

PROGRESSIVE CORP/OH/  
Form 10-Q  
November 07, 2011

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended September 30, 2011

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)

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**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)

**44143**  
(Zip Code)

**(440) 461-5000**

(Registrant's telephone number, including area code)

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Shares, \$1.00 par value: 620,628,395 outstanding at September 30, 2011

**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.**

The Progressive Corporation and Subsidiaries

**Consolidated Statements of Income**

(unaudited)

| Periods Ended September 30,<br>(millions except per share amounts)                               | 2011            | Three Months<br>2010 | % Change    | 2011            | Nine Months<br>2010 | % Change   |
|--|-----------------|----------------------|-------------|-----------------|---------------------|------------|
| <b>Revenues</b>  |                 |                      |             |                 |                     |            |
| Net premiums earned  | \$ 3,740.7      | \$ 3,599.9           | 4           | \$ 11,125.9     | \$ 10,691.2         | 4          |
| Investment income  | 117.4           | 131.5                | (11)        | 361.5           | 391.9               | (8)        |
| Net realized gains (losses) on securities:   |                 |                      |             |                 |                     |            |
| Other-than-temporary impairment (OTTI) losses:   |                 |                      |             |                 |                     |            |
| Total OTTI losses  | (1.4)           | (1.9)                | (26)        | (5.9)           | (19.1)              | (69)       |
| Non-credit losses, net of credit losses recognized on previously recorded non-credit OTTI losses | 0               | (.2)                 | NM          | .9              | 5.3                 | (83)       |
| Net impairment losses recognized in earnings   | (1.4)           | (2.1)                | (33)        | (5.0)           | (13.8)              | (64)       |
| Net realized gains (losses) on securities  | (51.2)          | 29.0                 | NM          | 78.1            | 32.0                | 144        |
| Total net realized gains (losses) on securities  | (52.6)          | 26.9                 | NM          | 73.1            | 18.2                | 302        |
| Service revenues   | 5.6             | 4.8                  | 17          | 16.8            | 14.0                | 20         |
| Net gain (loss) on extinguishment of debt  | (.1)            | 6.4                  | NM          | (.1)            | 6.4                 | NM         |
| <b>Total revenues</b>  | <b>3,811.0</b>  | <b>3,769.5</b>       | <b>1</b>    | <b>11,577.2</b> | <b>11,121.7</b>     | <b>4</b>   |
| <b>Expenses</b>  |                 |                      |             |                 |                     |            |
| Losses and loss adjustment expenses  | 2,749.3         | 2,543.4              | 8           | 7,918.3         | 7,510.0             | 5          |
| Policy acquisition costs   | 350.2           | 342.4                | 2           | 1,045.2         | 1,014.3             | 3          |
| Other underwriting expenses  | 460.5           | 459.1                | 0           | 1,381.2         | 1,331.8             | 4          |
| Investment expenses  | 4.0             | .3                   | 1233        | 10.6            | 8.5                 | 25         |
| Service expenses   | 5.1             | 5.2                  | (2)         | 13.9            | 15.9                | (13)       |
| Interest expense   | 33.4            | 31.9                 | 5           | 96.4            | 102.2               | (6)        |
| <b>Total expenses</b>  | <b>3,602.5</b>  | <b>3,382.3</b>       | <b>7</b>    | <b>10,465.6</b> | <b>9,982.7</b>      | <b>5</b>   |
| <b>Net Income</b>  |                 |                      |             |                 |                     |            |
| Income before income taxes   | 208.5           | 387.2                | (46)        | 1,111.6         | 1,139.0             | (2)        |
| Provision for income taxes   | 57.8            | 125.6                | (54)        | 352.8           | 369.9               | (5)        |
| <b>Net income</b>  | <b>\$ 150.7</b> | <b>\$ 261.6</b>      | <b>(42)</b> | <b>\$ 758.8</b> | <b>\$ 769.1</b>     | <b>(1)</b> |
| <b>Computation of Earnings Per Share</b>   |                 |                      |             |                 |                     |            |
| <b>Basic:</b>  |                 |                      |             |                 |                     |            |
| Average shares outstanding   | 626.9           | 655.8                | (4)         | 640.5           | 659.2               | (3)        |
| Per share  | \$ .24          | \$ .40               | (40)        | \$ 1.18         | \$ 1.17             | 2          |
| <b>Diluted:</b>  |                 |                      |             |                 |                     |            |
| Average shares outstanding   | 626.9           | 655.8                | (4)         | 640.5           | 659.2               | (3)        |

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|   |              |              |            |              |              |            |
|---|--------------|--------------|------------|--------------|--------------|------------|
| Net effect of dilutive stock-based compensation | 4.5          | 5.4          | (17)       | 4.3          | 5.2          | (17)       |
| <b>Total equivalent shares</b>                  | <b>631.4</b> | <b>661.2</b> | <b>(5)</b> | <b>644.8</b> | <b>664.4</b> | <b>(3)</b> |
| Per share                                       | \$ .24       | \$ .40       | (40)       | \$ 1.18      | \$ 1.16      | 2          |
| <b>Dividends declared per share<sup>1</sup></b> | <b>\$ 0</b>  | <b>\$ 0</b>  |            | <b>\$ 0</b>  | <b>\$ 0</b>  |            |

NM = Not Meaningful

<sup>1</sup> Progressive maintains an annual dividend program. See *Note 9 Dividends* for further discussion.

