

Report of Examination of

**Progressive Specialty Insurance Company**  
Cleveland, Ohio

As of December 31, 2007

## Table of Contents

Subject	Page
Salutation .....	1
Description of Company .....	2
Scope of Examination .....	2
Management and Control:	
Board of Directors.....	3
Officers .....	3
Insurance Holding Company System.....	4
Reinsurance.....	6
Territory and Plan of Operations .....	7
Financial Statements:	
Statement of Assets, Liabilities, Surplus and Other Funds.....	8
Statement of Operations.....	10
Statement of Changes in the Capital and Surplus Account .....	11
Summary of Examination Changes .....	11
Notes to Financial Statements:	
Investments .....	11
Loss and Loss Adjustment Expense Reserves .....	12
Subsequent Event.....	12
Conclusion .....	12
Acknowledgement .....	13

Columbus, Ohio  
February 12, 2009

Honorable Alfred W. Gross  
Commissioner  
Chairman, Financial Condition (E) Committee  
National Association of Insurance Commissioners  
Division of Insurance  
State of Virginia  
1300 East Main Street  
Richmond, Virginia 23219

Honorable Merle Scheiber  
Director of Insurance  
Secretary, Midwestern Zone  
National Association of Insurance Commissioners  
South Dakota Division of Insurance  
Department of Revenue and Regulation  
445 East Capitol Avenue, 1<sup>st</sup> Floor  
Pierre, South Dakota 57501-3185

Honorable Thomas R. Sullivan  
Commissioner of Insurance  
Secretary, Northeastern Zone  
National Association of Insurance Commissioners  
Connecticut Department of Insurance  
PO Box 816  
Hartford, Connecticut 06142-0816

Honorable Julie McPeak  
Executive Director of Insurance  
Secretary, Southeastern Zone  
National Association of Insurance Commissioners  
Kentucky Office of Insurance  
PO Box 517  
Frankfort, Kentucky 40602-0517

Honorable Morris Chavez  
Superintendent of Insurance  
Secretary, Western Zone  
National Association of Insurance Commissioners  
New Mexico Insurance Division  
PO Drawer 1269  
Santa Fe, New Mexico 87504-1269

Honorable Mary Jo Hudson  
Director  
State of Ohio  
Department of Insurance  
50 West Town Street  
3<sup>rd</sup> Floor – Suite 300  
Columbus, Ohio 43215

Dear Madams and Sirs:

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 examination was conducted at the Company’s home office, located at 6300 Wilson Mills Road, Cleveland, Ohio.

A report of this examination is hereby respectfully submitted.

**Scope of Examination**

The Department last examined the Company as of December 31, 2002. The current full scope association examination covers the intervening period to and including December 31, 2007.

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.

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

For each year during the period under examination, the Certified Public Accounting firm of PricewaterhouseCoopers, LLP (“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.

The Department's property and casualty actuary was retained to review the relevant work performed by the opining actuary, to report on the adequacy of the carried reserves, and to comment on any other statutory matters relating to reserves.

### **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.

<b>Name</b>	<b>Principal Occupation</b>
Karen M. Barone	Progressive Insurance Companies, Personal Lines General Manager
Richard R. Crawley	Progressive Insurance Companies, Direct Auto Product R&D
Steven B. Gellen	Progressive Insurance Companies, Customer Relationship Management Manager
Mark D. Niehaus	Progressive Insurance Companies, Personal Lines General Manager
David J. Skove	Progressive Insurance Companies, Personal Lines General Manager

#### **Officers**

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

<b>Name</b>	<b>Title</b>
David J. Skove	President
Thomas A. King	Treasurer
Peter J. Albert	Secretary

## **Insurance Holding Company System**

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. The following displays the chain of ownership of the insurance companies as of December 31, 2007:

- The Progressive Corporation – Ohio
  - Progressive RSC, Inc. – Ohio
  - Pacific Motor Club – California
  - Progressive Capital Management Corp. – New York
  - Progressive Investment Company, Inc. – Delaware
  - Progressive Insurance Agency, Inc. – Ohio
  - Progressive Adjusting Company, Inc. – Ohio
  - Progressive Premium Budget, Inc. – Ohio
  - Wilson Mills Land Company – Ohio
  - Village Transport Corp. – Delaware
  - Progressive Corporate Support, Inc. – Ohio
  - Silver Key Insurance Agency, Inc. – Nevada
  - Garden Sun Insurance Services, Inc. – Hawaii
  - Progn Agency, Inc. – New York
  - Progressive Vehicle Service Company – Ohio
  - Progressive Direct Holdings, Inc. – Delaware
    - Progressive Freedom Insurance Company – New Jersey
    - Progressive Specialty Insurance Agency, Inc. – Ohio
    - Progressive Auto Pro Insurance Agency, Inc. – Florida
    - Progressive Choice Insurance Company – Ohio
    - Mountain Laurel Assurance Company – Ohio
    - Progressive Marathon Insurance Company – Michigan
    - Midland Financial Group, Inc. – Ohio
      - Midland Risk Services, Inc. – Tennessee
      - Progressive Advanced Insurance Company – Ohio
    - Progressive Direct Resources Services Company – Ohio
    - Progressive Select Insurance Company – Florida
    - Progressive Max Insurance Company – Ohio
    - Progressive Paloverde Insurance Company – Indiana
    - Progressive Premier Insurance Company of Illinois – Ohio
    - Progressive Universal Insurance Company – Wisconsin
    - Progressive Direct Insurance Company – Ohio
      - Gadsden, Al, LLC – Ohio
    - Progressive Garden State Insurance Company – New Jersey
  - Progressive Commercial Holdings, Inc. – Delaware
    - National Continental Insurance Company – New York
    - Progressive Express Insurance Company – Florida
    - Commercial Resource Services Company – Ohio
    - Artman and Truckers Casualty Company – Wisconsin
    - United Financial Casualty Company – Ohio

Progressive Commercial Casualty Company – Ohio  
Drive Insurance Holdings, Inc. – Delaware  
Progressive West Insurance Company – Ohio  
Progressive Mountain Insurance Company – Ohio  
Progressive Preferred Insurance Company – Ohio  
Progressive Classic Insurance Company – Wisconsin  
Progressive Bayside Insurance Company – Florida  
Progressive Hawaii Insurance Corp. – Ohio  
Progressive Southeastern Insurance Company – Indiana  
Progressive Northeastern Insurance Company – New York  
Drive Resource Services Company – Ohio  
Progressive Michigan Insurance Company – Michigan  
Progressive Northern Insurance Company – Wisconsin  
Bayside Underwriters Insurance Agency, Inc. – Florida  
Progressive Security Insurance Company – Louisiana  
Progressive Northwestern Insurance Company – Ohio  
Progressive American Insurance Company – Florida  
Progressive DLP Corp. – Ohio  
Progressive Casualty Insurance Company – Ohio  
Progressive Specialty Insurance Company – Ohio  
Trussville/Cahaba, AL., LLC - Ohio  
Progressive Gulf Insurance Company – Ohio  
PC Investment Company – Delaware  
Progressive Alliance Insurance Agency, Inc – Washington  
Drive New Jersey Insurance Company – New Jersey

## Reinsurance

The Company is a 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 the Company, the Agency Pool manager. 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 Northwestern Insurance Company	12%
Progressive Northern 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 Southeastern Insurance Company	1%
Progressive Mountain Insurance Company	1%
Progressive Hawaii Insurance Corp.	0%
United Financial Casualty Company	0%
National Continental Insurance Company	0%
	<hr/>
	100%

The Agency Pool's affiliated assumed reinsurance transactions are a result of (1) 90% quota-share reinsurance agreements with four of its non-pooled insurance affiliates, (2) a 100% quota-share reinsurance agreement with Progressive County Mutual Insurance Company, a managed but not owned affiliate, and (3) an aggregate excess of loss reinsurance agreement with National Continental Insurance Company and Progressive Max Insurance Company, two affiliated companies. The Agency Pool's ceded non-affiliated reinsurance transactions are primarily a result of business written under state-mandated involuntary Commercial Auto Insurance Plans/Procedures ("CAIP"), for which the Agency Pool retains no indemnity risk, and state-provided reinsurance facilities. The Agency Pool's remaining reinsurance primarily arises from its non-auto programs.

The Company has policies and procedures in place to comply with Statements of Statutory Accounting Principles 62 and 63.

