

Report of Examination of

Progressive Gulf Insurance Company
Cleveland, Ohio

As of December 31, 2007

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

Dear Madams and Sir:

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

Progressive Gulf 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, 2003. 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 opening 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.

Name	Principal Occupation
Karen M. Barone	Progressive Insurance Companies, Personal Lines General Manager
Richard R. Crawley	Progressive Insurance Companies, Direct Auto Product Research & Development Leader
Christopher J. Garson	Progressive Insurance Companies, Information Technology Business Leader
Steven B. Gellen	Progressive Insurance Companies, Customer Relationship Manager
Thomas H. Hollyer	Progressive Insurance Companies, National Product Development Leader

Officers

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

Name	Title
Richard R. Crawley	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
 Progny 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 Progressive Casualty Insurance 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 the states of Georgia, Mississippi, Ohio, and Virginia.

Percentage of Net Business Written by Line

<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	\$256,237,813
Total cash and invested assets	256,237,813

Investment income due and accrued	2,824,525
Uncollected premiums and agents' balances in course of collection	8,397,883
Deferred premiums, agents' balances and installments booked but deferred and not yet due	46,425,200
Amounts recoverable from reinsurers	2,570,402
Net deferred tax asset	6,179,818
Receivables from parent, subsidiaries and affiliates	7,172,283
Total admitted assets	\$329,807,924

Liabilities, capital and surplus

Liabilities:

Losses	\$56,434,723
Reinsurance payable on paid losses and loss adjustment expenses	1,347,201
Loss adjustment expenses	13,885,359
Commissions payable, contingent commissions, and other charges	436,612
Other expenses	5,149,507
Taxes, licenses and fees	1,341,633
Current federal and foreign income taxes	1,485,955
Unearned premiums	49,258,051
Advance premiums	1,171,665
Drafts outstanding	15,233,298
Payable for securities	80,354
Aggregate write-ins for liabilities:	
State plan liability	534,560
Unearned fee reserve	8,277
Escheatable property	2,371
Total liabilities	146,369,566

Capital and surplus:

Common capital stock	1,500,000
Gross paid in and contributed surplus	3,188,612
Unassigned funds	178,749,746
Total capital and surplus	183,438,358
Total liabilities, capital and surplus	\$329,807,924

Statement of Operations

December 31, 2007

Premiums earned	\$169,829,772
Losses incurred	101,134,648
Loss expenses incurred	20,061,482
Other underwriting expenses incurred	36,502,558
Net underwriting gain	<u>12,131,084</u>
Net investment income earned	10,573,224
Net realized capital gains	194,776
Net investment gain	<u>10,768,000</u>
Net gain (loss) from agents' or premium balances charged off	(4,039,279)
Finance and service charges not included in premiums	5,716,497
Aggregate write-ins for miscellaneous income:	
Interest income on intercompany balances	850,897
Miscellaneous income	79,189
Service business revenue	41,698
Total other income	<u>2,649,002</u>
Net income before federal and foreign income taxes	25,548,086
Federal and foreign income taxes incurred	6,650,714
Net income	<u>\$18,897,372</u>

Statement of Changes in the Capital and Surplus Account

(In thousands)

	2003	2004	2005	2006	2007
Capital and surplus December 31, previous year	<u>\$60,560</u>	<u>\$84,164</u>	<u>\$114,213</u>	<u>\$138,557</u>	<u>\$164,604</u>
Net income	24,235	30,729	25,363	26,436	18,897
Change in net deferred income tax	(75)	(527)	(55)	(867)	(573)
Change in nonadmitted assets	<u>(556)</u>	<u>(153)</u>	<u>(964)</u>	478	510
Net change in capital and surplus	<u>23,604</u>	<u>30,049</u>	<u>24,344</u>	<u>26,047</u>	<u>18,834</u>
Capital and surplus December 31, current year	<u>\$84,164</u>	<u>\$114,213</u>	<u>\$138,557</u>	<u>\$164,604</u>	<u>\$183,438</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	<u>100.0%</u>	<u>77.7%</u>
Totals	<u>100.0%</u>	<u>77.7%</u>

The bond portfolio included 49.4% of federal, state, and local government issues, 16.4% special revenue and 34.2% industrial and miscellaneous. The NAIC Securities Valuation Office (SVO) and/or a NAIC Acceptable Rating Organization (ARO) rated 96.4% of the bond portfolio as Class 1 and 3.6% Class 5.

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

Loss and Loss Adjustment Expense Reserves

The Company's 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 \$10,044,346 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>\$329,807,924</u>
Liabilities	\$146,369,566
Surplus as Regards Policyholders	<u>183,438,358</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$329,807,924</u>

Acknowledgement

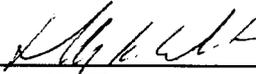
Appreciation is expressed for the assistance extended by the officers and employees of the Company during the course of this examination.

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