See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries

**Consolidated Balance Sheets**

(unaudited)

| (millions)   | September 30, |             | December 31, |
|--|---------------|-------------|--------------|
|  | 2011          | 2010        | 2010         |
| <b>Assets</b>  |               |             |              |
| Investments Available-for-sale, at fair value:   |               |             |              |
| Fixed maturities (amortized cost: \$11,531.9, \$11,727.3, and \$11,630.8)  | \$ 11,815.6   | \$ 12,085.8 | \$ 11,850.0  |
| Equity securities:   |               |             |              |
| Nonredeemable preferred stocks (cost: \$493.6, \$610.6, and \$601.3)   | 873.0         | 1,189.4     | 1,157.6      |
| Common equities (cost: \$1,391.5, \$1,014.7, and \$1,021.7)  | 1,599.5       | 1,285.3     | 1,425.0      |
| Short-term investments (amortized cost: \$1,699.7, \$1,815.5, and \$1,090.8)   | 1,699.7       | 1,815.5     | 1,090.8      |
| <br>   |               |             |              |
| Total investments  | 15,987.8      | 16,376.0    | 15,523.4     |
| Cash   | 170.3         | 155.0       | 158.9        |
| Accrued investment income  | 98.3          | 107.3       | 109.3        |
| Premiums receivable, net of allowance for doubtful accounts of \$117.0, \$109.5, and \$114.9   | 3,086.0       | 2,858.6     | 2,738.4      |
| Reinsurance recoverables, including \$36.5, \$34.4, and \$37.4 on paid losses and loss adjustment expenses                               | 798.1         | 685.2       | 741.5        |
| Prepaid reinsurance premiums   | 81.8          | 97.8        | 88.1         |
| Deferred acquisition costs   | 458.1         | 450.5       | 417.2        |
| Income taxes   | 298.5         | 164.6       | 189.0        |
| Property and equipment, net of accumulated depreciation of \$561.7, \$560.1, and \$564.3   | 910.9         | 932.0       | 932.6        |
| Other assets   | 254.5         | 197.6       | 251.9        |
| <br>   |               |             |              |
| Total assets   | \$ 22,144.3   | \$ 22,024.6 | \$ 21,150.3  |
| <b>Liabilities and Shareholders Equity</b>   |               |             |              |
| Unearned premiums  | \$ 4,830.1    | \$ 4,711.0  | \$ 4,353.8   |
| Loss and loss adjustment expense reserves  | 7,256.8       | 6,953.4     | 7,071.0      |
| Accounts payable, accrued expenses, and other liabilities  | 1,797.2       | 1,689.2     | 1,718.4      |
| Debt <sup>1</sup>  | 2,443.9       | 1,957.8     | 1,958.2      |
| <br>   |               |             |              |
| Total liabilities  | 16,328.0      | 15,311.4    | 15,101.4     |
| <br>   |               |             |              |
| Common Shares, \$1.00 par value (authorized 900.0; issued 797.7, 797.7, and 797.7, including treasury shares of 177.1, 134.3, and 135.3) | 620.6         | 663.4       | 662.4        |
| Paid-in capital  | 986.7         | 977.0       | 1,007.1      |
| Retained earnings  | 3,632.4       | 4,273.6     | 3,595.7      |
| Accumulated other comprehensive income (loss), net of tax:   |               |             |              |
| Net non-credit related OTTI losses, adjusted for valuation changes   | (6.3)         | (3.1)       | (1.8)        |
| Other net unrealized gains (losses) on securities  | 572.2         | 785.8       | 769.1        |
| <br>   |               |             |              |
| Total net unrealized gains (losses) on securities  | 565.9         | 782.7       | 767.3        |
| Net unrealized gains on forecasted transactions  | 8.7           | 15.4        | 14.7         |
| Foreign currency translation adjustment  | 2.0           | 1.1         | 1.7          |
| <br>   |               |             |              |
| Total accumulated other comprehensive income (loss)  | 576.6         | 799.2       | 783.7        |
| <br>   |               |             |              |
| Total shareholders equity  | 5,816.3       | 6,713.2     | 6,048.9      |
| <br>   |               |             |              |
| Total liabilities and shareholders equity  | \$ 22,144.3   | \$ 22,024.6 | \$ 21,150.3  |

<sup>1</sup> Consists of both short- and long-term debt. *See Note 4 Debt.*  
See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries

**Consolidated Statements of Cash Flows**

(unaudited)

| Nine months ended September 30,<br>(millions)                                     | 2011      | 2010      |
|---|-----------|-----------|
| <b>Cash Flows From Operating Activities</b>                                       |           |           |
| Net income  | \$ 758.8  | \$ 769.1  |
| Adjustments to reconcile net income to net cash provided by operating activities: |           |           |
| Depreciation  | 65.3      | 62.4      |
| Amortization of fixed-income securities   | 174.7     | 172.9     |
| Amortization of stock-based compensation  | 36.4      | 35.2      |
| Net realized (gains) losses on securities   | (73.1)    | (18.2)    |
| Net (gain) loss on disposition of property and equipment                          | 7.8       | (1.2)     |
| Net (gain) loss on extinguishment of debt   | .1        | (6.4)     |
| Changes in:   |           |           |
| Premiums receivable   | (347.6)   | (403.8)   |
| Reinsurance recoverables  | (56.6)    | (120.4)   |
| Prepaid reinsurance premiums  | 6.3       | (28.5)    |
| Deferred acquisition costs  | (40.9)    | (48.3)    |
| Income taxes  | .9        | 64.2      |
| Unearned premiums   | 476.3     | 538.1     |
| Loss and loss adjustment expense reserves   | 185.8     | 300.4     |
| Accounts payable, accrued expenses, and other liabilities                         | 278.9     | 362.3     |
| Other, net  | 22.2      | .1        |
| Net cash provided by operating activities   | 1,495.3   | 1,677.9   |
| <b>Cash Flows From Investing Activities</b>                                       |           |           |
| Purchases:  |           |           |
| Fixed maturities  | (5,208.0) | (3,515.7) |
| Equity securities   | (424.0)   | (453.7)   |
| Sales:  |           |           |
| Fixed maturities  | 4,057.2   | 2,448.1   |
| Equity securities   | 264.8     | 153.6     |
| Maturities, paydowns, calls, and other:   |           |           |
| Fixed maturities  | 1,107.4   | 912.9     |
| Net purchases of short-term investments - other                                   | (608.8)   | (736.9)   |
| Net unsettled security transactions   | (14.2)    | 47.2      |
| Purchases of property and equipment   | (53.3)    | (39.5)    |
| Sales of property and equipment   | 1.9       | 7.6       |
| Net cash used in investing activities   | (877.0)   | (1,176.4) |
| <b>Cash Flows From Financing Activities</b>                                       |           |           |
| Proceeds from exercise of stock options   | 6.8       | 14.4      |
| Tax benefit from exercise/vesting of stock-based compensation                     | 2.7       | 6.0       |
| Proceeds from debt issuance   | 491.9     | 0         |
| Reacquisition of debt   | (12.7)    | (214.3)   |
| Dividends paid to shareholders <sup>1</sup>                                       | (263.6)   | (108.2)   |
| Acquisition of treasury shares  | (832.1)   | (205.5)   |
| Net cash used in financing activities   | (607.0)   | (507.6)   |