All contracts contained an insolvency clause, errors and omission clause and an arbitration clause, which meet the guidelines prescribed by the NAIC.

### **Territory and Plan of Operations**

The Company was licensed to transact business in all states except Louisiana, Massachusetts, New Hampshire, North Carolina and Wyoming.

<u>Percentage of Net Business Written by Line</u>	
<u>Description</u>	<u>2007</u>
Private passenger auto liability	54.0%
Auto physical damage	37.8%
Commercial auto liability	5.6%
All other	2.6%
Total	<u>100.0%</u>

### **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, Surplus and Other Funds  
Statement of Operations  
Statement of Changes in the Capital and Surplus Account

## Statement of Assets, Liabilities, Surplus and Other Funds

December 31, 2007

### Admitted assets

Cash and invested assets:	
Bonds	\$588,096,786
Preferred stocks	202,534,115
Common stocks	181,813,068
Cash and short-term investments	320,928
Other invested assets	9,986,869
Receivable for securities	263,620
Total cash and invested assets	<u>983,015,386</u>
Investment income due and accrued	10,210,157
Uncollected premiums and agents' balances	17,972,798
Deferred premiums, agents' balances and installments booked but deferred and not yet due	98,040,363
Amounts recoverable from reinsurers	8,141,208
Net deferred tax asset	10,241,351
Receivables from parent, subsidiaries and affiliates	23,857,363
Aggregate write-ins for other than invested assets:	
Equities and deposits in pools and associations	1,125,723
State tax credits	35,000
Total admitted assets	<u>\$1,152,639,349</u>

**December 31, 2007**

**Liabilities, capital and surplus**

Liabilities:	
Losses	\$197,521,531
Reinsurance payable on paid losses	4,715,200
Loss adjustment expenses	48,598,756
Commissions payable	1,528,140
Other expenses	18,077,270
Taxes, licenses and fees	4,695,716
Current federal and foreign income taxes	4,429,127
Unearned premiums	172,403,179
Advance premium	3,814,066
Ceded reinsurance premiums payable	623,909
Drafts outstanding	27,692,744
Aggregate write-ins for liabilities:	
Escheatable property	34,533
Unearned fee reserve	28,970
Other liabilities	21,785
Total liabilities	<u>484,184,926</u>
Capital and surplus:	
Common capital stock	3,500,000
Gross paid in and contributed surplus	80,677,139
Unassigned funds	584,277,284
Total capital and surplus	<u>668,454,423</u>
Total liabilities, capital and surplus	<u>\$1,152,639,349</u>

## Statement of Operations

**December 31, 2007**

Premiums earned	\$594,404,202
Losses incurred	353,971,268
Loss expenses incurred	70,215,186
Other underwriting expenses incurred	127,758,953
Net underwriting gain	<u>42,458,795</u>
Net investment income earned	41,138,692
Net realized capital gains (losses)	(823,789)
Net investment gain	<u>40,314,903</u>
Net gain (loss) from agents' or premium balances charged off	(11,471,842)
Finance and service charges not included in premiums	14,081,798
Aggregate write-ins for miscellaneous income:	
Interest income on intercompany balances	1,837,541
Miscellaneous income	277,162
Service business revenue	145,944
Total other income	<u>4,870,603</u>
Net income before federal and foreign income taxes	87,644,301
Federal and foreign income taxes incurred	<u>26,293,933</u>
Net income	<u>\$61,350,368</u>

## Statement of Changes in the Capital and Surplus Account

(In thousands)

	2003	2004	2005	2006	2007
Capital and surplus December 31, previous year	\$215,436	\$318,885	\$427,401	\$509,748	\$619,532
Net income	86,904	107,129	83,796	89,238	61,350
Net unrealized capital gains (losses)	12,670	5,022	2,790	12,817	(10,464)
Change in net deferred income tax	(1,666)	(4,148)	(473)	(1,084)	(1,998)
Change in nonadmitted assets	5,531	503	(3,765)	(1,223)	34
Change in provision for reinsurance	10	1	(1)	1	-0-
Surplus paid in	-0-	9	-0-	10,035	-0-
Net change in capital and surplus	<u>103,449</u>	<u>108,516</u>	<u>82,347</u>	<u>109,784</u>	<u>48,922</u>
Capital and surplus December 31, current year	<u>\$318,885</u>	<u>\$427,401</u>	<u>\$509,748</u>	<u>\$619,532</u>	<u>\$668,454</u>

### Summary of Examination Changes

There were no changes made as a result of this examination.

