

PROGRESSIVE CORP/OH/  
Form 10-K  
February 26, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended December 31, 2013

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 1-9518

THE PROGRESSIVE CORPORATION  
(Exact name of registrant as specified in its charter)

Ohio  
(State or other jurisdiction of  
incorporation or organization)

34-0963169  
(I.R.S. Employer  
Identification No.)

6300 Wilson Mills Road, Mayfield Village, Ohio  
(Address of principal executive offices)  
(440) 461-5000  
(Registrant's telephone number, including area code)

44143  
(Zip 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. ☒ Yes ☐ 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. ☐ Yes ☒ 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.

☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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. ☒ No

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 ☒ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2013: \$14,008,711,206

The number of the registrant's Common Shares, \$1.00 par value, outstanding as of January 31, 2014: 595,282,483

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 16, 2014, and the Annual Report to Shareholders for the year ended December 31, 2013, included as Exhibit 13 to this Form 10-K, are incorporated by reference in Parts I, II, III, and IV hereof.

## INTRODUCTION

Portions of the information included in The Progressive Corporation's Proxy Statement for the Annual Meeting of Shareholders to be held on May 16, 2014 (the "Proxy Statement") have been incorporated by reference herein and are identified under the appropriate items in this Form 10-K. The 2013 Annual Report to Shareholders (the "Annual Report") of The Progressive Corporation and subsidiaries, which will be attached as an Appendix to the 2014 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 54 subsidiaries, one mutual insurance company affiliate, and one limited partnership investment affiliate. Our insurance subsidiaries and mutual insurance company affiliate provide personal and commercial automobile insurance and other specialty property-casualty insurance and related services. Our property-casualty insurance products protect our customers against losses due to collision and physical damage to their motor vehicles, 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 and limited partnership investment affiliate generally support our insurance and investment operations. We operate our businesses throughout the United States and sell personal auto insurance on an Internet-only basis in Australia.

#### (b) Financial Information About Segments

Incorporated by reference from Note 10 - Segment Information in our 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 \$17.3 billion in 2013, compared to \$16.4 billion in 2012 and \$15.1 billion in 2011. Our combined ratio, which we calculate by dividing the sum of our loss and loss adjustment expenses, policy acquisition costs, and other underwriting expenses, net of "fees and other revenues," by our net premiums earned, was 93.5 in 2013, 95.6 in 2012, and 93.0 in 2011.

#### Organization

Auto insurance differs greatly by community because legal requirements and 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:

**Personal Lines** – A Group President manages our Personal Lines business, which includes insurance for personal autos and special lines products (e.g., motorcycles, ATVs, RVs, mobile homes, watercraft, snowmobiles, and similar items): We currently write personal auto insurance in all 50 of the United States, the District of Columbia, and on an Internet-only basis in Australia. Our personal auto management group is organized by state into four geographic regions in the United States, plus a region for Australia. Each region is led by a general manager. We have a separate manager for our California Agency organization.

We write the majority of our special lines products in all 50 states. Our special lines management group is organized by product and led by a general manager.

**Commercial Lines** – A Group President manages our Commercial Lines business, which offers products in 49 states; we do not currently write Commercial Lines in Hawaii or the District of Columbia. The Commercial Lines business is organized by state, with product managers responsible for local implementation. These state-level managers are led by two regional directors who report to a general manager.

**Claims** – A Group President manages our Claims business function, which is organized into four groups. Three of the groups are based on geographic region, and one is a countrywide group that provides various claims-related services, including catastrophe response and special investigations. Each group is headed by a general manager, and each handles both Personal Lines and Commercial Lines claims.



Our customer service groups, located at call centers in Mayfield Village, Ohio; Austin, Texas; Tampa, Florida; Sacramento, California; Phoenix, Arizona; and Colorado Springs, Colorado, support our policy servicing, agency distribution, claims, and direct sales operations.

Our executive management team sets policies and makes key strategic decisions. This team includes the Chief Executive Officer, Chief Financial Officer, Chief Legal Officer, Chief Investment Officer, Chief Information Officer, Chief Human Resource Officer, and Chief Marketing Officer, as well as our three Group Presidents (discussed above). 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 personal autos 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 approximately 90% of total net premiums written during each of the last three years. Our strategy is to be a competitively priced provider of a full line of auto insurance products with distinctive service, distributed through whichever channel the customer prefers. Volume potential is driven by our price competitiveness, brand recognition, service quality, and the actions of our competitors, among other factors. See “Competitive Factors” herein for further discussion.