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|   |          |          |
|---|----------|----------|
| Effect of exchange rate changes on cash | .1       | .4       |
| Increase (decrease) in cash             | 11.4     | (5.7)    |
| Cash, January 1                         | 158.9    | 160.7    |
| Cash, September 30                      | \$ 170.3 | \$ 155.0 |

<sup>1</sup> Progressive maintains an annual dividend program. See *Note 9 Dividends* for further discussion.

See notes to consolidated financial statements.



The Progressive Corporation and Subsidiaries

## Notes to Consolidated Financial Statements

(unaudited)

**Note 1 Basis of Presentation** The consolidated financial statements include the accounts of The Progressive Corporation, its subsidiaries, and a mutual company affiliate. All of the subsidiaries and the mutual company affiliate are wholly owned or controlled. The consolidated financial statements reflect all normal recurring adjustments that, in the opinion of management, were necessary for a fair statement of the results for the interim periods presented. The results of operations for the period ended September 30, 2011, are not necessarily indicative of the results expected for the full year. These consolidated financial statements and the notes thereto should be read in conjunction with Progressive's audited financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2010.

**Note 2 Investments** The following tables present the composition of our investment portfolio by major security type consistent with our internal classification, which represents how we manage, monitor, and measure the portfolio:

| (\$ in millions)                       | Cost        | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Net<br>Realized<br>Gains<br>(Losses) <sup>1</sup> | Fair<br>Value | % of<br>Total<br>Fair<br>Value |
|--|-------------|------------------------------|-------------------------------|---|---------------|--------------------------------|
| <b>September 30, 2011</b>              |             |                              |                               |   |               |                                |
| Fixed maturities:                      |             |                              |                               |   |               |                                |
| U.S. government obligations            | \$ 2,921.7  | \$ 129.1                     | \$ (.1)                       | \$ 0  | \$ 3,050.7    | 19.1 %                         |
| State and local government obligations | 1,930.6     | 56.4                         | (1.1)                         | 0   | 1,985.9       | 12.4                           |
| Corporate debt securities              | 2,680.2     | 86.4                         | (10.4)                        | 5.2   | 2,761.4       | 17.3                           |
| Residential mortgage-backed securities | 471.3       | 9.4                          | (36.5)                        | 0   | 444.2         | 2.8                            |
| Commercial mortgage-backed securities  | 1,826.2     | 43.2                         | (9.7)                         | 0   | 1,859.7       | 11.6                           |
| Other asset-backed securities          | 1,265.5     | 14.8                         | (1.3)                         | .7  | 1,279.7       | 8.0                            |
| Redeemable preferred stocks            | 436.4       | 20.1                         | (22.5)                        | 0   | 434.0         | 2.7                            |
| Total fixed maturities                 | 11,531.9    | 359.4                        | (81.6)                        | 5.9   | 11,815.6      | 73.9                           |
| Equity securities:                     |             |                              |                               |   |               |                                |
| Nonredeemable preferred stocks         | 493.6       | 387.4                        | (2.6)                         | (5.4)   | 873.0         | 5.5                            |
| Common equities                        | 1,391.5     | 288.4                        | (80.4)                        | 0   | 1,599.5       | 10.0                           |
| Short-term investments:                |             |                              |                               |   |               |                                |
| Other short-term investments           | 1,699.7     | 0                            | 0                             | 0   | 1,699.7       | 10.6                           |
| Total portfolio <sup>2,3</sup>         | \$ 15,116.7 | \$ 1,035.2                   | \$ (164.6)                    | \$ .5   | \$ 15,987.8   | 100.0 %                        |

| (\$ in millions)                       | Cost       | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Net<br>Realized<br>Gains<br>(Losses) <sup>1</sup> | Fair<br>Value | % of<br>Total<br>Fair<br>Value |
|--|------------|------------------------------|-------------------------------|---|---------------|--------------------------------|
| <b>September 30, 2010</b>              |            |                              |                               |   |               |                                |
| Fixed maturities:                      |            |                              |                               |   |               |                                |
| U.S. government obligations            | \$ 3,411.7 | \$ 110.0                     | \$ 0                          | \$ 0  | \$ 3,521.7    | 21.5 %                         |
| State and local government obligations | 1,865.1    | 67.8                         | (.6)                          | 0   | 1,932.3       | 11.8                           |
| Corporate debt securities              | 2,392.6    | 109.3                        | (1.2)                         | 5.1   | 2,505.8       | 15.3                           |
| Residential mortgage-backed securities | 576.8      | 14.4                         | (24.5)                        | 0   | 566.7         | 3.4                            |
| Commercial mortgage-backed securities  | 1,801.0    | 72.3                         | (5.7)                         | 0   | 1,867.6       | 11.4                           |
| Other asset-backed securities          | 1,077.2    | 16.5                         | (1.7)                         | (.2)  | 1,091.8       | 6.7                            |
| Redeemable preferred stocks            | 602.9      | 26.0                         | (29.0)                        | 0   | 599.9         | 3.7                            |
| Total fixed maturities                 | 11,727.3   | 416.3                        | (62.7)                        | 4.9   | 12,085.8      | 73.8                           |

