PROGRESSIVE CORP/OH/
Form 10-K
February 27, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

þ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2007

or

o **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 1-9518
THE PROGRESSIVE CORPORATION

(Exact name of registrant as specified in its charter)

Ohio	34-0963169
(State or other jurisdiction incorporation or organization)	(I.R.S. Employer Identification No.)
6300 Wilson Mills Road, Mayfield Village, Ohio	44143
(Address of principal executive offices)	(Zip Code)

(440) 461-5000

(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares, $1.00 Par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

(Title of class)

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes þ No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

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

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2007: $16,060,333,034

The number of the registrant s Common Shares, $1.00 par value, outstanding as of January 31, 2008: 678,367,604

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for the Annual Meeting of Shareholders to be held on April 18, 2008, to be filed on or about March 7, 2008, and the Annual Report to Shareholders for the year ended December 31, 2007, included as Exhibit 13 to this Form 10-K, are incorporated by reference in Parts I, II, III and IV hereof.

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INTRODUCTION

Portions of the information included in The Progressive Corporation s Proxy Statement to be filed on or about March 7, 2008, for the Annual Meeting of Shareholders to be held on April 18, 2008 (the Proxy Statement) have been incorporated by reference herein and are identified under the appropriate items in this Form 10-K. The 2007 Annual Report to Shareholders (the Annual Report) of The Progressive Corporation and subsidiaries, which will be attached as an Appendix to the 2008 Proxy Statement, is included as Exhibit 13 to this Form 10-K. Cross references to relevant sections of the Annual Report are included under the appropriate items of this Form 10-K.

PART I

ITEM 1. BUSINESS

(a) General Development of Business

The Progressive insurance organization began business in 1937. The Progressive Corporation, an insurance holding company formed in 1965, currently has 65 subsidiaries and 1 mutual insurance company affiliate. Progressive s insurance subsidiaries and affiliate provide personal and commercial automobile insurance and other specialty property-casualty insurance and related services throughout the United States. Our property-casualty insurance products protect our customers against losses due to collision and physical damage to their motor vehicles and uninsured and underinsured bodily injury, and liability to others for personal injury or property damage arising out of the use of those vehicles. Our non-insurance subsidiaries generally support our insurance and investment operations.

(b) Financial Information About Segments

Incorporated by reference from *Note 9 Segment Information*, beginning on page App.-A-22 of the Annual Report, which is included as Exhibit 13 to this Form 10-K.

(c) Narrative Description of Business

We offer a number of personal and commercial property-casualty insurance products primarily related to motor vehicles. Net premiums written were $13.8 billion in 2007, compared to $14.1 billion in 2006 and $14.0 billion in 2005. Our combined ratio, calculated in accordance with accounting principles generally accepted in the United States of America (GAAP), was 92.6 in 2007, 86.7 in 2006 and 88.1 in 2005.

Organization

We write private passenger auto insurance and the majority of our special lines products in 49 states; we expect to begin writing private passenger auto in Massachusetts during the second quarter 2008 and special lines later in the year. We also write private passenger auto in the District of Columbia. We write commercial auto policies in 49 states; we do not currently write commercial auto in Hawaii or the District of Columbia.

Auto insurance differs greatly by community because regulations and legal decisions vary by state and because, among other factors, traffic, law enforcement, cultural attitudes, insurance agents, medical services and auto repair services vary by community. To respond to these local differences, we are organized as follows:

Our Personal Lines product management group is organized by state into four geographical regions, led by a general manager for each region for our private passenger auto products. The special lines product management group is organized by product and led by a general manager.

Our Commercial Auto Business is organized by state with product managers responsible for local implementation. These state-level managers are led by a general manager.

Our Claims business area is organized into six geographical regions, with a general manager responsible for each region.

Our business area general managers each report to one of our Group Presidents (discussed below).

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Our Customer Service groups, located at call centers in Mayfield Village, Ohio; Austin, Texas; Tampa, Florida; Sacramento, California; Tempe, Arizona; and Colorado Springs, Colorado, support our underwriting and claims operations.

Our executive management team sets policy and makes key strategic decisions and includes the Chief Executive Officer, Chief Financial Officer, Chief Legal Officer, Chief Investment Officer, Chief Information Officer and Chief Human Resource Officer, as well as our three Group Presidents (Personal Lines, Commercial Lines and Claims). The Group Presidents are responsible for the development and management of our product offerings and customer service processes that are tailored to the unique characteristics and purchasing preferences of customers who shop for and select our insurance products.

