. NeCastro

President & CEO

/s/ Gregory J. Gutting

Gregory J. Gutting

Executive Vice President & CFO

October 29, 2020

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.