The Personal Lines segment consists of our personal auto insurance products, as well as our special lines products.

Personal auto insurance represented approximately 90% of our total Personal Lines net premiums written for each of the last three years. This business includes Snapshot®, our usage-based insurance program, which is available to consumers through both the Agency and Direct channels in 44 states and the District of Columbia and to consumers in Massachusetts only on a Direct basis; continued expansion is planned for 2014, depending on regulatory approval. During 2013, the annual premiums from customers choosing Snapshot surpassed \$2 billion.

We ranked fourth in market share in the U.S. private passenger auto market for 2012 based on net premiums written and believe that we held that position for 2013. There are approximately 320 competitors in this market. Progressive and the other leading 14 private passenger auto insurers, each of which writes over \$2.0 billion of premiums, comprise about 75% of this market. For 2012, the industry net premiums written for private passenger auto insurance in the United States was \$167.9 billion, and our share of this market was approximately 8.5%, compared to \$163.3 billion and 8.1% in 2011, respectively; comparable industry data is not available for 2013 at this time. All industry data, including ranking and market share, was obtained directly from data reported by either SNL Financial or A.M. Best Company, Inc. (“A.M. Best”), or was estimated using A.M. Best data as the primary source.

Special lines products include insurance for motorcycles, ATVs, RVs, mobile homes, watercraft, snowmobiles, and similar items, and represent about 10% of our Personal Lines business. 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 the motorcycle product since 1998. We also offer a personal umbrella insurance product in 37 states and the District of Columbia through certain independent agents and to Direct customers via telephone.

Our Personal Lines products are sold through both the Agency and Direct channels:

The Agency business includes business written by our network of more than 35,000 independent insurance agencies located throughout the United States, including 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 insurance through strategic alliance business relationships with other insurance companies, financial institutions, and national agencies. The total net premiums written through the Agency business represented 56% of our Personal Lines volume in both 2013 and 2012, compared to 57% in 2011.

The Direct business includes business written directly by us online, via mobile devices, and over the phone. The Direct business represented 44% of our Personal Lines volume in both 2013 and 2012, compared to 43% in 2011.

#### Commercial Lines

The Commercial Lines business writes primary liability and physical damage insurance for automobiles and trucks owned and/or operated predominantly by small businesses and represented approximately 10% of our total net premiums written during each of the last three years. The majority of our Commercial Lines customers insure two or fewer vehicles. The Commercial Lines business, which is primarily distributed through the independent agency channel, operates in the following business market targets:

- Business auto – autos, vans, and pick-up trucks used by small businesses, such as retailing, farming, services, and private trucking

- For-hire transportation – tractors, trailers, and straight trucks primarily used by regional general freight and expeditor-type businesses and non-fleet long-haul operators

- Contractor – vans, pick-up trucks, and dump trucks used by small businesses, such as artisans, heavy construction, and landscapers/snowplowers

- For-hire specialty – dump trucks, log trucks, and garbage trucks used by dirt, sand and gravel, logging, and coal-type businesses, and

- Tow – tow trucks and wreckers used in towing services and gas/service station businesses.

Business auto is our largest business market target, measured by premium volume, and accounts for approximately one third of our total Commercial Lines premiums, while the for-hire transportation and contractor business market targets each account for about another 25%. Business auto and contractor together account for approximately 75% of the vehicles we insure in this business, while for-hire transportation accounts for about 15%. Although Commercial Lines differs from Personal Lines auto in its customer base and products written, both businesses require the same fundamental skills, including disciplined underwriting and pricing, as well as excellent claims service.

There are approximately 340 competitors in the total commercial auto market. We primarily compete with about 32 other large companies/groups, each with over \$140 million of commercial auto premiums written annually. These leading commercial auto insurers comprise about 75% of this market. Our Commercial Lines business ranked second in the commercial auto insurance market for 2012, up one place from 2011, based on net premiums written. We believe that we retained the number two position for 2013.

