

Report of Examination of

Progressive Preferred Insurance Company
Cleveland, Ohio

As of December 31, 2007

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Columbus, Ohio
February 12, 2009

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Chairman, Financial Condition (E) Committee
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Honorable Mary Jo Hudson
Director
State of Ohio
Department of Insurance
50 West Town Street
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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 Preferred 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.

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
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 the following states:

Alaska	Arizona	Colorado	Delaware
District of Columbia	Georgia	Hawaii	Idaho
Indiana	Iowa	Kentucky	Maine
Maryland	Michigan	Minnesota	Mississippi
Missouri	Montana	Nebraska	Nevada
New Jersey	New Mexico	New York	North Carolina
Ohio	Oklahoma	Oregon	Pennsylvania
Rhode Island	South Carolina	South Dakota	Tennessee
Texas	Utah	Virginia	Washington
West 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	\$416,414,425
Receivable for securities	5,754
Total cash and invested assets	<u>416,420,179</u>

Investment income due and accrued	7,137,732
Uncollected premiums and agents' balances	18,469,688
Deferred premiums, agents' balances and installments booked but deferred and not yet due	96,024,011
Amounts recoverable from reinsurers	4,976,250
Net deferred tax asset	18,308,980
Receivables from parent, subsidiaries and affiliates	25,315,129
Aggregate write-ins for other than invested assets:	
State tax credits	358,750
Total admitted assets	<u>\$587,010,719</u>

December 31, 2007

Liabilities, capital and surplus

Liabilities:

Losses	\$169,304,169
Reinsurance payable on paid losses	4,041,602
Loss adjustment expenses	41,656,077
Commissions payable	1,309,835
Other expenses	15,448,519
Taxes, licenses and fees	4,024,900
Current federal and foreign income taxes	2,890,300
Unearned premiums	147,774,154
Advance premium	5,130,446
Ceded reinsurance premiums payable	371,837
Drafts outstanding	33,321,762
Payable for securities	41,779
Aggregate write-ins for liabilities:	
Other liabilities	845,793
State plan liability	523,851
Escheatable property	226,528
Unearned fee reserve	24,831
Total liabilities	<u>426,936,383</u>

Capital and surplus:

Common capital stock	3,003,300
Gross paid in and contributed surplus	40,712,474
Unassigned funds	<u>116,358,562</u>
Total capital and surplus	<u>160,074,336</u>
Total liabilities, capital and surplus	<u>\$587,010,719</u>

Statement of Operations

December 31, 2007

Premiums earned	\$509,489,316
Losses incurred	303,403,944
Loss expenses incurred	60,184,445
Other underwriting expenses incurred	109,507,674
Net underwriting gain	<u>36,393,253</u>
Net investment income earned	21,182,935
Net realized capital gains	750,429
Net investment gain	<u>21,933,364</u>
Net gain (loss) from agents' or premium balances charged off	(8,271,798)
Finance and service charges not included in premiums	13,699,137
Aggregate write-ins for miscellaneous income:	
Interest income on intercompany balances	1,794,799
Miscellaneous income	237,567
Service business revenue	125,094
Total other income	<u>7,584,799</u>
Net income before federal and foreign income taxes	65,911,416
Federal and foreign income taxes incurred	21,051,532
Net income	<u>\$44,859,884</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>\$181,182</u>	<u>\$238,111</u>	<u>\$198,108</u>	<u>\$184,203</u>	<u>\$171,521</u>
Net income	75,497	86,987	65,700	71,349	44,859
Net unrealized capital gains (losses)	(149)	-0-	-0-	-0-	-0-
Change in net deferred income tax	(601)	(1,877)	(1,347)	(2,359)	(310)
Change in nonadmitted assets	(818)	(113)	(258)	1,328	(1,796)
Dividends to stockholders	<u>(17,000)</u>	<u>(125,000)</u>	<u>(78,000)</u>	<u>(83,000)</u>	<u>(54,200)</u>
Net change in capital and surplus	<u>56,929</u>	<u>(40,003)</u>	<u>(13,905)</u>	<u>(12,682)</u>	<u>(11,447)</u>
Capital and surplus December 31, current year	<u>\$238,111</u>	<u>\$198,108</u>	<u>\$184,203</u>	<u>\$171,521</u>	<u>\$160,074</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>70.9%</u>
Totals	<u>100.0%</u>	<u>70.9%</u>

The bond portfolio included 99.8% of federal, state, and local government issues and 0.2% industrial and miscellaneous. The NAIC Securities Valuation Office (SVO) and/or a NAIC Acceptable Rating Organization (ARO) rated 100.0 % of the bond portfolio as Class 1. 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.

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

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:

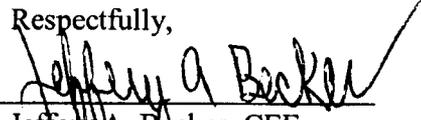
Total Admitted Assets	<u>\$587,010,719</u>
Liabilities	\$426,936,383
Surplus as Regards Policyholders	<u>160,074,336</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$587,010,719</u>

Acknowledgement

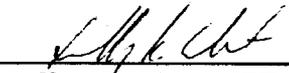
Appreciation is expressed for the assistance extended by the officers and employees of the Company during the course of this examination.

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