Personal Lines

Our Personal Lines segment writes insurance for private passenger automobiles and recreational and other vehicles. This business generally offers more than one program in a single state, with each program targeted to a specific distribution channel, market or customer group. The Personal Lines Business accounted for 87% of total net premiums written in 2007, compared to 86% in 2006 and 87% in 2005. Our strategy is to be the low-cost provider of a full line of auto insurance products with superior service, distributed through whichever channel the customer prefers.

We ranked third in industry market share for 2006 based on net premiums written, and believe that we are in a virtual tie for third for 2007. There are approximately 370 competitors in the total private passenger auto market. Progressive and the other leading 15 private passenger auto insurers, each of whom write over $2 billion of premiums, comprise about 75% of this market. For 2007, the estimated industry net premiums written for personal auto insurance in the United States was $160.8 billion, and our share of this market was approximately 7.2%, compared to $160.2 billion and 7.4%, respectively, in 2006, and $159.6 billion and 7.5% in 2005. Except as otherwise noted, all industry data and our market share or ranking in the industry either were derived directly from data reported by A.M. Best Company, Inc. (A.M. Best) or were estimated using A.M. Best data as the primary source.

Private passenger automobile insurance represented 90% of our total Personal Lines net premiums written in 2007, compared to 91% in 2006 and 92% in 2005. Volume potential is driven by our price competitiveness, brand recognition, service quality and the actions of our competitors, among other factors. See Competitive Factors on page 5 of this report for further discussion.

Our specialty Personal Lines products include insurance for motorcycles, recreational vehicles, mobile homes, watercraft, snowmobiles and similar items. Due to the nature of these products, we typically experience higher losses during the warmer weather months. Our competitors are specialty companies and large multi-line insurance carriers. Although industry figures are not available, based on our analysis of this market, we believe that we are one of the largest participants in the specialty personal lines market, and that we have been the market share leader for personal watercraft insurance since 2002 and for the motorcycle product since 1998.

We also started offering a Personal Umbrella insurance product in select markets in 2006. This product was expanded in 2007 and is currently being offered through certain independent agents in 13 states and to Direct business customers in three states. We plan to continue to expand this product to an additional 12 states for the Agency business in 2008. We will continue to evaluate the customer service experience through the Direct channel before determining to what extent and how to expand this product offering to additional markets during 2008.

The Personal Lines Business is generated either by independent agents and brokers or written directly online or by phone. The Agency business includes business written by our network of more than 30,000 independent insurance agencies located throughout the United States, as well as brokerages in New York and California. These independent insurance agents and brokers have the ability to place business with Progressive for specified insurance coverages within prescribed underwriting guidelines, subject to compliance with company-mandated procedures. Our guidelines prescribe the kinds and amounts of coverage that may be written and the premium rates that may be charged for specified categories of risk. The agents and brokers do not have authority on behalf of Progressive to establish underwriting guidelines, develop rates, settle or adjust claims, or enter into other transactions or commitments. The Agency business also writes through strategic alliance business relationships with other insurance companies, financial institutions and national agencies. In 2007, the total net premiums written through the Agency business represented 63% of our Personal Lines volume, compared to 64% in 2006 and 66% in 2005.

The Direct business includes business written directly by us online and over the phone. Net premiums written in the Direct business were 37%, 36% and 34% of our Personal Lines volume in 2007, 2006 and 2005, respectively.

Commercial Auto

The Commercial Auto Business writes primary liability and physical damage insurance for automobiles and trucks owned by small businesses and represented 13% of our total net premiums written in 2007, compared to 14% in 2006 and 13% in 2005. The majority of our Commercial Auto customers insure three or fewer vehicles. The Commercial Auto Business, which is primarily distributed through the independent agency channel, operates in the specialty truck and business auto markets. The specialty truck commercial auto market, which accounts for slightly more than half of the total Commercial Auto premiums and approximately 40% of the vehicles we insure in this business, includes dump trucks, logging trucks, tow trucks, local cartage and other short-haul commercial vehicles. The remainder is in the business auto market, which includes autos, vans and pick-up trucks used by artisans, such as contractors, landscapers and plumbers, and a variety of other small businesses. In 2007, we introduced cargo and general liability insurance in select markets, with further state expansion in 2008. Although the Commercial Auto Business differs from Personal Lines auto in its customer bases and products written, both businesses require the same fundamental skills, including disciplined underwriting and pricing, as well as excellent claims service. There are approximately 370 competitors in the total commercial auto market. We primarily compete with approximately 30 other large companies/groups, each with over $200 million of commercial auto premiums written annually. These leading commercial auto insurers comprise about 75% of this market. Our Commercial Auto Business ranked third in the commercial auto insurance market for 2006, and we believe that we held that position for 2007.