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|                                |             |            |           |        |             |         |
|--------------------------------|-------------|------------|-----------|--------|-------------|---------|
| Equity securities:             |             |            |           |        |             |         |
| Nonredeemable preferred stocks | 610.6       | 580.0      | 0         | (1.2)  | 1,189.4     | 7.3     |
| Common equities                | 1,014.7     | 279.6      | (9.0)     | 0      | 1,285.3     | 7.8     |
| Short-term investments:        |             |            |           |        |             |         |
| Other short-term investments   | 1,815.5     | 0          | 0         | 0      | 1,815.5     | 11.1    |
| Total portfolio <sup>2,3</sup> | \$ 15,168.1 | \$ 1,275.9 | \$ (71.7) | \$ 3.7 | \$ 16,376.0 | 100.0 % |

| (\$ in millions)                       | Cost               | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Net<br>Realized<br>Gains<br>(Losses) <sup>1</sup> | Fair<br>Value      | % of<br>Total<br>Fair<br>Value |
|--|--------------------|------------------------------|-------------------------------|---|--------------------|--------------------------------|
| <b>December 31, 2010</b>               |                    |                              |                               |   |                    |                                |
| Fixed maturities:                      |                    |                              |                               |   |                    |                                |
| U.S. government obligations            | \$ 3,203.2         | \$ 56.3                      | \$ (16.9)                     | \$ 0  | \$ 3,242.6         | 20.9 %                         |
| State and local government obligations | 1,955.5            | 43.0                         | (9.4)                         | 0   | 1,989.1            | 12.8                           |
| Corporate debt securities              | 2,579.0            | 78.1                         | (13.3)                        | 2.3   | 2,646.1            | 17.0                           |
| Residential mortgage-backed securities | 567.1              | 17.8                         | (21.3)                        | 0   | 563.6              | 3.6                            |
| Commercial mortgage-backed securities  | 1,772.1            | 66.9                         | (6.9)                         | 0   | 1,832.1            | 11.8                           |
| Other asset-backed securities          | 1,063.9            | 12.4                         | (2.2)                         | (.1)  | 1,074.0            | 6.9                            |
| Redeemable preferred stocks            | 490.0              | 29.6                         | (17.1)                        | 0   | 502.5              | 3.3                            |
| <b>Total fixed maturities</b>          | <b>11,630.8</b>    | <b>304.1</b>                 | <b>(87.1)</b>                 | <b>2.2</b>  | <b>11,850.0</b>    | <b>76.3</b>                    |
| Equity securities:                     |                    |                              |                               |   |                    |                                |
| Nonredeemable preferred stocks         | 601.3              | 560.2                        | 0                             | (3.9)   | 1,157.6            | 7.5                            |
| Common equities                        | 1,021.7            | 406.5                        | (3.2)                         | 0   | 1,425.0            | 9.2                            |
| Short-term investments:                |                    |                              |                               |   |                    |                                |
| Other short-term investments           | 1,090.8            | 0                            | 0                             | 0   | 1,090.8            | 7.0                            |
| <b>Total portfolio<sup>2,3</sup></b>   | <b>\$ 14,344.6</b> | <b>\$ 1,270.8</b>            | <b>\$ (90.3)</b>              | <b>\$ (1.7)</b>                                   | <b>\$ 15,523.4</b> | <b>100.0 %</b>                 |

<sup>1</sup> Represents net holding period gains (losses) on certain hybrid securities (discussed below).

<sup>2</sup> At September 30, 2011, we had \$60.5 million of net unsettled security transactions included in other assets, compared to \$46.3 million at December 31, 2010; at September 30, 2010, we had \$54.9 million of net unsettled security transactions included in other liabilities.

<sup>3</sup> The total fair value of the portfolio at September 30, 2011 and 2010, and December 31, 2010 included \$1.7 billion, \$1.6 billion, and \$2.2 billion, respectively, of securities held in a consolidated, non-insurance subsidiary of the holding company, net of any unsettled security transactions.

Our other short-term investments include Eurodollar deposits, commercial paper, reverse repurchase transactions, and other investments that are expected to mature within one year.

Included in our fixed-maturity and equity securities are hybrid securities, which are reported at fair value:

| (millions)                     | September 30,<br>2011 | September 30,<br>2010 | December 31,<br>2010 |
|--------------------------------|-----------------------|-----------------------|----------------------|
| Fixed maturities:              |                       |                       |                      |
| Corporate debt securities      | \$ 234.8              | \$ 133.9              | \$ 176.4             |
| Other asset-backed securities  | 16.4                  | 14.8                  | 14.9                 |
| <b>Total fixed maturities</b>  | <b>251.2</b>          | <b>148.7</b>          | <b>191.3</b>         |
| Equity securities:             |                       |                       |                      |
| Nonredeemable preferred stocks | 15.1                  | 55.5                  | 52.8                 |
| <b>Total hybrid securities</b> | <b>\$ 266.3</b>       | <b>\$ 204.2</b>       | <b>\$ 244.1</b>      |

Certain corporate debt securities are accounted for as hybrid securities since they were acquired at a substantial premium and contain a change-of-control put feature that permits the investor, at its sole option once the change of control is triggered, to put the security back to the issuer at a 1% premium to par. Due to this change-of-control put option and the substantial market premium paid, there is a potential that the election to put, upon the occurrence of a change in control, could result in the investment not returning substantially all of the original investment. The one hybrid security held in the asset-backed portfolio was acquired at a deep discount to par due to a failing auction, and contains a put option (derivative feature) that allows the investor to put that security back to the auction at par. If the auction is restored, this embedded derivative has the potential to more than double our initial investment yield. The hybrid securities in our nonredeemable preferred stock portfolio are perpetual preferred stocks that have call features with fixed-rate coupons, whereby the change in value of the call features is a component of the overall change in value of the preferred stocks.

Our securities are reported at fair value, with the changes in fair value of these securities (other than hybrid securities and derivative instruments) reported as a component of accumulated other comprehensive income, net of deferred income taxes. The changes in fair value of the hybrid securities and derivative instruments are recorded as a component of net realized gains (losses) on securities.