#### Other Indemnity

Our other indemnity businesses consist of managing our run-off businesses, including the run-off of our professional liability business, which was sold in 2010. Pursuant to our agreement with the purchaser of this business, from the date of sale through April 30, 2012, we continued to write these policies, principally directors and officers liability insurance for community banks. All professional liability insurance policies written in July 2010 and later were 100% reinsured. From August 2009 through June 2010, the substantial majority of the risks on this business were 100% reinsured and prior to August 2009, a majority of the risk on this business was reinsured with various reinsurance entities.



### Service Businesses

Our service businesses, which represent less than 1% of our total revenues and do not have a material effect on our overall operations, primarily include:

**Commercial Auto Insurance Procedures/Plans (CAIP)** – We are the only servicing carrier on a nationwide basis for CAIP, which are state-supervised plans servicing the involuntary market in 42 states and the District of Columbia. As a service provider, we provide policy issuance and claims adjusting services and collect fee revenue that is earned on a pro rata basis over the terms of the related policies. We have an agreement with AIPSO (the national organization responsible for administering the involuntary insurance market) under which we will receive a supplemental fee, when necessary, to satisfy a minimum servicing fee requirement; this agreement is scheduled to expire on August 31, 2014. 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.

**Commission-Based Businesses** – We have two commission-based service businesses.

Through Progressive Home Advantage®, we offer, either directly or through our network of independent agents, home, condominium, and renters insurance written by eleven unaffiliated homeowner's insurance companies. Progressive Home Advantage is not currently available to customers in Alaska and is available to only Agency customers in Florida. For the policies written under this program in our Direct business, we receive commissions, all of which are used to offset the expenses associated with maintaining this program.

Through Progressive Commercial Advantage<sup>SM</sup>, we offer our customers the ability to package their auto coverage with other commercial coverages that are written by seven unaffiliated insurance companies or placed with additional companies through unaffiliated insurance agencies. This program offers general liability and business owners policies throughout the continental United States and workers' compensation coverage in 44 states as of December 31, 2013. We receive commissions for the policies written under this program, all of which are used to offset the expenses associated with maintaining this program.

### Claims

We manage our claims handling on a companywide basis through approximately 275 claims offices located throughout the United States. In 48 metropolitan areas across the country, we have in operation 63 Service Centers, of which 30 have combined our claims offices and Service Centers to improve our efficiency and manage costs. Insureds and other claimants can elect to have their vehicles repaired by their own repair shops, have their vehicles repaired by one of our network shops, or have the entire repair process coordinated by one of our Service Centers. If a customer elects to repair their vehicle through a Service Center, we 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 arrange the repair, including pick-up and delivery of the vehicle, and inspect the vehicle once the repairs are complete. Under the Service Center option, we guarantee the repairs for as long as the customer owns or leases their car. If a customer decides not to repair their vehicle, our representatives will write an estimate and the customer can receive payment on the spot. This innovative, patented approach to the vehicle repair process increases consumer satisfaction and our productivity and improves the cycle time in comparison to our other claims settlement processes.

### 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, agent commission rates, consumer recognition and confidence, 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 in both the Agency and Direct channels, and by smaller regional insurers. In the Agency channel, some of our competitors have broad distribution networks of employed or captive agents. With widely available comparative rating services, consumers can easily compare prices among competitors. Many competitors invest heavily in advertising and



marketing efforts and/or expanding their online or mobile service offerings. Over the past decade, these changes have further intensified the competitive nature of the automobile and other property-casualty insurance markets in which we operate.

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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.

Competition in our insurance markets is affected by the pace of technological developments. An insurer's ability to innovate, develop, and implement new applications and other technologies can affect its competitive position. In addition, there has been a proliferation of patents related to new ways in which technologies can affect its competitive position. We have seven U.S. patents, and additional patents pending, with respect to certain methods, systems, and devices related to usage-based insurance. Certain of these patents expire on or about January 29, 2016, while others extend well beyond that date. Three of these seven patents have been challenged in actions filed with the Patent Trial and Appeal Board (PTAB) of the U.S. Patent and Trademark Office. The challenger has prevailed in the initial proceeding with respect to two of those patents, and we are awaiting a ruling from the PTAB with respect to the third patent. We also have a significant amount of "know-how" developed from years of experience with usage-based insurance, and from analyzing the data from over 9 billion driving miles derived from usage-based devices. We believe this intellectual property provides us with a competitive advantage in the usage-based insurance market. We also hold a U.S. patent (expiring June 2021), and a U.S. patent application pending, on our innovative approach to the vehicle repair service described above, and a U.S. patent (expiring in June 2028) on the Name Your Price<sup>®</sup> functionality on our website. In addition, we hold four patents (expiring July 2019), and additional patents pending, related to our online policy self-service technology. Two of these four patents have been challenged in actions filed with the PTAB. The challenger has prevailed in these initial proceedings. We intend to appeal all of the adverse rulings from the PTAB. The patents that are the subject of these rulings remain valid and in effect until all appeals are exhausted.