Other Indemnity Businesses

Our other indemnity businesses, which represented less than 1% of our 2007, 2006 and 2005 net premiums written, include providing professional liability insurance to community banks, principally directors and officers liability insurance. We reinsure the majority of the risk on these coverages with a small mutual reinsurer controlled by its bank customers and various other reinsurance entities. The program, sponsored by the American Bankers Association, insures over 1,700 banks, representing every state. In addition, our other indemnity businesses include managing our run-off businesses.

Service Businesses

Our service businesses include providing insurance-related services, primarily policy issuance and claims adjusting services in 27 states for Commercial Auto Insurance Procedures/Plans (CAIP), which are state-supervised plans serving the involuntary markets. We process approximately half of the premiums in the CAIP market and compete with two other providers countrywide. One of these other carriers has indicated that it will cease writing new business in 2008, and we expect our market share of this business will increase as a result. As a service provider, we collect fee revenue that is earned on a pro rata basis over the term of the related policies. We cede 100% of the premiums and losses to the plans. Reimbursements to us from the CAIP plans are required by state laws and regulations. Material violations of contractual service standards can result in ceding restrictions for the affected business. We have maintained, and plan to continue to maintain, compliance with these standards. Any changes in our participation as a CAIP service provider would not materially affect our financial condition, results of operations or cash flows. The service businesses represented less than 1% of our 2007, 2006 and 2005 revenues.

Claims

We manage our claims handling on a companywide basis through approximately 475 claims offices located throughout the United States. In addition, we have in operation 54 centers, in 41 metropolitan areas across the country, that provide our concierge level claims service. These facilities are designed to provide end-to-end resolution for auto physical damage losses. Customers can choose to bring their vehicles to one of these sites, where they can pick up a rental vehicle. Our representatives will then write the estimate, select a qualified repair shop, arrange the repair, including pick up and delivery of the vehicle, and inspect the vehicle once the repairs are

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complete. This innovative approach to the vehicle repair process, increases consumer satisfaction, increases our productivity and improves the cycle time and quality of repairs. Concierge level of claims service is our primary approach to damage assessment and coordination of vehicle repairs at authorized auto repair facilities in these markets. We expect to construct 5 new centers in 2008 and 2009, of which 3 centers will replace existing leased facilities. We are pleased to report that on January 29, 2008, we received a U.S. patent for our unique concierge-level method of managing the vehicle repair process.

Competitive Factors

The automobile insurance and other property-casualty markets in which we operate are highly competitive. Property-casualty insurers generally compete on the basis of price, consumer recognition, coverages offered and other product features, claims handling, financial stability, customer service and geographic coverage. Vigorous competition is provided by large, well-capitalized national companies, some of which have broad distribution networks of employed or captive agents, and by smaller regional insurers. Over the last few years, third party comparative rating services have gained prominence, adding transparency to industry pricing, and many of our competitors have significantly increased their advertising and marketing efforts and/or expanded their online service offerings. These changes have further intensified the competitive nature of the automobile and other property-casualty insurance markets.

We rely heavily on technology and extensive data gathering and analysis to segment markets and price accurately according to risk potential. We have remained competitive by refining our risk measurement and price segmentation skills, closely managing expenses and achieving operating efficiencies. Superior customer service, fair and accurate claims adjusting and strong brand recognition are also important factors in our competitive strategy.

State Insurance Licenses

Progressive s insurance subsidiaries operate under licenses issued by various state insurance authorities. These licenses may be of perpetual duration or renewable periodically, provided the holder continues to meet applicable regulatory requirements. Our licenses govern the kinds of insurance coverages that may be written by our insurance subsidiaries in the issuing state. Such licenses are normally issued only after the filing of an appropriate application and the satisfaction of prescribed criteria. All licenses that are material to the subsidiaries businesses are in good standing.

Insurance Regulation

Progressive s insurance subsidiaries are generally subject to regulation and supervision by insurance departments of the jurisdictions in which they are domiciled or licensed to transact business. At least one of our insurance subsidiaries is licensed and subject to regulation in each of the 50 states and the District of Columbia. The nature and extent of such regulation and supervision varies from jurisdiction to jurisdiction. Generally, an insurance company is subject to a higher degree of regulation and supervision in its state of domicile. Progressive s insurance subsidiaries and affiliate are domiciled in the states of Florida, Indiana, Louisiana, Michigan, New Jersey, New York, Ohio, Texas and Wisconsin. State insurance departments have broad administrative power relating to licensing insurers and agents, regulating premium changes and policy forms, establishing reserve requirements, prescribing statutory accounting methods and the form and content of statutory financial reports, and regulating the type and amount of investments permitted. Rate regulation varies from use and file, to file and use, to prior approval, to mandated rates.