**Gross Unrealized Losses** As of September 30, 2011, we had \$84.2 million of gross unrealized losses in our fixed-income portfolio (i.e., fixed-maturity securities and nonredeemable preferred stocks) and \$80.4 million in our common equities. We currently do not intend to sell the fixed-income securities and determined that it is more likely than not that we will not be required to sell these securities for the period of time necessary to recover their cost bases. In addition, we may retain the common stocks to maintain correlation to the Russell 1000 Index. If our strategy was to change and these securities were determined to be other-than-temporarily impaired, we would recognize a write-down in accordance with our stated policy.

The following tables show the composition of gross unrealized losses by major security type and by the length of time that individual securities have been in a continuous unrealized loss position:

| (millions)                             | Total      | Gross             | Less than 12 Months |                   | 12 Months or Greater |                   |
|--|------------|-------------------|---------------------|-------------------|----------------------|-------------------|
|  | Fair Value | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value           | Unrealized Losses |
| <b>September 30, 2011</b>              |            |                   |                     |                   |                      |                   |
| Fixed maturities:                      |            |                   |                     |                   |                      |                   |
| U.S. government obligations            | \$ 125.3   | \$ (.1)           | \$ 125.3            | \$ (.1)           | \$ 0                 | \$ 0              |
| State and local government obligations | 154.3      | (1.1)             | 126.0               | (.7)              | 28.3                 | (.4)              |
| Corporate debt securities              | 466.3      | (10.4)            | 327.2               | (7.7)             | 139.1                | (2.7)             |
| Residential mortgage-backed securities | 320.7      | (36.5)            | 79.6                | (4.1)             | 241.1                | (32.4)            |
| Commercial mortgage-backed securities  | 429.9      | (9.7)             | 342.8               | (7.0)             | 87.1                 | (2.7)             |
| Other asset-backed securities          | 169.0      | (1.3)             | 165.3               | (.9)              | 3.7                  | (.4)              |
| Redeemable preferred stocks            | 233.8      | (22.5)            | 85.0                | (.9)              | 148.8                | (21.6)            |
| Total fixed maturities                 | 1,899.3    | (81.6)            | 1,251.2             | (21.4)            | 648.1                | (60.2)            |
| Equity securities:                     |            |                   |                     |                   |                      |                   |
| Nonredeemable preferred stocks         | 20.5       | (2.6)             | 20.5                | (2.6)             | 0                    | 0                 |
| Common equities                        | 420.2      | (80.4)            | 407.3               | (76.6)            | 12.9                 | (3.8)             |
| Total equity securities                | 440.7      | (83.0)            | 427.8               | (79.2)            | 12.9                 | (3.8)             |
| Total portfolio                        | \$ 2,340.0 | \$ (164.6)        | \$ 1,679.0          | \$ (100.6)        | \$ 661.0             | \$ (64.0)         |

| (millions)                             | Total<br>Fair<br>Value | Gross<br>Unrealized<br>Losses | Less than 12 Months |                      | 12 Months or<br>Greater |                      |
|--|------------------------|-------------------------------|---------------------|----------------------|-------------------------|----------------------|
|  |                        |                               | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value           | Unrealized<br>Losses |
| <u>September 30, 2010</u>              |                        |                               |                     |                      |                         |                      |
| Fixed maturities:                      |                        |                               |                     |                      |                         |                      |
| U.S. government obligations            | \$ 0                   | \$ 0                          | \$ 0                | \$ 0                 | \$ 0                    | \$ 0                 |
| State and local government obligations | 101.4                  | (.6)                          | 89.0                | (.2)                 | 12.4                    | (.4)                 |
| Corporate debt securities              | 96.7                   | (1.2)                         | 48.0                | (.2)                 | 48.7                    | (1.0)                |
| Residential mortgage-backed securities | 283.3                  | (24.5)                        | 46.0                | (.7)                 | 237.3                   | (23.8)               |
| Commercial mortgage-backed securities  | 189.4                  | (5.7)                         | 114.7               | (.6)                 | 74.7                    | (5.1)                |
| Other asset-backed securities          | 111.3                  | (1.7)                         | 105.7               | (.4)                 | 5.6                     | (1.3)                |
| Redeemable preferred stocks            | 374.1                  | (29.0)                        | 0                   | 0                    | 374.1                   | (29.0)               |
| Total fixed maturities                 | 1,156.2                | (62.7)                        | 403.4               | (2.1)                | 752.8                   | (60.6)               |
| Equity securities:                     |                        |                               |                     |                      |                         |                      |
| Nonredeemable preferred stocks         | 0                      | 0                             | 0                   | 0                    | 0                       | 0                    |
| Common equities                        | 125.8                  | (9.0)                         | 121.1               | (8.5)                | 4.7                     | (.5)                 |
| Total equity securities                | 125.8                  | (9.0)                         | 121.1               | (8.5)                | 4.7                     | (.5)                 |
| Total portfolio                        | \$ 1,282.0             | \$ (71.7)                     | \$ 524.5            | \$ (10.6)            | \$ 757.5                | \$ (61.1)            |