In addition, we have licensed certain of our patent rights for domestic use to five other insurance companies. We continue to pursue other ways in which to leverage this intellectual property. Currently, we do not expect these licensing activities to have a material effect on our operations, results of operations, or financial condition in the current fiscal year.

#### State Insurance Licenses

Our 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 our 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 its mutual insurance company affiliate are domiciled in the states of Indiana, Louisiana, Michigan, New Jersey, New York, Ohio, Texas, and Wisconsin. In addition, California and Florida treat certain Progressive subsidiaries as domestic insurers for certain purposes under their "commercial domicile" laws.

State insurance laws impose numerous requirements, conditions, and limitations on the operations of insurance companies. Insurance departments have broad regulatory powers relating to those operations. Regulated areas include, among others:

- Licensing of insurers and agents
- Capital and surplus requirements
- Statutory accounting principles specific to insurance companies and the content of required financial and other reports
- Requirements for establishing insurance reserves

Investments

Acquisitions of insurers and transactions between insurers and affiliates

Limitations on rates of return or profitability

Rating criteria, rate levels, and rate changes

Insolvencies of insurance companies

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Assigned risk programs

Authority to exit a business, and

Numerous requirements relating to other areas of insurance operations, including: required coverages, policy forms, underwriting standards, and claims handling.

Insurance departments are authorized to conduct periodic and other examinations of regulated insurers' financial condition and operations to monitor the financial stability of the insurers and to ensure adherence to statutory accounting principles and compliance with state insurance laws and regulations. In addition, in some states, the attorney general's office may exercise certain supervisory authority over insurance companies and, from time to time, may investigate certain insurance company practices.

Insurance departments establish and monitor compliance with capital and surplus requirements. 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 surplus, generally 3 to 1. Thus, the amount of an insurer's statutory surplus, in certain cases, may limit its ability to grow its business. At year-end 2013, we had net premiums written of \$17.3 billion and statutory surplus of \$6.0 billion. The combined premiums-to-surplus ratio for all Progressive insurance companies was 2.9 to 1. In addition, as of December 31, 2013, we had access to \$1.8 billion of securities held in a non-insurance subsidiary, portions of which could be contributed to the capital of our insurance subsidiaries to support growth and for other purposes as needed. The National Association of Insurance Commissioners (NAIC) also has developed a risk-based capital (RBC) program to enable regulators to identify and 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. At December 31, 2013, Progressive's RBC ratios were well in excess of minimum requirements.

Insurance companies are generally required to file detailed annual and other reports with the insurance department of each jurisdiction in which they conduct business. These reports include:

- the insurer's financial statements under statutory accounting principles
- details concerning claims reserves held by the insurer
- specific investments held by the insurer, and
- numerous other disclosures about the insurer's financial condition and operations.

State insurance laws and insurance departments also regulate investments that insurers are permitted to make.

Limitations are placed on the amounts an insurer may invest in a particular issuer, as well as the aggregate amount an insurer may invest in certain types of investments. Certain investments are prohibited.

Insurance holding company laws enacted in many jurisdictions authorize insurance departments to regulate acquisitions of insurers and certain other transactions and to require periodic disclosure of specified information. These laws impose prior approval requirements for certain transactions between insurers and their affiliates and generally regulate dividend and other distributions, including loans and cash advances, between insurers and their affiliates. See the "Dividends" discussion in Item 5(c) herein for further information on these dividend limitations. The scope of insurance holding company regulation has expanded as states have adopted the revised model holding company act promulgated by the NAIC in 2010.

Under state insolvency and guaranty laws, 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 that cannot find coverage 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.

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.

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As mentioned above, insurance departments have regulatory authority over many other aspects of an insurer's insurance operations, including coverages, forms, rating criteria, and rate levels. The ability to implement changes to these items on a timely basis is critical to our ability to compete effectively in the marketplace. Rate regulation varies from "use and file," to "file and use," to prior approval.