Insurance departments are charged with the responsibility of ensuring that insurance companies maintain adequate capital and surplus and comply with a variety of operational standards. Insurance companies are generally required to file detailed annual and other reports with the insurance department of each jurisdiction in which they conduct business. Insurance departments are authorized to make periodic and other examinations of regulated insurers financial condition and operations to monitor financial stability of the insurers and to ensure adherence to statutory accounting principles and compliance with state insurance laws and regulations.

Insurance holding company laws enacted in many jurisdictions grant to insurance authorities the power to regulate acquisitions of insurers and certain other transactions and to require periodic disclosure of certain information. These laws impose prior approval requirements for certain transactions between regulated insurers and their affiliates and generally regulate dividend and other distributions, including loans and cash advances, between regulated insurers and their affiliates. See the Dividends discussion in Item 5(c) for further information on these dividend limitations.

Under state insolvency and guaranty laws, regulated insurers can be assessed or required to contribute to state guaranty funds to cover policyholder losses resulting from the insolvency of other insurers. Insurers are also required by many states, as a condition of doing business in the state, to provide coverage to certain risks which are not insurable in the voluntary market. These assigned risk plans generally specify the types of insurance and the level of coverage that must be offered to such involuntary risks, as well as the allowable premium. Many states also have involuntary market plans which hire a limited number of servicing carriers to provide insurance to involuntary risks. These plans, through assessments, pass underwriting and administrative expenses on to insurers that write voluntary coverages in those states.

Insurance companies are generally required by insurance regulators to maintain sufficient surplus to support their writings. Although the ratio of writings to surplus that the regulators will allow is a function of a number of factors (including applicable law, the type of business being written, the adequacy of the insurer s reserves and the quality of the insurer s assets), the annual net premiums that an insurer may write have historically been perceived to be limited to a specified multiple of the insurer s total policyholders surplus, generally 3 to 1. Thus, the amount of an insurer s surplus, in certain cases, may limit its ability to grow its business. At year-end 2007, the combined premiums to surplus ratio for all Progressive insurance companies was 3.0 to 1, although we have access to $2.1 billion in a non-insurance subsidiary, portions of which could be contributed to the capital of our insurance subsidiaries to support growth as needed. The National Association of Insurance Commissioners (NAIC) also has developed a risk-based capital (RBC) program to enable regulators to take appropriate and timely regulatory actions relating to insurers that show signs of weak or deteriorating financial condition. RBC is a series of dynamic surplus-related formulas that contain a variety of factors that are applied to financial balances based on the degree of certain risks, such as asset, credit and underwriting risks. Progressive s RBC ratios are well in excess of minimum requirements.

Many states have laws and regulations that limit an insurer s ability to exit a market. For example, certain states limit an automobile insurer s ability to cancel or non-renew policies. Certain states also prohibit an insurer from withdrawing one or more lines of business from the state, except pursuant to a plan that is approved by the state insurance department. The state insurance department may disapprove a plan that may lead to market disruption. Laws and regulations that limit the cancellation or non-renewal of policies, or that subject program withdrawals to prior approval requirements, may restrict an insurer s ability to exit unprofitable markets or businesses.

Regulation of insurance constantly changes as real or perceived issues and developments arise. Some changes may be due to economic developments, such as changes in investment laws made to recognize new investment products; other changes result from such general pressures as consumer resistance to price increases and concerns relating to insurer rating and underwriting practices and solvency. In recent years, legislation, regulatory measures and voter initiatives have been introduced, and in some cases adopted, which deal with use of non-public consumer information, use of financial responsibility and credit information in underwriting, insurance rate development, rate of return limitations, rate determination and the ability of insurers to cancel or non-renew insurance policies, reflecting concerns about consumer privacy, coverage, availability, prices and alleged discriminatory pricing. In addition, from time to time, the United States Congress and certain federal agencies investigate the current condition of the insurance industry to determine whether federal regulation is necessary.

In a number of states, Progressive s insurance subsidiaries use financial responsibility or credit information (credit) as part of the underwriting or rating process. This practice is expressly authorized by the federal Fair Credit Reporting Act, and our information demonstrates that credit is an effective predictor of insurance risk. The use of credit in underwriting and rating is the subject of significant regulatory and legislative activity. Regulators and legislators have expressed a number of concerns related to the use of credit, including: questions regarding the accuracy of credit reports, perceptions that credit may have a disparate effect on the poor and certain minority groups, the perceived lack of a demonstrated causal relationship between credit and insurance risk, the treatment of persons with limited or no credit, the impact on credit of extraordinary life events (e.g., catastrophic injury or death of a spouse), and the credit attributes applied in the credit scoring models used by insurers. A number of state

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insurance departments have issued bulletins, directives or regulations to regulate the use of credit by insurers. In addition, a number of states are considering or have passed legislation to regulate insurers use of credit. Also, at the direction of Congress, the Federal Trade Commission studied the effects of the use of credit information on the availability and affordability of insurance and the extent to which credit information impacted the availability and affordability of insurance by geography, income, ethnicity, and race. As a result of this study, it is possible that Congress or one or more states may enact further legislation affecting the use of credit in underwriting and rating.

