

Report of Examination of

Progressive Specialty Insurance Company
Mayfield Village, Ohio

As of December 31, 2012

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Columbus, Ohio
August 6, 2013

Honorable Mary Taylor
Lt. Governor/Director
Ohio Department of Insurance
50 West Town Street
3rd Floor – Suite 300
Columbus, Ohio 43215

Dear Madam:

In accordance with Section 3901.07 of the Ohio Revised Code (“ORC”), the Ohio Department of Insurance (“Department”) conducted an examination of

Progressive Specialty Insurance Company

an Ohio domiciled, stock, property and casualty insurance company, hereinafter referred to as the (“Company”). The Company is 100% owned by Progressive Casualty Insurance Company (“PCIC”) and PCIC is 100% owned by Drive Insurance Holdings, Inc. (“DIHI”) and DIHI is 100% owned by The Progressive Corporation. The examination was conducted at Progressive’s home office, located at 6300 Wilson Mills Road, Mayfield Village, Ohio.

Scope of Examination

The State of Florida last examined the Company as of December 31, 2007. The Company was redomesticated from Florida to Ohio effective August 30, 2010. The current examination covers the period of January 1, 2008 through and including December 31, 2012.

The Department conducted the examination in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook. The Handbook requires that the Department plan and perform the examination to evaluate the Company’s financial condition and identify prospective risks including corporate governance, identify and assess inherent risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

The State of Ohio took the lead role to perform the coordinated exam of the Progressive insurance companies and the States of Indiana, Louisiana, Michigan, New Jersey, New York, Texas and Wisconsin were all participants on the group examination.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

For years covered by the examination, the certified public accounting firm of PricewaterhouseCoopers (“PwC”) provided an unqualified opinion based on statutory accounting principles. Relevant work performed by PwC during its annual audit of the Company was reviewed during the examination and incorporated into the examination work papers.

In addition, the following items were reviewed during the course of this examination:

1. Company history;
2. fidelity bonds and other insurance;
3. officers’, employees’, and agents’ welfare and pension plans;
4. growth of Company;
5. loss experience;
6. pending litigation; and
7. Articles of Incorporation and Bylaws.

Management and Control

Board of Directors

Management of the Company is vested in its Board of Directors, which was comprised of the following members as of the examination date.

<u>Name</u>	<u>Principal Occupation</u>
Karen Marie Bailo	Business Leader Agency Distribution, Commercial Lines - Progressive
Kathryn Margaret Lemieux	Customer Relation Management Systems Leader, Personal Lines – Progressive
Mark Donald Niehaus	Personal Lines Product Management General Manager – Progressive
David Lloyd Pratt	Business Leader Usage Based Insurance, Personal Lines – Progressive
David James Skove	Personal Lines Product Management General Manager – Progressive

Officers

As of the examination date, the following officers were elected and serving in accordance with the Company's Bylaws:

<u>Name</u>	<u>Title</u>
David James Skove	President
Peter James Albert	Secretary
Thomas Alfred King	Treasurer

Insurance Holding Company System

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. The Progressive Corporation is the ultimate controlling party of the insurance holding company system.

Territory and Plan of Operations

The Company is licensed to transact business in the District of Columbia and the following states:

Alabama	Alaska	Arizona	Arkansas	California
Colorado	Connecticut	Delaware	Florida	Georgia
Hawaii	Idaho	Illinois	Indiana	Iowa
Kansas	Kentucky	Maine	Maryland	Michigan
Minnesota	Mississippi	Missouri	Montana	Nebraska
Nevada	New Jersey	New Mexico	New York	North Dakota
Ohio	Oklahoma	Oregon	Pennsylvania	Rhode Island
South Carolina	South Dakota	Tennessee	Texas	Utah
Vermont	Virginia	Washington	West Virginia	Wisconsin

The following schedule illustrates the Company's premium written in 2012 by line of business:

	Direct	Assumed	Ceded	Net	Percent
Private passenger auto liability	\$ 574,390,658	\$ 363,089,261	\$ 574,390,658	\$ 363,089,261	57.1%
Auto physical damage	334,634,527	216,408,991	334,634,527	216,408,991	34.1%
Commercial auto liability	26,144,050	38,891,141	26,144,050	38,891,141	6.1%
Inland marine	10,689,833	10,640,494	10,689,833	10,640,494	1.7%
Other liability – occurrence	3,855,529	4,419,992	3,855,529	4,419,992	0.7%
All other lines	<u>2,346</u>	<u>1,970,089</u>	<u>2,346</u>	<u>1,970,089</u>	<u>0.3%</u>
Totals	<u>\$ 949,716,943</u>	<u>\$ 635,419,968</u>	<u>\$ 949,716,943</u>	<u>\$ 635,419,968</u>	<u>100.0%</u>

Significant Operating Results

The Company reported the following net underwriting results, reported in thousands, during the examination period:

	2012	2011	2010	2009	2008
Premiums earned	<u>\$ 623,471</u>	<u>\$ 585,037</u>	<u>\$ 566,990</u>	<u>\$ 570,021</u>	<u>\$ 568,670</u>
Losses incurred	403,903	360,388	337,596	337,454	350,623
Loss adjustment expenses incurred	64,458	60,565	61,248	62,232	67,620
Other underwriting expenses incurred	134,650	130,271	129,440	124,739	124,009
Aggregate write-ins	<u> -</u>	<u> -</u>	<u> (108)</u>	<u> 108</u>	<u> -</u>
Total underwriting deductions	<u>603,011</u>	<u>551,224</u>	<u>528,176</u>	<u>524,533</u>	<u>542,252</u>
Net underwriting gain	\$ 20,460	\$ 33,814	\$ 38,814	\$ 45,488	\$ 26,418
Loss ratio	64.8%	61.6%	59.5%	59.2%	61.7%
Loss adjustment expense ratio	<u>10.3%</u>	<u>10.4%</u>	<u>10.8%</u>	<u>10.9%</u>	<u>11.9%</u>
Loss and LAE ratio	75.1%	72.0%	70.3%	70.1%	73.6%
Other underwriting expense ratio	<u>21.2%</u>	<u>22.0%</u>	<u>22.6%</u>	<u>22.1%</u>	<u>22.0%</u>
Combined ratio	<u>96.3%</u>	<u>94.0%</u>	<u>92.9%</u>	<u>92.2%</u>	<u>95.6%</u>

Reinsurance

The Company is party to various reinsurance agreements including a pooling agreement with affiliated property casualty companies (“Agency Pool”). 100% of the underwriting business of each member company, net of external reinsurance, is ceded to Progressive Casualty Insurance Company, the pool manager and a pool participant. The combined premiums, losses, and expenses are then retroceded to each Agency Pool member based on pre-determined pooling percentages.

The companies participating in the Agency Pool are listed below, each with their respective pooling percentage:

Progressive Casualty Insurance Company	49%
Progressive Northern Insurance Company	12%
Progressive Northwestern Insurance Company	12%
Progressive Specialty Insurance Company	7%
Progressive Preferred Insurance Company	6%
Progressive Michigan Insurance Company	4%
Progressive Classic Insurance Company	3%
Progressive American Insurance Company	2%
Progressive Gulf Insurance Company	2%
Progressive Bayside Insurance Company	1%
Progressive Mountain Insurance Company	1%
Progressive Southeastern Insurance Company	1%
Progressive Hawaii Insurance Corp.	<u>0%</u>
	100%

The Agency Pool’s affiliated assumed reinsurance transactions are a result of (1) 90% quota-share reinsurance agreements with three of its non-pooled insurance affiliates, (2) a 100% quota-share reinsurance agreement with Progressive County Mutual Insurance Company, a managed but not owned insurance affiliate, and (3) aggregate stop loss reinsurance agreements with National Continental Insurance Company and Progressive Max Insurance Company, two affiliated insurance companies. The Agency Pool’s ceded premiums consist of “State Plans”. State Plans include (1) amounts ceded to state-provided reinsurance facilities, including the Michigan Catastrophic Claims Association and the North Carolina Reinsurance Facility, and (2) state-mandated involuntary CAIP, for which the Agency Pool retains no loss indemnity risk.