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 insurance departments have issued bulletins, directives, or regulations that regulate or prohibit the use of credit by insurers. In addition, a number of states are considering or have passed legislation to regulate insurers' use of credit information. The use of credit information continues to be a regulatory and legislative issue, and it is possible that the U.S. Congress or one or more states may enact further legislation affecting its use in underwriting and rating.

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 or to respond to perceived investment risks, while others reflect concerns about consumer privacy, insurance availability, prices, allegations of discriminatory pricing, 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 credit information in underwriting and rating, insurance rate development, rate of return limitations, and the ability of insurers to cancel or non-renew insurance policies. 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 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act created a new Federal Insurance Office, which is required to collect information about the insurance industry and monitor the industry for systemic risk.

In addition to our U.S. operations, we write personal auto physical damage and property damage liability insurance in Australia through a branch of one of our U.S. insurance subsidiaries. This insurance is offered solely through the Internet. We do not write auto bodily injury liability or medical payment insurance in Australia. There are two primary agencies that regulate insurance in Australia: the Australian Securities and Investment Commission, which regulates customer disclosures, and the Australian Prudential Regulatory Authority, which regulates solvency. Both agencies enforce laws within their jurisdiction, issue regulations, take enforcement actions, and, in general, have broad regulatory powers. Progressive Direct Insurance Company has been issued licenses by both agencies and the licenses are in good standing.

# Statutory Accounting Principles

Our results are reported in accordance with accounting principles generally accepted in the United States of America (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 the successful acquisition of 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	Premiums receivable are reported net of an allowance for doubtful accounts.	Premiums receivable over 90 days past due are “non-admitted,” which means they are excluded from surplus. For premium receivable 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 would be recorded for any tax benefits that are not expected to be realized.	The accounting for deferred tax assets is consistent with GAAP, except for deferred tax assets that do not meet statutory requirements for recognition, which 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 fair values.	Fixed-maturity securities are reported at amortized cost or the lower of amortized cost or fair value, depending on the NAIC designation of the security.
	Preferred stocks, both redeemable and nonredeemable, are reported at fair values.	Redeemable preferred stocks are reported at amortized cost or the lower of amortized cost or fair value, depending on the NAIC designation of the security. Nonredeemable preferred stocks are reported at fair value, consistent with GAAP.

Federal Income

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Taxes

Federal tax expense includes 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 on admissibility.

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## Investments

Our investment goals are to manage our portfolio on a total return basis to support all of the insurance premiums that we can profitably write and contribute to our comprehensive income. Our portfolio is invested primarily in short-term and intermediate-term, investment-grade fixed-income securities. Our investment portfolio had a fair value of \$18.1 billion at December 31, 2013, compared to \$16.5 billion at December 31, 2012. 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. Total investment income, including net realized gains (losses) on securities, before expenses and taxes, was \$740.4 million in 2013, compared to \$749.8 million in 2012 and \$582.6 million in 2011. On a pretax total return basis (i.e., total investment income plus changes in unrealized gains/losses) investment income was \$870.0 million, \$1,026.6 million, and \$452.6 million for the years ended December 31, 2013, 2012, and 2011, respectively. For more detailed discussion, see Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report, which is included as Exhibit 13 to this Form 10-K.

## Employees

The number of employees, excluding temporary employees, at December 31, 2013 was 26,145, 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. Adjustments, if any, relating to accidents that occurred in prior years are reflected in the current year results of operations and are referred to as "development" of the prior year estimates. 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 July 12, 2013, as well as in section "V. Critical Accounting Policies" of our Management's Discussion and Analysis of Financial Condition and Results of Operations in our 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 the last three years:

## RECONCILIATION OF NET RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

(millions)	2013	2012	2011
Balance at January 1	\$7,838.4	\$7,245.8	\$7,071.0
Less reinsurance recoverables on unpaid losses	862.1	785.7	704.1
Net balance at January 1	6,976.3	6,460.1	6,366.9
Incurred related to:			
Current year	12,427.3	11,926.0	10,876.8
Prior years	45.1	22.0	(242.0)
Total incurred	12,472.4	11,948.0	10,634.8
Paid related to:			
Current year	8,095.0	7,895.3	7,289.3
Prior years	3,919.9	3,536.5	3,252.3
Total paid	12,014.9	11,431.8	10,541.6
Net balance at December 31	7,433.8	6,976.3	6,460.1
Plus reinsurance recoverables on unpaid losses	1,045.9	862.1	785.7
Balance at December 31	\$8,479.7	\$7,838.4	\$7,245.8