In some states, the automobile insurance industry has been under pressure in past years from regulators, legislators or special interest groups to reduce, freeze or set rates to or at levels that are not necessarily related to underlying costs, including initiatives to roll back automobile and other personal lines rates. Automobile insurers have also been subject to legislative and regulatory actions designed to limit their ability to manage effectively the cost of motor vehicle repairs. These kinds of activities have affected adversely, and in the future may affect adversely, the profitability and growth of our subsidiaries automobile insurance business in those jurisdictions, and may limit the subsidiaries ability to increase rates to compensate for increases in costs. Adverse legislative and regulatory activity limiting the subsidiaries ability to price automobile insurance adequately or to manage the cost of motor vehicle repairs, or that could affect the subsidiaries insurance operations adversely in other ways, may occur in the future. The impact of these legislative or regulatory changes on the subsidiaries businesses cannot be predicted.

Statutory Accounting Principles

Our results are reported in accordance with GAAP, which differ in certain respects from amounts reported under statutory accounting principles (SAP) prescribed by insurance regulatory authorities. Certain significant differences are described below:

Category	GAAP Accounting	SAP Accounting
Acquisition Expenses	Commissions, premium taxes and other variable costs incurred in connection with writing new and renewal business are capitalized and amortized pro rata over the policy term as premiums are earned.	Commissions, premium taxes and all other acquisition expenses are expensed as incurred.
Non-admitted Assets	Premium receivables are reported net of an allowance for doubtful accounts.	Premium receivables over 90 days past due are non-admitted, which means they are written off against surplus. For premium receivables less than 90 days past due, we also estimate a bad debt reserve.
	Furniture, equipment, application software, leasehold improvements and prepaid expenses are capitalized and amortized over their useful lives or periods benefited.	Excluding computer equipment and operating software, the value of all other furniture, equipment, application software, leasehold improvements and prepaid expenses, net of accumulated depreciation or amortization, is non-admitted against surplus. Computer equipment and operating software are capitalized, subject to statutory limitations based on surplus, and depreciated over three years.

	Deferred tax assets are recorded based on estimated future tax effects attributable to temporary differences. A valuation allowance is recorded for any tax benefits that are not expected to be realized.	Deferred tax assets that do not meet certain statutory requirements for recognition are non-admitted against surplus.
Reinsurance	Ceded reinsurance balances are shown as an asset on the balance sheet as prepaid reinsurance premiums and reinsurance recoverables.	Ceded unearned premiums are netted against the unearned premiums liability. Ceded unpaid loss and loss adjustment expense (LAE) amounts are netted against loss and LAE reserves. Only ceded paid loss and LAE are shown as a reinsurance recoverables asset.
Investment Valuation	Fixed-maturity securities, which are classified as available-for-sale, are reported at current fair values.	Fixed-maturity securities are reported at amortized cost or the lower of amortized cost or fair value, depending on the class of security.
	Preferred stocks are reported at quoted fair values.	Redeemable preferred stocks are reported at amortized cost or the lower of amortized cost or fair value, depending on the class of security. Nonredeemable preferred stocks are reported at quoted fair value.

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Category (con t)	**GAAP Accounting**	**SAP Accounting**
Federal Income Taxes	Federal tax expense and tax liability or recoverable balances include current and deferred income taxes.	For income statement reporting, federal tax expense only includes the current tax provision. Deferred taxes are posted to surplus. SAP deferred tax assets are subject to certain limitations.

Investments

We employ a conservative approach to investment and capital management intended to ensure that we have sufficient capital to support all of the insurance premium that we can profitably write. Our portfolio is invested primarily in short-term and intermediate-term, investment-grade fixed-income securities. Our investment portfolio had a fair value of $14.2 billion at December 31, 2007, compared to $14.7 billion at December 31, 2006. Investment income is affected by the variability of cash flows to or from the portfolio, shifts in the type and quality of investments in the portfolio, changes in yield and other factors. Investment income, including net realized gains (losses) on securities, before expenses and taxes, was $787.1 million in 2007, compared to $638.1 million in 2006 and $498.8 million in 2005. For more detailed discussion, see *Management s Discussion and Analysis of Financial Condition and Results of Operations*, beginning on page App.-A-30 of the Annual Report, which is included as Exhibit 13 to this Form 10-K.

