

Report of Examination of

**Progressive Gulf Insurance Company**  
Mayfield Village, Ohio

As of December 31, 2012

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Columbus, Ohio  
August 6, 2013

Honorable Mary Taylor  
Lt. Governor/Director  
Ohio Department of Insurance  
50 West Town Street  
3<sup>rd</sup> Floor – Suite 300  
Columbus, Ohio 43215

Dear Madam:

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 Company is 100% owned by Progressive Casualty Insurance Company (“PCIC”) and PCIC is 100% owned by Drive Insurance Holdings, Inc. (“DIHI”) and DIHI is 100% owned by The Progressive Corporation. The examination was conducted at Progressive’s home office, located at 6300 Wilson Mills Road, Mayfield Village, Ohio.

### **Scope of Examination**

The Department last examined the Company as of December 31, 2007. The current examination covers the period of January 1, 2008 through and including December 31, 2012.

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.

The State of Ohio took the lead role to perform the coordinated exam of the Progressive insurance companies and the States of Indiana, Louisiana, Michigan, New Jersey, New York, Texas and Wisconsin were all participants on the group examination.

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

For years covered by the examination, the certified public accounting firm of PricewaterhouseCoopers (“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.

In addition, the following items were reviewed during the course of this examination:

1. Company history;
2. fidelity bonds and other insurance;
3. officers’, employees’, and agents’ welfare and pension plans;
4. growth of Company;
5. loss experience;
6. pending litigation; and
7. Articles of Incorporation and Bylaws.

**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.

<u>Name</u>	<u>Principal Occupation</u>
Karen Marie Bailo	Business Leader Agency Distribution, Commercial Lines - Progressive
Thomas Hudson Hollyer	National Product Development Leader, Personal Lines - Progressive
Kathryn Margaret Lemieux	Customer Relation Management Systems Leader, Personal Lines - Progressive
Daniel Peter Mascaro	Business Leader Claims Legal, Claims Resolution – Progressive
David Lloyd Pratt	Business Leader Usage Based Insurance, Personal Lines – Progressive

## Officers

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

<u>Name</u>	<u>Title</u>
Kathryn Margaret Lemieux	President
Peter James Albert	Secretary
Thomas Alfred King	Treasurer

## Insurance Holding Company System

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. The Progressive Corporation is the ultimate controlling party of the insurance holding company system.

## Territory and Plan of Operations

The Company is licensed to transact business in the following states:

Georgia      Mississippi      Ohio      Virginia

The following schedule illustrates the Company's premium written in 2012 by line of business:

	<b>Direct</b>	<b>Assumed</b>	<b>Ceded</b>	<b>Net</b>	<b>Percent</b>
Private passenger auto liability	\$ 160,173,647	\$ 103,739,789	\$ 160,173,647	\$ 103,739,789	57.1%
Auto physical damage	99,750,218	61,831,140	99,750,218	61,831,140	34.1%
Commercial auto liability	20,101,130	11,111,755	20,101,130	11,111,755	6.1%
Inland marine	4,834,877	3,040,141	4,834,877	3,040,141	1.7%
Other liability – occurrence	2,589,359	1,262,855	2,589,359	1,262,855	0.7%
Homeowners multiple peril	-	561,591	-	561,591	0.3%
All other lines	=	<u>1,292</u>	=	<u>1,292</u>	<u>0.0%</u>
Totals	<u>\$ 287,449,231</u>	<u>\$ 181,548,563</u>	<u>\$ 287,449,231</u>	<u>\$ 181,548,563</u>	<u>100.0%</u>

## Significant Operating Results

The Company reported the following net underwriting results, reported in thousands, during the examination period:

	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Premiums earned	<u>\$ 178,135</u>	<u>\$ 167,153</u>	<u>\$ 161,997</u>	<u>\$ 162,863</u>	<u>\$ 162,477</u>
Losses incurred	115,401	102,968	96,456	96,415	100,178
Loss adjustment expenses incurred	18,416	17,304	17,499	17,781	19,320
Other underwriting expenses incurred	38,472	37,220	36,983	35,640	35,431
Aggregate write-ins	-	-	<u>(31)</u>	<u>31</u>	-
Total underwriting deductions	<u>172,289</u>	<u>157,492</u>	<u>150,907</u>	<u>149,867</u>	<u>154,929</u>
Net underwriting gain	<u>\$ 5,846</u>	<u>\$ 9,661</u>	<u>\$ 11,090</u>	<u>\$ 12,997</u>	<u>\$ 7,548</u>
Loss ratio	64.8%	61.6%	59.5%	59.2%	61.7%
Loss adjustment expense ratio	<u>10.3%</u>	<u>10.4%</u>	<u>10.8%</u>	<u>10.9%</u>	<u>11.9%</u>
Loss and LAE ratio	75.1%	72.0%	70.3%	70.1%	73.6%
Other underwriting expense ratio	<u>21.2%</u>	<u>22.0%</u>	<u>22.6%</u>	<u>22.1%</u>	<u>22.0%</u>
Combined ratio	<u>96.3%</u>	<u>94.0%</u>	<u>92.9%</u>	<u>92.2%</u>	<u>95.6%</u>