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Our reserves developed unfavorably by \$45.1 million in 2013 and \$22.0 million in 2012, compared to favorable development of \$242.0 million in 2011, which is reflected as "Incurred related to prior years" in the table above. Total development consists of net changes made by our actuarial department on prior accident year reserves, based on regularly scheduled reviews, claims settling for more or less than reserved, changes in reserve estimates by claim representatives, and emergence of unrecorded claims at rates different than anticipated.

During 2013, unfavorable reserve development in our Commercial Lines business was primarily attributable to higher frequency and severity on late emerging claims primarily in our bodily injury coverage for our truck business. In addition, unfavorable development in our Personal Lines business reflects unfavorable reserve development in our Agency auto business IBNR reserves due to higher frequency and severity on late emerging claims, offset in large part by favorable development in our Direct auto business due to lower than anticipated severity costs on case reserves.

We also experienced unfavorable reserve development in our other businesses, primarily due to reserve increases in our run-off professional liability group business, based on recent internal actuarial reviews of our claims history.

During 2012, unfavorable reserve development in our personal auto product was primarily attributable to reserve development in our Florida personal injury protection (PIP) coverage and an increase in our estimate of bodily injury severity for accident year 2011. In addition, unfavorable development in our Commercial Lines business reflects higher than anticipated frequency and severity costs on late emerging claims and higher settlements on large losses.

This unfavorable development was partially offset by favorable reserve adjustments, primarily in our loss adjustment expense reserves and our personal auto bodily injury reserves for accident years 2009 and 2008.

In 2011, the favorable reserve development reflected the settlement of larger losses for amounts less than we originally reserved in our Personal Lines (primarily in our personal auto product) and Commercial Lines businesses.

We also experienced lower than expected defense and cost containment costs, reflecting a combination of fewer claims being litigated, as well as the fact that a greater percentage of these cases are now being handled by our in-house counsel, which is a cost-effective alternative to using external law firms.

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, claims resolution practices, 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.

## ANALYSIS OF LOSS AND LOSS ADJUSTMENT EXPENSES DEVELOPMENT

(\$ in millions)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
LIABILITY FOR UNPAID LOSSES AND LAE - GROSS	\$4,576.3	\$5,285.6	\$5,660.3	\$5,725.0	\$5,942.7	\$6,177.4	\$6,653.0	\$7,071.0	\$7,245.8	\$7,838.4
LESS:										
REINSURANCE RECOVERABLES ON UNPAID LOSSES	229.9	337.1	347.2	361.4	287.5	244.5	529.4	704.1	785.7	862.1
LIABILITY FOR UNPAID LOSSES AND LAE - NET <sup>1</sup>	4,346.4	4,948.5	5,313.1	5,363.6	5,655.2	5,932.9	6,123.6	6,366.9	6,460.1	6,976.3
PAID (CUMULATIVE) AS OF:										
One year later	2,233.8	2,355.5	2,662.1	2,897.4	3,036.9	3,172.0	3,047.0	3,252.3	3,536.5	3,919.9
Two years later	3,148.1	3,430.6	3,931.0	4,240.4	4,361.4	4,427.8	4,348.4	4,724.0	5,111.6	—
Three years later	3,642.5	3,999.9	4,584.7	4,856.2	4,966.1	5,031.7	5,007.9	5,459.4	—	—
Four years later	3,873.0	4,269.6	4,839.1	5,121.9	5,227.5	5,314.7	5,323.9	—	—	—
Five years later	3,977.1	4,368.6	4,948.7	5,229.0	5,340.1	5,452.0	—	—	—	—
Six years later	4,012.5	4,419.2	4,995.6	5,282.1	5,402.3	—	—	—	—	—
Seven years later	4,034.4	4,445.7	5,023.7	5,317.8	—	—	—	—	—	—
Eight years later	4,047.3	4,459.8	5,042.3	—	—	—	—	—	—	—
Nine years later	4,054.9	4,467.4	—	—	—	—	—	—	—	—
Ten years later	4,060.3	—	—	—	—	—	—	—	—	—
LIABILITY RE-ESTIMATED AS OF:										
One year later	4,237.3	4,592.6	5,066.2	5,443.9	5,688.4	5,796.9	5,803.2	6,124.9	6,482.1	7,021.4
Two years later	4,103.3	4,485.2	5,130.5	5,469.8	5,593.8	5,702.1	5,647.7	6,074.4	6,519.6	—
Three years later	4,048.0	4,501.6	5,093.6	5,381.9	5,508.0	5,573.8	5,575.0	6,075.9	—	—
Four years later	4,070.0	4,471.0	5,046.7	5,336.5	5,442.1	5,538.5	5,564.6	—	—	—
Five years later	4,073.7	4,475.5	5,054.6	5,342.8	5,452.8	5,580.0	—	—	—	—
Six years later	4,072.4	4,486.4	5,060.8	5,352.8	5,475.6	—	—	—	—	—
Seven years later	4,080.5	4,486.3	5,070.2	5,369.7	—	—	—	—	—	—
Eight years later	4,077.8	4,493.3	5,081.7	—	—	—	—	—	—	—
Nine years later	4,082.7	4,497.5	—	—	—	—	—	—	—	—
Ten years later	4,086.1	—	—	—	—	—	—	—	—	—
NET CUMULATIVE DEVELOPMENT FAVORABLE/ (UNFAVORABLE)	\$260.3	\$451.0	\$231.4	\$(6.1)	\$179.6	\$352.9	\$559.0	\$291.0	\$(59.5)	\$(45.1)
PERCENTAGE <sup>2</sup>	6.0	9.1	4.4	(.1)	3.2	5.9	9.1	4.6	(.9)	(.6)
RE-ESTIMATED LIABILITY FOR UNPAID LOSSES	\$4,463.2	\$5,005.0	\$5,688.2	\$6,033.7	\$6,175.5	\$6,319.6	\$6,360.3	\$6,963.8	\$7,446.5	\$8,020.4