Effective April 11, 2011, the Company and thirty-two affiliates entered into an excess of loss agreement with Swiss Reinsurance America Corporation (“Swiss Re”), that applies to commercial vehicle policies with vehicle liability limits in excess of \$1 million, but not to exceed \$2 million. The companies cede to Swiss Re \$1 million in excess of \$1 million.

The examination noted that the Company has policies and procedures in place to comply with SSAP 62R and 63.

Financial Statements

The financial condition and the results of its operations for the five year period under examination as reported and filed by the Company with the Department and audited by the Company’s external auditors, are reflected in the following:

- Statement of Assets, Liabilities, Capital and Surplus
- Statement of Income
- Statement of Changes in the Capital and Surplus Account

**Statement of Assets
December 31, 2012**

Admitted assets

Bonds	\$ 544,653,787
Preferred stocks	90,496,775
Common stocks	102,928,250
Cash equivalents and short-term investments	<u>10,915,260</u>
Total cash and invested assets	748,994,072
Investment income due and accrued	4,775,324
Uncollected premiums and agents' balances in the course of collection	26,394,451
Deferred premiums, agents' balances and installments booked but deferred and not yet due	155,965,587
Amounts recoverable from reinsurers	6,665,302
Net deferred tax asset	20,433,688
Receivables from parent, subsidiaries and affiliates	30,504,711
Aggregate write-ins for other than invested assets	
Equities and deposits in pools and associations	<u>566,274</u>
Total admitted assets	<u>\$ 994,299,409</u>

**Statement of Liabilities, Capital and Surplus
December 31, 2012**

Liabilities

Losses	\$ 217,147,501
Reinsurance payable on paid losses and loss adjustment expenses	4,978,502
Loss adjustment expenses	43,354,212
Commissions payable, contingent commissions and other similar charges	1,036,140
Other expenses	19,944,840
Taxes, licenses and fees	5,108,680
Current federal and foreign income taxes	7,229,334
Unearned premiums	189,117,054
Advance premium	4,873,125
Ceded reinsurance premiums payable	42,208
Amount withheld or retained by company for account of others	262,564
Drafts outstanding	32,097,485
Aggregate write-ins for liabilities	
Other liabilities	1,669,608
Escheatable property	110,970
Unearned fee reserve	<u>5,993</u>
Total liabilities	526,978,216

Capital and Surplus

Common capital stock	3,500,000
Gross paid in and contributed surplus	106,071,065
Unassigned funds	<u>357,750,128</u>
Surplus as regards policyholders	<u>467,321,193</u>
Total liabilities, capital and surplus	<u>\$ 994,299,409</u>

Statement of Income
As of December 31, 2012

Premiums earned	<u>\$ 623,470,798</u>
Losses incurred	403,903,130
Loss adjustment expenses incurred	64,457,556
Other underwriting expenses incurred	<u>134,650,346</u>
Net underwriting gain	20,459,766
Net investment income earned	27,785,399
Net realized capital gains less capital gains tax	<u>21,363,892</u>
Net investment gain	<u>49,149,291</u>
Net loss from agents' or premium balances charged off	(14,354,119)
Finance and service charges not included in premiums	25,716,336
Aggregate write-ins for miscellaneous income:	
Miscellaneous income	540,919
Service business revenue	54,831
Interest income on intercompany balances	<u>49,343</u>
Total other income	<u>12,007,310</u>
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	<u>81,616,367</u>
Federal and foreign income taxes incurred	<u>21,268,871</u>
Net income	<u>\$ 60,347,496</u>

Statement of Changes in the Capital and Surplus Account
(In thousands)

