

Report of Examination of

Progressive Northwestern 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 & Regulation
445 East Capital Avenue, 1st 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, KY 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
3rd 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 Northwestern 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 Company was last examined by the State of Washington as of December 31, 2002 and the state of domicile was changed to Ohio on December 21, 2004. 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.

Name	Principal Occupation
Richard R. Crawley	Progressive Insurance Companies, Direct Auto Product Research and Development Leader
Steven B. Gellen	Progressive Insurance Companies, Customer Relationship Management Manager
Thomas H. Hollyer	Progressive Insurance Companies, National Product Development Leader
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:

Name	Title
Mark D. Niehaus	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

Artisan 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 style="width: 100%; border: 1px solid black;"/>
	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 following states:

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

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	5.7%
All Other	2.5%
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	\$616,885,789
Preferred stocks	39,416,308
Common stocks	353,925,548
Cash and short-term investments	12,335,516
Receivable for securities	300,240
Total cash and invested assets	<u>1,022,863,401</u>

Investment income due and accrued	9,404,339
Uncollected premiums and agents' balances	15,778,079
Deferred premiums, agents' balances and installments booked but deferred and not yet due	75,061,641
Amounts recoverable from reinsurers	4,174,005
Receivables from parent, subsidiaries and affiliates	13,716,692
Total admitted assets	<u>\$1,140,998,157</u>

December 31, 2007

Liabilities, capital and surplus

Liabilities:

Losses	\$338,608,338
Reinsurance payable on paid losses and loss adjustment expenses	8,083,204
Loss adjustment expenses	83,312,153
Commissions payable, contingent commissions and other charges	2,619,669
Other expenses	31,011,031
Taxes, licenses and fees	8,049,799
Current federal and foreign income taxes	6,492,039
Net deferred tax liability	13,038,866
Unearned premiums	295,548,307
Advance premiums	3,153,473
Amounts withheld or retained by company for account of others	79
Drafts outstanding	27,247,777
Aggregate write-ins for liabilities:	
State plan liability	3,618,106
Escheatable property	109,199
Unearned fee reserve	49,663
Other liabilities	43,310
Total liabilities	<u>820,985,013</u>

Capital and surplus:

Common capital stock	3,000,025
Gross paid in and contributed surplus	124,299,975
Unassigned funds	192,713,144
Total capital and surplus	<u>320,013,144</u>
Total liabilities, capital and surplus	<u>\$1,140,998,157</u>

Statement of Operations

December 31, 2007

Premiums earned	\$1,018,978,633
Losses incurred	606,807,889
Loss expenses incurred	120,368,890
Other underwriting expenses incurred	219,015,348
Net underwriting gain	<u>72,786,506</u>
Net investment income earned	40,135,745
Net realized capital gains	627,649
Net investment gain	<u>40,763,394</u>
Net gain (loss) from agents' or premium balances charged off	(5,918,437)
Finance and service charges not included in premiums	9,717,184
Interest income on intercompany balances	1,854,947
Miscellaneous income	475,135
Service business revenue	250,189
Total other income	<u>6,379,018</u>
Net income before federal and foreign income taxes	119,928,918
Federal and foreign income taxes incurred	<u>34,330,866</u>
Net income	<u>\$85,598,052</u>

Statement of Changes in the Capital and Surplus Account

(In thousands)

	2003	2004	2005	2006	2007
Capital and surplus December 31, previous year	\$375,645	\$490,673	\$438,470	\$373,558	\$359,268
Net income	144,576	174,211	138,676	140,506	85,598
Net unrealized capital gains	34,024	16,612	12,649	23,065	4,731
Change in net deferred income tax	(3,534)	(6,898)	(3,723)	(3,887)	(2,775)
Change in nonadmitted assets	9,962	(1,128)	(514)	1,026	191
Dividends to stockholders	(70,000)	(235,000)	(212,000)	(175,000)	(127,000)
Net change in capital and surplus	115,028	(52,203)	(64,913)	(14,290)	(39,255)
Capital and surplus December 31, current year	<u>\$490,673</u>	<u>\$438,470</u>	<u>\$373,558</u>	<u>\$359,268</u>	<u>\$320,013</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	60.3%	54.0%
Common stocks	34.6%	31.0%
Preferred stocks	3.9%	3.5%
Cash and short-term investments	1.2%	1.1%
Receivables for securities	0.0%	0.0%
Totals	<u>100.0%</u>	<u>89.6%</u>

The bond portfolio included 17.7% of federal, state, and local government issues, 27.7% special revenue and 54.6% industrial and miscellaneous. The NAIC Securities Valuation Office (SVO) and/or a NAIC Acceptable Rating Organization (ARO) rated 86.5% of the bond portfolio as Class 1, 8.3% Class 2, 1.5% Class 3, and 3.7% Class 6. 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'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 \$42,638,709 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:

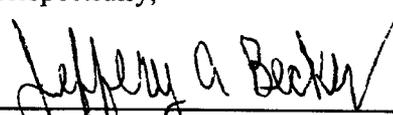
Total Admitted Assets	<u>\$1,140,998,157</u>
Liabilities	\$820,985,013
Surplus as Regards Policyholders	<u>320,013,144</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$1,140,998,157</u>

Acknowledgement

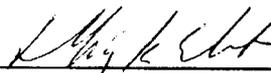
Appreciation is expressed for the assistance extended by the officers and employees of the Company during the course of this examination.

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; 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 2/12/09
Jeffery A. Becker, CFE Date
Examiner-In-Charge

Jeffrey K. Ebert 2/12/09
Jeffrey K. Ebert, CFE Date
Assistant Chief Examiner

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 **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 **ELIZABETH CHASE**
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2012
My Commission Expires