AND LAE - GROSS

LESS:

RE-ESTIMATED

REINSURANCE

RECOVERABLES	377.1	507.5	606.5	664.0	699.9	739.6	795.7	887.9	926.9	999.0
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ON UNPAID

LOSSES

RE-ESTIMATED

LIABILITY FOR

UNPAID LOSSES	\$4,086.1	\$4,497.5	\$5,081.7	\$5,369.7	\$5,475.6	\$5,580.0	\$5,564.6	\$6,075.9	\$6,519.6	\$7,021.4
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AND LAE - NET<sup>1</sup>

GROSS

CUMULATIVE

DEVELOPMENT:	\$113.1	\$280.6	\$(27.9 )	\$(308.7 )	\$(232.8 )	\$(142.2 )	\$292.7	\$107.2	\$(200.7 )	\$(182.0 )
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FAVORABLE/

(UNFAVORABLE)

<sup>1</sup> Represents loss and LAE reserves net of reinsurance recoverables on net unpaid losses at the balance sheet date.

<sup>2</sup> Cumulative development ÷ liability for unpaid losses and LAE - net.

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The above table presents the development of balance sheet liabilities for losses and LAE from 2003 through 2012. The top line of the table shows the estimated liability for unpaid losses and LAE recorded at December 31 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 and net 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 middle 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 balance sheet date. The estimate is increased or decreased as more information about the claims becomes known for individual years. For example, as of December 31, 2013, our insurance subsidiaries had paid \$4,467.4 million of the currently estimated \$4,497.5 million of losses and LAE that had been unpaid at the end of 2004; thus, an estimated \$30.1 million of losses incurred through 2004 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 2003 liability has developed favorably by \$260.3 million over ten years. That amount has been reflected in income over the ten years and had the largest impact on income in calendar year 2005. 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 10 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 2013, but incurred in 2010, will be included in the cumulative development amount for years 2010, 2011, and 2012. 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.

Our bodily injury severity change was much lower than we expected between 2003 and 2005; thus, the reserve run-off for these years was very favorable following the end of each year, or about 4% to 9% of our original carried amounts. The favorable reserve development for 2007 through 2010 was about 3% to 9% of our original carried reserves, which primarily reflects the decreases in severity between our original estimate and what we experienced in both our personal auto and commercial auto businesses during that period. For 2011 and 2012, we experienced very minimal unfavorable development, or less than 1% of our o