Employees

The number of employees, excluding temporary employees, at December 31, 2007, was 26,851, all of whom were employed by subsidiaries of The Progressive Corporation.

Liability for Property-Casualty Losses and Loss Adjustment Expenses

The consolidated financial statements include the estimated liability for unpaid losses and loss adjustment expenses (LAE) of Progressive s insurance subsidiaries. Our objective is to ensure that total reserves (i.e., case reserves and incurred but not recorded reserves, or IBNR) are adequate to cover all loss costs, while sustaining minimal variation from the time reserves are initially established until losses are fully developed. The liabilities for losses and LAE are determined using actuarial and statistical procedures and represent undiscounted estimates of the ultimate net cost of all unpaid losses and LAE incurred through December 31 of each year. These estimates are subject to the effect of future trends on claims settlement, among other factors. These estimates are continually reviewed and adjusted as experience develops and new information becomes known. Such adjustments, if any, are reflected in the current results of operations. A detailed discussion of our loss reserving practices can be found in our Report on Loss Reserving Practices, which was filed with the Securities and Exchange Commission (SEC) on Form 8-K on June 28, 2007, as well as in the Critical Accounting Policies section of our *Management s Discussion and Analysis of Financial Condition and Results of Operations*, beginning on page App.-A-53 of the Annual Report, which is included as Exhibit 13 to this Form 10-K. The accompanying tables present information concerning our property-casualty losses and LAE.

The following table provides a reconciliation of beginning and ending estimated liability balances for 2007, 2006 and 2005:

RECONCILIATION OF NET RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

(millions)	2007	2006	2005
Balance at January 1	$ 5,725.0	$ 5,660.3	$ 5,285.6
Less reinsurance recoverables on unpaid losses	361.4	347.2	337.1
Net balance at January 1	5,363.6	5,313.1	4,948.5
Incurred related to:			
Current year	9,845.9	9,641.8	9,720.7
Prior years	80.3	(246.9)	(355.9)
Total incurred	9,926.2	9,394.9	9,364.8
Paid related to:			
Current year	6,737.2	6,682.3	6,644.7
Prior years	2,897.4	2,662.1	2,355.5
Total paid	9,634.6	9,344.4	9,000.2
Net balance at December 31	5,655.2	5,363.6	5,313.1
Plus reinsurance recoverable on unpaid losses	287.5	361.4	347.2
Balance at December 31	$ 5,942.7	$ 5,725.0	$ 5,660.3

During 2007 we experienced $80.3 million of unfavorable loss reserve development, compared to favorable development of $246.9 million and $355.9 million, in 2006 and 2005, respectively. The unfavorable development in 2007 was due to settlement of some large outstanding litigation, the number of large losses emerging from prior accident years being more than anticipated plus the result of reviews of large bodily injury and uninsured motorist claims. The favorable development in 2006 and 2005 was driven by actuarial adjustments, resulting from regularly scheduled actuarial reviews, as well as favorable all other development (e.g., claims settling for more or less than reserved, emergence of unrecorded claims at rates different than reserved and changes in reserve estimates by claims representatives). The favorable all other development also reflected the continued recognition of lower severity for prior accident years than had been previously estimated. We conduct extensive reviews each month on portions of our business to help ensure that we are meeting our objective of having reserves that are adequate, with minimal variation. In establishing loss reserves, we take into account projected changes in claim severity caused by anticipated inflation and a number of factors that vary with the individual type of policies written. These severities are projected based on historical trends adjusted for anticipated changes in underwriting standards, inflation, policy provisions and general economic trends. These anticipated trends are reconsidered periodically based on actual development and are modified if necessary.

We have not entered into any loss reserve transfers or similar transactions having a material effect on earnings or reserves.