### Reinsurance

The Company is 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 Progressive Casualty Insurance Company, the pool manager and a pool participant. 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 Northern Insurance Company	12%
Progressive Northwestern 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 Mountain Insurance Company	1%
Progressive Southeastern Insurance Company	1%
Progressive Hawaii Insurance Corp.	<u>0%</u>
	100%

The Agency Pool's affiliated assumed reinsurance transactions are a result of (1) 90% quota-share reinsurance agreements with three of its non-pooled insurance affiliates, (2) a 100% quota-share reinsurance agreement with Progressive County Mutual Insurance Company, a managed but not owned insurance affiliate, and (3) aggregate stop loss reinsurance agreements with National Continental Insurance Company and Progressive Max Insurance Company, two affiliated insurance companies. The Agency Pool's ceded premiums consist of "State Plans". State Plans include (1) amounts ceded to state-provided reinsurance facilities, including the Michigan Catastrophic Claims Association and the North Carolina Reinsurance Facility, and (2) state-mandated involuntary CAIP, for which the Agency Pool retains no loss indemnity risk.

Effective April 11, 2011, the Company and thirty-two affiliates entered into an excess of loss agreement with Swiss Reinsurance America Corporation ("Swiss Re"), that applies to commercial vehicle policies with vehicle liability limits in excess of \$1 million, but not to exceed \$2 million. The companies cede to Swiss Re \$1 million in excess of \$1 million.

The examination noted that the Company has policies and procedures in place to comply with SSAP 62R and 63.

### **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, Capital and Surplus
- Statement of Income
- Statement of Changes in the Capital and Surplus Account

**Statement of Assets**  
**December 31, 2012**

**Admitted assets**

Bonds	\$ 198,578,444
Cash equivalents	<u>6,299,843</u>
Total cash and invested assets	204,878,287
Investment income due and accrued	1,370,416
Uncollected premiums and agents' balances in the course of collection	5,324,276
Deferred premiums, agents' balances and installments booked but deferred and not yet due	55,796,127
Amounts recoverable from reinsurers	1,357,669
Net deferred tax asset	6,820,109
Receivables from parent, subsidiaries and affiliates	6,874,783
Aggregate write-ins for other than invested assets	
State tax credits	<u>24,982</u>
Total admitted assets	<u>\$ 282,446,649</u>

**Statement of Liabilities, Capital and Surplus  
December 31, 2012**

**Liabilities**

Losses	\$ 62,042,143
Reinsurance payable on paid losses and loss adjustment expenses	1,422,431
Loss adjustment expenses	12,386,918
Commissions payable, contingent commissions and other similar charges	296,040
Other expenses	5,694,701
Taxes, licenses and fees	1,459,623
Current federal and foreign income taxes	2,565,050
Unearned premiums	54,033,444
Advance premium	1,422,212
Ceded reinsurance premiums payable	22,556
Drafts outstanding	13,221,692
Aggregate write-ins for liabilities	
State plan liability	677,118
Escheatable property	116,209
Other liabilities	74,727
Unearned fee reserve	<u>1,712</u>
Total liabilities	155,436,576

**Capital and Surplus**

Common capital stock	1,500,000
Gross paid in and contributed surplus	3,188,612
Unassigned funds	<u>122,321,461</u>
Surplus as regards policyholders	<u>127,010,073</u>
Total liabilities, capital and surplus	<u>\$ 282,446,649</u>