| (millions)                             | Total<br>Fair<br>Value | Gross<br>Unrealized<br>Losses | Less than 12 Months |                      | 12 Months or<br>Greater |                      |
|--|------------------------|-------------------------------|---------------------|----------------------|-------------------------|----------------------|
|  |                        |                               | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value           | Unrealized<br>Losses |
| <u>December 31, 2010</u>               |                        |                               |                     |                      |                         |                      |
| Fixed maturities:                      |                        |                               |                     |                      |                         |                      |
| U.S. government obligations            | \$ 495.3               | \$ (16.9)                     | \$ 495.3            | \$ (16.9)            | \$ 0                    | \$ 0                 |
| State and local government obligations | 461.9                  | (9.4)                         | 454.0               | (8.7)                | 7.9                     | (.7)                 |
| Corporate debt securities              | 589.3                  | (13.3)                        | 541.3               | (11.6)               | 48.0                    | (1.7)                |
| Residential mortgage-backed securities | 314.1                  | (21.3)                        | 74.0                | (1.0)                | 240.1                   | (20.3)               |
| Commercial mortgage-backed securities  | 332.0                  | (6.9)                         | 269.7               | (3.1)                | 62.3                    | (3.8)                |
| Other asset-backed securities          | 214.8                  | (2.2)                         | 209.8               | (1.1)                | 5.0                     | (1.1)                |
| Redeemable preferred stocks            | 216.7                  | (17.1)                        | 0                   | 0                    | 216.7                   | (17.1)               |
| Total fixed maturities                 | 2,624.1                | (87.1)                        | 2,044.1             | (42.4)               | 580.0                   | (44.7)               |
| Equity securities:                     |                        |                               |                     |                      |                         |                      |
| Nonredeemable preferred stocks         | 0                      | 0                             | 0                   | 0                    | 0                       | 0                    |
| Common equities                        | 60.5                   | (3.2)                         | 57.3                | (3.1)                | 3.2                     | (.1)                 |
| Total equity securities                | 60.5                   | (3.2)                         | 57.3                | (3.1)                | 3.2                     | (.1)                 |
| Total portfolio                        | \$ 2,684.6             | \$ (90.3)                     | \$ 2,101.4          | \$ (45.5)            | \$ 583.2                | \$ (44.8)            |

*OTHER-THAN-TEMPORARY IMPAIRMENT (OTTI)*

The following tables provide a rollforward of the amounts related to credit losses recognized in earnings for which a portion of the OTTI loss was recognized in accumulated other comprehensive income at the time the credit impairment was determined and recognized:

| (millions)  | Three Months Ended September 30, 2011 |            |           |         |
|---|---------------------------------------|------------|-----------|---------|
|   | Mortgage-Backed                       |            | Corporate | Total   |
|   | Residential                           | Commercial | Debt      |         |
| Beginning balance at July 1, 2011   | \$ 36.2                               | \$ .9      | \$ 6.5    | \$ 43.6 |
| Credit losses for which an OTTI was previously recognized                                       | 0                                     | 0          | 0         | 0       |
| Credit losses for which an OTTI was not previously recognized                                   | 0                                     | 0          | 0         | 0       |
| Change in recoveries of future cash flows expected to be collected <sup>1,2</sup>               | (1.6)                                 | .4         | 0         | (1.2)   |
| Reductions for previously recognized credit impairments written-down to fair value <sup>3</sup> | 0                                     | 0          | 0         | 0       |
| Ending balance at September 30, 2011  | \$ 34.6                               | \$ 1.3     | \$ 6.5    | \$ 42.4 |

| (millions)  | Nine Months Ended September 30, 2011 |            |           |         |
|---|--------------------------------------|------------|-----------|---------|
|   | Mortgage-Backed                      |            | Corporate | Total   |
|   | Residential                          | Commercial | Debt      |         |
| Beginning balance at January 1, 2011  | \$ 32.3                              | \$ 1.0     | \$ 6.5    | \$ 39.8 |
| Credit losses for which an OTTI was previously recognized                                       | 1.0                                  | 0          | 0         | 1.0     |
| Credit losses for which an OTTI was not previously recognized                                   | 1.1                                  | .4         | 0         | 1.5     |
| Change in recoveries of future cash flows expected to be collected <sup>1,2</sup>               | 1.3                                  | .3         | 0         | 1.6     |
| Reductions for previously recognized credit impairments written-down to fair value <sup>3</sup> | (1.1)                                | (.4)       | 0         | (1.5)   |
| Ending balance at September 30, 2011  | \$ 34.6                              | \$ 1.3     | \$ 6.5    | \$ 42.4 |

| (millions)  | Three Months Ended September 30, 2010 |            |           |         |
|---|---------------------------------------|------------|-----------|---------|
|   | Mortgage-Backed                       |            | Corporate | Total   |
|   | Residential                           | Commercial | Debt      |         |
| Beginning balance at July 1, 2010   | \$ 44.2                               | \$ 1.5     | \$ 6.5    | \$ 52.2 |
| Credit losses for which an OTTI was previously recognized                                       | 0                                     | .2         | 0         | .2      |
| Credit losses for which an OTTI was not previously recognized                                   | 0                                     | .2         | 0         | .2      |
| Change in recoveries of future cash flows expected to be collected <sup>1</sup>                 | (.6)                                  | 0          | 0         | (.6)    |
| Reductions for previously recognized credit impairments written-down to fair value <sup>3</sup> | (7.7)                                 | (.6)       | 0         | (8.3)   |
| Ending balance at September 30, 2010  | \$ 35.9                               | \$ 1.3     | \$ 6.5    | \$ 43.7 |

| (millions)  | Nine Months Ended September 30, 2010 |            |           |         |
|---|--------------------------------------|------------|-----------|---------|
|   | Mortgage-Backed                      |            | Corporate | Total   |
|   | Residential                          | Commercial | Debt      |         |
| Beginning balance at January 1, 2010  | \$ 41.1                              | \$ .9      | \$ 6.5    | \$ 48.5 |
| Credit losses for which an OTTI was previously recognized                       | 3.0                                  | .3         | 0         | 3.3     |
| Credit losses for which an OTTI was not previously recognized                   | 2.4                                  | .9         | 0         | 3.3     |
| Change in recoveries of future cash flows expected to be collected <sup>1</sup> | (1.7)                                | 0          | 0         | (1.7)   |
|   | (8.9)                                | (.8)       | 0         | (9.7)   |

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Reductions for previously recognized credit impairments written-down to fair value<sup>3</sup>

|                                      |         |    |     |    |     |         |
|--------------------------------------|---------|----|-----|----|-----|---------|
| Ending balance at September 30, 2010 | \$ 35.9 | \$ | 1.3 | \$ | 6.5 | \$ 43.7 |
|--------------------------------------|---------|----|-----|----|-----|---------|

- <sup>1</sup> Reflects expected recovery of prior period impairments that will be accreted into income over the remaining life of the security, net of any current quarter (increases) decreases in expected cash flows on previously recorded reductions.
- <sup>2</sup> Includes \$1.9 million received on a residential mortgage-backed security in excess of the cash flows expected at the time of the write-down.
- <sup>3</sup> Reflects reductions of prior credit impairments where the current credit impairment requires writing securities down to fair value (i.e., no remaining non-credit loss).