### Notes to Financial Statements

#### Investments

At December 31, 2007, the Company's investments, as measured by statement valuations, were composed of:

<u>Invested Assets</u>	<u>Ratio to Total</u>	
	<u>Investments</u>	<u>Assets</u>
Bonds	59.8%	51.0%
Preferred stocks	20.6%	17.6%
Common Stocks	18.5%	15.8%
All other	<u>1.1%</u>	<u>0.9%</u>
Totals	<u>100.0%</u>	<u>85.3%</u>

The bond portfolio included 17.4% of federal, state, and local government issues, 30.5% special revenue and 52.1% industrial and miscellaneous. The NAIC Securities Valuation Office (SVO) and/or a NAIC Acceptable Rating Organization (ARO) rated 87.6 % of the bond portfolio as Class 1 and 12.4% Class 2. Cash includes demand deposits.

The Company's investments were in compliance with Section 3925.08 of the ORC.

### **Loss and Loss Adjustment Expense Reserves**

The Company corporate actuary, Allan R. Neis, FCAS, MAAA, certified the total reserves for the years covered by the examination. The Department's actuary, Mary D. Miller, FCAS, MAAA, reviewed the detailed calculations for the reserves of the major lines of business as of December 31, 2007.

On the basis of the above-mentioned analysis, it was determined that the loss and loss adjustment expense reserves were reasonable as of December 31, 2007.

### **Subsequent Event**

During 2008, results included write-downs of securities determined to have had an other-than-temporary decline in fair value of \$115,255,684 related to the financial sector. The Company properly accounted for these transactions.

### **Conclusion**

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2007, and is summarized as follows:

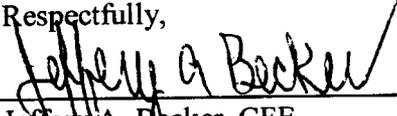
Total Admitted Assets	<u>\$1,152,639,349</u>
Liabilities	\$484,184,926
Surplus as Regards Policyholders	<u>668,454,423</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$1,152,639,349</u>

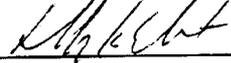
### Acknowledgement

Appreciation is expressed for the assistance extended by the officers and employees of the Company during the course of this examination.

In addition to the undersigned, the following representatives of the Department participated in this examination: William C. Harrington, CFE, CPA (inactive), Chief Examiner, David T. Finkler, CPA; Methuselah E. Nyangoro, CPA; Richard J. Mack, CFE; Vicky L. Hugo, CPA; Louis F. Radecky, CPA (inactive); Edward J. Nagorny, CPA, CFE; Mark W. Boston, CPA; C. Cameron Piatt, CPCU, CFE; Bradley J. Schroer; Mary D. Miller, FCAS, MAAA; William H. Ward, CPA, CFE; Floyd D. Meeks, AES; and Dominik R. Ilc, AES.

Respectfully,

  
\_\_\_\_\_  
Jeffery A. Becker, CFE  
Examiner-In-Charge  
Ohio Department of Insurance

  
\_\_\_\_\_  
Jeffrey K. Ebert, CFE  
Assistant Chief Examiner  
Ohio Department of Insurance

**Verification**

As required by Section 3901.07 of the Ohio Revised Code, 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, 2007.

Jeffery A. Becker  
Jeffery A. Becker, CFE  
Examiner-In-Charge

2/12/09  
Date

Jeffrey K. Ebert  
Jeffrey K. Ebert, CFE  
Assistant Chief Examiner

2/12/09  
Date

State of Ohio

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/her knowledge and belief.

Subscribed and sworn to before me this 12 day of February, 2009.

Elizabeth Chase  
(Notary Public)  
**ELIZABETH CHASE**  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2012  
My Commission Expires

State of Ohio

County of Franklin

Personally appeared before me the above named, Jeffrey K. Ebert, 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/her knowledge and belief.

Subscribed and sworn to before me this 12 day of February, 2009.

Elizabeth Chase  
(Notary Public)  
**ELIZABETH CHASE**  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2012  
My Commission Expires