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ANALYSIS OF LOSS AND LOSS ADJUSTMENT EXPENSES DEVELOPMENT
(millions)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Y FOR UNPAID AND LAE GROSS	$ 2,146.6	$ 2,188.6	$ 2,416.2	$ 2,986.4	$ 3,238.0	$ 3,813.0	$ 4,576.3	$ 5,285.6	$ 5,660.3	$ 5,725.0
INSURANCE RABLE ON UNPAID	279.1	242.8	216.0	201.1	168.3	180.9	229.9	337.1	347.2	361.4
Y FOR UNPAID AND LAE NET[1]	1,867.5	1,945.8	2,200.2	2,785.3	3,069.7	3,632.1	4,346.4	4,948.5	5,313.1	5,363.6
MULATIVE) AS OF:										
ater	922.0	1,082.8	1,246.5	1,409.3	1,601.7	1,860.7	2,233.8	2,355.5	2,662.1	2,897.4
later	1,289.6	1,487.9	1,738.5	2,047.2	2,290.7	2,688.9	3,148.1	3,430.6	3,931.0	
s later	1,474.9	1,680.6	2,001.4	2,355.0	2,655.8	3,084.6	3,642.5	3,999.9		
later	1,554.1	1,785.7	2,126.4	2,514.6	2,821.0	3,291.6	3,873.0			
later	1,596.7	1,836.4	2,191.4	2,586.3	2,910.2	3,381.7				
ater	1,618.2	1,865.3	2,225.5	2,631.2	2,945.7					
rs later	1,630.4	1,883.4	2,248.1	2,647.3						
s later	1,642.9	1,895.2	2,258.5							
later	1,650.5	1,900.3								
later	1,654.7									
Y RE-ESTIMATED AS										
ater	1,683.3	1,916.0	2,276.0	2,686.3	3,073.2	3,576.0	4,237.3	4,592.6	5,066.2	5,443.9
later	1,668.5	1,910.6	2,285.4	2,708.3	3,024.2	3,520.7	4,103.3	4,485.2	5,130.5	
s later	1,673.1	1,917.3	2,277.7	2,671.2	2,988.7	3,459.2	4,048.0	4,501.6		
later	1,669.2	1,908.2	2,272.3	2,666.9	2,982.7	3,457.8	4,070.0			
later	1,664.7	1,919.0	2,277.5	2,678.5	2,993.7	3,475.4				
ater	1,674.5	1,917.6	2,284.9	2,683.7	3,002.5					
rs later	1,668.4	1,921.9	2,287.4	2,688.4						
s later	1,673.9	1,923.4	2,291.9							
later	1,675.5	1,928.5								
later	1,680.8									
IULATIVE PMENT:										
BLE/(UNFAVORABLE)	$ 186.7	$ 17.3	$ (91.7)	$ 96.9	$ 67.2	$ 156.7	$ 276.4	$ 446.9	$ 182.6	$ (80.3)
TAGE[2]	10.0	.9	(4.2)	3.5	2.2	4.3	6.4	9.0	3.4	(1.5)
IATED LIABILITY AID LOSSES AND LAE	$ 1,952.9	$ 2,171.7	$ 2,514.9	$ 2,893.1	$ 3,195.2	$ 3,719.7	$ 4,384.7	$ 4,877.4	$ 5,506.6	$ 5,809.0
	272.1	243.2	223.0	204.7	192.7	244.3	314.7	375.8	376.1	365.1

-ESTIMATED ANCE RABLE ON UNPAID										
MATED LIABILITY AID LOSSES AND LAE	$ 1,680.8	$ 1,928.5	$ 2,291.9	$ 2,688.4	$ 3,002.5	$ 3,475.4	$ 4,070.0	$ 4,501.6	$ 5,130.5	$ 5,443.9
UMULATIVE PMENT: BLE/(UNFAVORABLE)	$ 193.7	$ 16.9	$ (98.7)	$ 93.3	$ 42.8	$ 93.3	$ 191.6	$ 408.2	$ 153.7	$ (84.0)

[1] Represents loss and LAE reserves net of reinsurance recoverables on unpaid losses at the balance sheet date.

[2] Cumulative development ÷ liability for unpaid losses and LAE Net.

The above table presents the development of balance sheet liabilities for losses and LAE from 1997 through 2006. The top line of the table shows the estimated liability for unpaid losses and LAE recorded at the balance sheet date for each of the indicated years for the property-casualty insurance subsidiaries only. This liability represents the estimated amount of losses and LAE for claims that were unpaid at the balance sheet date, including IBNR. The table also presents the re-estimated liability for unpaid losses and LAE on a gross basis, with separate disclosure of the re-estimated reinsurance recoverables on unpaid losses.

The upper section of the table (labeled Paid (Cumulative) as of:) shows the cumulative amount paid with respect to the previously recorded liability as of the end of each succeeding year. The lower portion of the table (labeled Liability Re-estimated as of:) shows the re-estimated amount of the previously recorded liability based on experience as of the end of each succeeding year. The re-estimated amount is the sum of the paid amounts above and the outstanding reserve for occurrences prior to the reserve date. The estimate is increased or decreased as more information about the claims becomes known for individual years. For example, as of December 31, 2007, our insurance subsidiaries had paid $1.90 billion of the currently estimated $1.93 billion of losses and LAE that had been unpaid at the end of 1998; thus, an estimated $28.2 million of losses incurred through 1998 remain unpaid as of the current financial statement date.