Since we determined that it is more likely than not that we will not be required to sell the securities prior to the recovery of their respective cost bases (which could be maturity), in order to measure the amount of credit losses on the securities that were determined to be other-than-temporarily impaired, we considered a number of factors and inputs related to the individual securities. The methodology and significant inputs used to measure the amount of credit losses in our asset-backed portfolio included: current performance indicators on the underlying assets (e.g., delinquency rates, foreclosure rates, and default rates), credit support (via current levels of subordination), and historical credit ratings. Updated cash flow expectations were also generated by our portfolio managers based upon these performance indicators. In order to determine the amount of credit loss, if any, the net present value of the cash flows expected (i.e., expected recovery value) was calculated using the current book yield for each security, and was compared to its current amortized value. In the event that the net present value was below the amortized value, a credit loss was deemed to exist, and the security was written down.

**Trading Securities** At September 30, 2011, September 30, 2010, and December 31, 2010, we did not hold any trading securities and did not have any net realized gains (losses) on trading securities for the three and nine months ended September 30, 2011 and 2010.

**Derivative Instruments** We have invested in the following derivative exposures at various times: interest rate swaps, asset-backed credit default swaps, U.S. corporate debt credit default swaps, cash flow hedges, and equity options.

For all derivative positions discussed below, realized holding period gains and losses are netted with any upfront cash that may be exchanged under the contract to determine if the net position should be classified either as an asset or liability. To be reported as an asset and a component of the available-for-sale portfolio, the inception-to-date realized gain on the derivative position at period end would have to exceed any upfront cash received (net derivative asset). On the other hand, a net derivative liability would include any inception-to-date realized loss plus the amount of upfront cash received (or netted, if upfront cash was paid) and would be reported as a component of other liabilities. These net derivative assets/liabilities are not separately disclosed on the balance sheet due to their immaterial effect on our financial condition, cash flows, and results of operations.



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The following table shows the status of our derivative instruments at September 30, 2011, September 30, 2010, and December 31, 2010, and for the three and nine months ended September 30, 2011 and 2010; amounts are on a pretax basis:

| (millions)                            | Notional Value <sup>1</sup> |             |             | Purpose                |                        | Classification    |                  | Balance Sheet        |                  |                              | Income Statement |                             |      |      |
|---------------------------------------|-----------------------------|-------------|-------------|------------------------|------------------------|-------------------|------------------|----------------------|------------------|------------------------------|------------------|-----------------------------|------|------|
|                                       |                             |             |             |                        |                        |                   |                  | Assets (Liabilities) |                  |                              | Net Realized     |                             |      |      |
|                                       | Sept. 30,                   | 2010        | Dec. 31,    | 2010                   | Forecasted transaction | Investments -     | Sept. 30,        | Dec. 31,             | 2010             | Three months ended Sept. 30, | 2010             | Nine months ended Sept. 30, | 2010 |      |
| <b>Derivatives designated as:</b>     | <b>2011</b>                 | <b>2010</b> | <b>2010</b> |                        |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| <b><u>Hedging instruments</u></b>     |                             |             |             |                        |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| Closed:                               |                             |             |             |                        |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
|                                       |                             |             |             |                        | Accumulated            |                   |                  |                      |                  |                              |                  |                             |      |      |
|                                       |                             |             |             |                        | other                  |                   |                  |                      |                  |                              |                  |                             |      |      |
| Effective cash flow hedge             | \$ 500                      | \$ 0        | \$ 0        | Forecasted transaction | comprehensive          | \$ (5.1)          | \$ 0             | \$ 0                 | \$ 0             | \$ 0                         | \$ 0             | \$ 0                        | \$ 0 | \$ 0 |
|                                       |                             |             |             | Manage                 | interest               |                   |                  |                      |                  |                              |                  |                             |      |      |
| Ineffective cash flow hedge           | 13                          | 223         | 223         | rate risk              | NA                     | 0                 | 0                | 0                    | .3               | 5.8                          | .3               | 5.8                         | .3   | 5.8  |
| <b><u>Non-hedging instruments</u></b> |                             |             |             |                        |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| <b><u>Assets:</u></b>                 |                             |             |             |                        |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| Corporate credit default swaps        | 25                          | 35          | 35          | Manage                 | Investments -          | .8                | .4               | 1.3                  | .5               | .6                           | (.1)             | 1.7                         |      |      |
|                                       |                             |             |             | credit risk            | fixed                  |                   |                  |                      |                  |                              |                  |                             |      |      |
|                                       |                             |             |             | duration               | maturities             |                   |                  |                      |                  |                              |                  |                             |      |      |
| <b><u>Liabilities:</u></b>            |                             |             |             |                        |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| Interest rate swaps                   | 1,513                       | 713         | 713         | Manage                 | Other                  | (110.0)           | (84.1)           | (41.7)               | (72.4)           | (34.3)                       | (93.8)           | (102.7)                     |      |      |
|                                       |                             |             |             | portfolio              | liabilities            |                   |                  |                      |                  |                              |                  |                             |      |      |
|                                       |                             |             |             | duration               |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| Closed:                               |                             |             |             |                        |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| Interest rate swaps                   | 100                         | 0           | 0           | Manage                 | NA                     | 0                 | 0                | 0                    | 0                | 0                            | .5               | 0                           |      |      |
|                                       |                             |             |             | portfolio              |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
|                                       |                             |             |             | duration               |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| Corporate credit default swaps        | 10                          | 25          | 25          | Manage                 | NA                     | 0                 | 0                | 0                    | .1               | (.2)                         | .5               | (.2)                        |      |      |
|                                       |                             |             |             | credit risk            |                        |                   |                  |                      |                  |                              |                  |                             |      |      |
| <b>Total</b>                          | <b>NA</b>                   | <b>NA</b>   | <b>NA</b>   |                        |                        | <b>\$ (114.3)</b> | <b>\$ (83.7)</b> | <b>\$ (40.4)</b>     | <b>\$ (71.5)</b> | <b>\$ (28.1)</b>             | <b>\$ (92.6)</b> | <b>\$ (95.4)</b>            |      |      |

NA= Not Applicable

<sup>1</sup> The amounts represent the value held at quarter and year end for open positions and the maximum amount held during the quarter for closed positions.