<u>Capital and Surplus</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Capital & surplus, prior year end	<u>\$ 574,738</u>	<u>\$ 800,353</u>	<u>\$ 719,871</u>	<u>\$ 589,385</u>	<u>\$ 668,454</u>
Net income	60,347	64,023	70,484	70,677	(62,250)
Change in net unrealized capital gains or (losses) less capital gains tax	10,383	(10,684)	12,839	39,196	(18,169)
Change in net deferred income tax	(3,049)	(1,404)	(6,685)	2,623	36,644
Change in non-admitted assets	1,072	(4,114)	3,844	17,689	(35,294)
Cumulative effect of changes in accounting principles	-	-	-	301	-
Paid in surplus adjustment	23,830	1,564	-	-	-
Dividends to stockholders	<u>(200,000)</u>	<u>(275,000)</u>	-	-	-
Net change in capital and surplus	<u>(107,417)</u>	<u>(225,615)</u>	<u>80,482</u>	<u>130,486</u>	<u>(79,069)</u>
Capital and surplus, current year end	<u>\$ 467,321</u>	<u>\$ 574,738</u>	<u>\$ 800,353</u>	<u>\$ 719,871</u>	<u>\$ 589,385</u>

Notes to Financial Statements

Investments

The Company's investment portfolio primarily consists of investment grade bonds and is in compliance with Section 3925.08 of the ORC. The investments were valued in accordance with the relevant Statements of Statutory Accounting Principles and the NAIC Securities Valuation Office.

Loss and Loss Adjustment Expense Reserves

The Company's Board of Directors appointed Gary S. Traicoff, FCAS, MAAA, of Progressive management to render a Statement of Actuarial Opinion ("Opinion") on the total reserves. Mr. Traicoff prepared an Actuarial Report supporting the Opinion in conjunction with the preparation of the Company's December 31, 2012 Annual Statement.

Thomas Botsko, ACAS, MAAA, the Department's Chief Property and Casualty Actuary, reviewed the Actuarial Report and performed other procedures as considered necessary to evaluate the loss and loss adjustment expense ("LAE") reserves. Mr. Botsko concluded the reserves fall within a reasonable range of reserve estimates at December 31, 2012.

Subsequent Events

There are no material subsequent events.

Conclusion

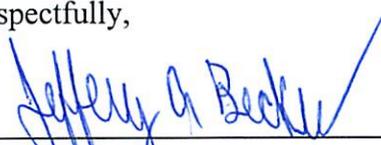
The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2012, and is summarized as follows:

Total Admitted Assets	<u>\$ 994,299,409</u>
Liabilities	526,978,216
Surplus as Regards Policyholders	<u>467,321,193</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$ 994,299,409</u>

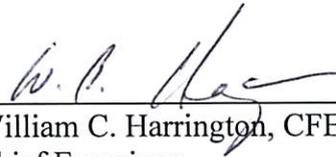
Acknowledgement

In addition to the aforementioned and undersigned, the following representatives of the Department participated in this examination: Mohammad Arif, AES, CISA, CPA; Edward Nagorny, CFE, CPA; Kim Somogyi, CPA; Bryan Radecky, CPA; and Bradley Schroer.

Respectfully,



Jeffery A. Becker, CFE
Examiner-In-Charge
Office of Risk Assessment
Ohio Department of Insurance



William C. Harrington, CFE
Chief Examiner
Office of Risk Assessment
Ohio Department of Insurance

Verification

As required by Section 3901.07 of the ORC, the undersigned hereby attest to the best of their knowledge and belief that the attached is a true Report of Examination as of December 31, 2012.

Jeffery A. Becker 8/6/13 W. C. Harrington 8/6/13
Examiner-In-Charge Date Chief Examiner Date

State of Oh. O
County of Franklin

Personally appeared before me the above named, Jeffery A. Becker, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 6 day of August, 2013.

Elizabeth Chase
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2017
My Commission Expires

State of Oh. O
County of Franklin

Personally appeared before me the above named, William C. Harrington, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 6 day of August, 2013.

Elizabeth Chase
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2017
My Commission Expires