The net cumulative development represents the aggregate change in the ultimate loss estimate over all prior years. For example, the 1997 liability has developed favorably by $186.7 million over ten years. That amount has been reflected in income over the ten years and had the largest impact on the income in calendar year 1998. The effects on income during the past three years due to changes in estimates of the liabilities for losses and LAE are shown in the reconciliation table on page 9 as the prior years contribution to incurred losses and LAE.

In evaluating this information, note that each cumulative development amount includes the effects of all changes in amounts during the current year for prior periods. For example, the amount of the development related to losses settled in 2007, but incurred in 2004, will be included in the cumulative development amount for years 2004, 2005 and 2006. Conditions and trends that have affected development of the liability in the past may not necessarily occur in the future. Accordingly, it generally is not appropriate to extrapolate future development based on this table.

We experienced significant favorable reserve development through the mid-1990 s until 1997, primarily due to decreasing bodily injury severity, while the carried reserves anticipated an increasing severity. From 1998 through 2001, we experienced an increase in bodily injury severity and, as a result, saw our reserve development much closer to our original estimates. The bodily injury severity change was much lower than we expected between 2002 and 2006. As a result, the reserve run-off for these years was very favorable. In 2007, the realization of higher prior years severity than anticipated resulted in our reserves developing unfavorably by 1.5%. Not only did this development impact 2006, but also impacted the run-off of most of the past year-end reserves. In 2007, the estimated severity for accident years 2005 and 2006 was higher than our estimated severity at the end of 2006 by 1.0% and .7%, respectively, for our personal auto products and by 4.0% and 7.7% for our commercial auto products.

Although the detail is not presented in the table on page 10, we also re-estimate the reinsurance recoverables on unpaid losses. The top of the table shows the amount of reinsurance recoverable on unpaid losses we had at the end of the calendar year, while the bottom shows the reserves re-estimated based on development in subsequent years. For example, at December 31, 2006, we estimated our reinsurance recoverables on unpaid losses to be $361.4 million. During 2007, these reserves developed unfavorably by $3.7 million, bringing the re-estimated reinsurance recoverables on unpaid losses to $365.1 million, as shown at the bottom of the table.

The Analysis of Loss and Loss Adjustment Expenses Development table on page 10 is constructed from Schedule P, Part-1, from the Consolidated Annual Statements of Progressive s insurance subsidiaries, as filed with the state insurance departments.

(d) Financial Information About Geographic Areas.

Progressive operates throughout the United States.

(e) Available Information.

Our Web site is located at progressive.com. As soon as reasonably practicable, we make all documents that we file with, or furnish to, the SEC, including our reports on Form 10-K, Form 10-Q and Form 8-K, and any amendments to these reports, available free of charge via our Web site at progressive.com/investors. These reports are also available on the SEC s Web site: http://www.sec.gov.

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ITEM 1A. RISK FACTORS

Progressive s business involves various risks and uncertainties, certain of which are discussed in this section. Management divides these risks into three broad categories in assessing how they may affect our ability to achieve our business objectives:

Operating Risks are those stemming from external or internal events or circumstances that directly or indirectly may affect our insurance operations.

Investing Risks are uncertainties relating to the performance and preservation of our investment portfolios. Unlike most other risks, the actual development of an investment risk factor (such as interest rates going down or up) may result in either an increase or decrease in the value of investments we hold.

Financing Risks generally relate to our ability to obtain capital, when necessary, to pay or otherwise perform our obligations, including obligations under any debt instruments issued, and to earn the cost of equity capital.

Although we have organized risks generally according to these categories in the discussion below, it should be noted that many of the risks may have ramifications in more than one category. For example, although presented as an Operating Risk below, state regulation of insurance companies may also affect our investing and financing activities. Similarly, while setting insurance rates, establishing loss reserves and adjusting claims are properly discussed as Operating Risks, errors in these disciplines may have an impact on the investing and financing areas as well. The categories, therefore, should be viewed as a starting point for understanding the significant risks facing us and not as a limitation on the potential impact of the matters being discussed.

This information should be considered carefully together with the other information contained in this report and in the other reports and materials filed by us with the SEC, as well as news releases and other information publicly disseminated by us from time to time.

Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also adversely affect our business. If any such risks or uncertainties, or any of the following risks or uncertainties, develop into actual events, this could have a materially adverse effect on our business, financial condition, cash flows or results of operations. In that case, the market price of our common shares could decline materially.

I. <u>Operating Risks</u>

We compete in the automobile insurance and other property-casualty markets, which are highly competitive.

We face vigorous competition from large, well-capitalized national companies and smaller regional insurers. Other large national and international insurance or financial services companies also may enter these markets in the future. Many of these companies may have greater financial, marketing and management resources than we have. In addition, competitors may offer consumers combinations of auto policies and other insurance products or financial services that we do not of