**Statement of Income**  
**As of December 31, 2012**

Premiums earned	<u>\$ 178,134,514</u>
Losses incurred	115,400,894
Loss adjustment expenses incurred	18,416,445
Other underwriting expenses incurred	<u>38,471,527</u>
Net underwriting gain	5,845,648
Net investment income earned	6,870,986
Net realized capital gains less capital gains tax	<u>423,602</u>
Net investment gain	<u>7,294,588</u>
Net loss from agents' or premium balances charged off	(3,160,297)
Finance and service charges not included in premiums	6,330,146
Aggregate write-ins for miscellaneous income:	
Miscellaneous income	154,550
Service business revenue	15,666
Interest income on intercompany balances	<u>14,886</u>
Total other income	<u>3,354,951</u>
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	<u>16,495,187</u>
Federal and foreign income taxes incurred	<u>5,481,117</u>
Net income	<u>\$ 11,014,070</u>

**Statement of Changes in the Capital and Surplus Account**  
(In thousands)

<u>Capital and Surplus</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Capital & surplus, prior year end	\$ 173,985	\$231,279	\$212,610	\$190,020	\$183,438
Net income	11,014	18,619	17,285	19,149	11,071
Change in net unrealized capital gains or (losses) less capital gains tax	(110)	(56)	718	2,210	(2,927)
Change in net deferred income tax	1,820	(992)	(41)	83	(210)
Change in non-admitted assets	(199)	135	707	647	(1,352)
Cumulative effect of changes in accounting principles	-	-	-	501	-
Dividends to stockholders	(59,500)	(75,000)	-	-	-
Net change in capital and surplus	<u>(46,975)</u>	<u>(57,294)</u>	<u>18,669</u>	<u>22,590</u>	<u>6,582</u>
Capital and surplus, current year end	<u>\$127,010</u>	<u>\$173,985</u>	<u>\$231,279</u>	<u>\$212,610</u>	<u>\$190,020</u>

**Notes to Financial Statements**

**Investments**

The Company's investment portfolio primarily consists of investment grade bonds and is in compliance with Section 3925.08 of the ORC. The investments were valued in accordance with the relevant Statements of Statutory Accounting Principles and the NAIC Securities Valuation Office.

**Loss and Loss Adjustment Expense Reserves**

The Company's Board of Directors appointed Gary S. Traicoff, FCAS, MAAA, of Progressive management to render a Statement of Actuarial Opinion ("Opinion") on the total reserves. Mr. Traicoff prepared an Actuarial Report supporting the Opinion in conjunction with the preparation of the Company's December 31, 2012 Annual Statement.

Thomas Botsko, ACAS, MAAA, the Department's Chief Property and Casualty Actuary, reviewed the Actuarial Report and performed other procedures as considered necessary to evaluate the loss and loss adjustment expense ("LAE") reserves. Mr. Botsko concluded the reserves fall within a reasonable range of reserve estimates at December 31, 2012.

**Subsequent Events**

There are no material subsequent events.

### Conclusion

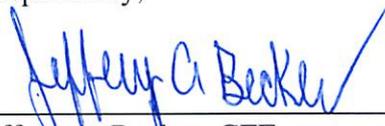
The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2012, and is summarized as follows:

Total Admitted Assets	<u>\$ 282,446,649</u>
Liabilities	155,436,576
Surplus as Regards Policyholders	<u>127,010,073</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$ 282,446,649</u>

### Acknowledgement

In addition to the aforementioned and undersigned, the following representatives of the Department participated in this examination: Mohammad Arif, AES, CISA, CPA; Edward Nagorny, CFE, CPA; Kim Somogyi, CPA; Bryan Radecky, CPA; and Bradley Schroer.

Respectfully,



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Jeffery A. Becker, CFE  
Examiner-In-Charge  
Office of Risk Assessment  
Ohio Department of Insurance



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William C. Harrington, CFE  
Chief Examiner  
Office of Risk Assessment  
Ohio Department of Insurance

Verification

As required by Section 3901.07 of the ORC, 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, 2012.

Jeffery A Becker  
Examiner-In-Charge

8/6/13  
Date

William C. Harrington  
Chief Examiner

8/6/13  
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 knowledge and belief.

Subscribed and sworn to before me this 6 day of August, 2013.

Elizabeth Chase  
(Notary Public)

**ELIZABETH CHASE**  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2017

State of Ohio

County of Franklin

Personally appeared before me the above named, William C. Harrington, 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 knowledge and belief.

Subscribed and sworn to before me this 6 day of August, 2013.

Elizabeth Chase  
(Elizabeth Chase)

**ELIZABETH CHASE**  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2017  
My Commission Expires

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A. Johnson*

*August*

ELIZABETH CHASE  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2017

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A. Johnson*

*August*

ELIZABETH CHASE  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2017