**CASH FLOW HEDGES**

During the third quarter 2011, we issued \$500 million of 3.75% Senior Notes due 2021 and entered into a forecasted debt issuance hedge (cash flow hedge) against a possible rise in interest rates (see Note 4 Debt for further discussion). Upon issuance of the 3.75% Senior Notes, the hedge was closed and we recognized, as part of accumulated other comprehensive income, a pretax unrealized loss of \$5.1 million.

During the third quarter 2011, we repurchased \$12.7 million of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 at or near par in the open market (see Note 4 Debt for further discussion). We reclassified \$0.3 million (pretax) from accumulated other comprehensive income on the balance sheet to net realized gains (losses) on securities on the income statement, reflecting the portion of the unrealized gain on forecasted transactions that was related to these debt extinguishments.

During the third quarter 2010, we finalized the Tender Offer for, and purchased \$222.9 million of, the 6.70% Debentures discussed above (see Note 4 Debt for further discussion). We reclassified \$5.8 million (pretax) from accumulated other comprehensive income on the balance sheet to net realized gains (losses) on securities on the income statement, reflecting the portion of the unrealized gain on forecasted transactions that was related to the 6.70% Debentures that were extinguished pursuant to the Tender Offer.



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*INTEREST RATE SWAPS*

At September 30, 2011, September 30, 2010, and December 31, 2010, we held interest rate swap positions, primarily to manage the fixed-income portfolio duration. During the fourth quarter 2009, we entered into a 9-year interest rate swap position pursuant to which we are paying a fixed rate and receiving a variable rate. We closed a portion of this position during the first quarter 2011. During the second and third quarters of 2011, we entered into 5-year interest rate swap positions with notional values of \$400 million and \$500 million, respectively, pursuant to which we are paying a fixed rate and receiving a variable rate. The combined open positions have generated an aggregate realized loss through September 30, 2011, as interest rates have fallen since the inception of these positions. As of September 30, 2011, September 30, 2010, and December 31, 2010, we delivered \$117.8 million, \$94.2 million, and \$52.2 million, respectively, in cash collateral to the counterparties on our then open interest rate swap positions.

*CORPORATE CREDIT DEFAULT SWAPS*

At September 30, 2011, September 30, 2010, and December 31, 2010, we held a position, which was opened during the third quarter 2008, on one corporate issuer within the financial services sector for which we bought credit default protection in the form of a credit default swap for a 5-year time horizon. We hold this protection to reduce our exposure to additional valuation declines on a preferred stock position of the same issuer. As of September 30, 2011, September 30, 2010, and December 31, 2010, we received \$0.8 million, \$0.4 million, and \$0.5 million, respectively, in cash collateral from the counterparty on this position.

During the third quarter 2011, we closed the position where we sold credit protection in the form of a corporate credit default swap on one issuer in the automotive sector with a 5-year time horizon; the position was opened during the second quarter 2010. We acquired an equal par value amount of U.S. Treasury Notes with a similar maturity to cover the credit default swap's notional exposure. As of September 30, 2010 and December 31, 2010, we received \$0.1 million and \$1.1 million, respectively, in cash collateral from the counterparty.

As of September 30, 2010, we closed two positions on one corporate issuer within the industrial sector for which we bought credit default protection in the form of credit default swaps for 2-year and 4-year time horizons; both positions were opened during the second quarter 2010. We paid \$0.2 million in upfront cash when we entered the 4-year exposure position, which was offset against our then open exposure. We held this protection to reduce our exposure to additional valuation declines on a corporate position of the same issuer due to potential future credit impairment.

**Note 3 Fair Value** We have categorized our financial instruments, based on the degree of subjectivity inherent in the method by which they are valued, into a fair value hierarchy of three levels, as follows:

*Level 1:* Inputs are unadjusted quoted prices in active markets for identical instruments at the measurement date (e.g., U.S. government obligations and active exchange-traded equity securities).

*Level 2:* Inputs (other than quoted prices included within Level 1) that are observable for the instrument either directly or indirectly (e.g., certain corporate and municipal bonds and certain preferred stocks). This includes: (i) quoted prices for similar instruments in active markets, (ii) quoted prices for identical or similar instruments in markets that are not active, (iii) inputs other than quoted prices that are observable for the instruments, and (iv) inputs that are derived principally from or corroborated by observable market data by correlation or other means.

*Level 3:* Inputs that are unobservable. Unobservable inputs reflect our subjective evaluation about the assumptions market participants would use in pricing the financial instrument (e.g., certain structured securities and privately held investments).

We evaluate whether a market is distressed or inactive in determining the fair value of our portfolio. We review certain market level inputs to evaluate whether sufficient activity, volume, and new issuances exist to create an active market. Based on this evaluation, we concluded that there was sufficient activity related to the sectors and securities for which we obtained valuations.

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The composition of the investment portfolio by major security type was:

| (millions)                                   | Fair Value |            |          | Total       | Cost        |
|--|------------|------------|----------|-------------|-------------|
|  | Level 1    | Level 2    | Level 3  |             |             |
| <b>September 30, 2011</b>                    |            |            |          |             |             |
| Fixed maturities:                            |            |            |          |             |             |
| U.S. government obligations                  | \$ 3,050.7 | \$ 0       | \$ 0     | \$ 3,050.7  | \$ 2,921.7  |
| State and local government obligations       | 0          | 1,985.9    | 0        | 1,985.9     | 1,930.6     |
| Corporate debt securities                    | 0          | 2,731.8    | 29.6     | 2,761.4     | 2,680.2     |
| Subtotal                                     | 3,050.7    | 4,717.7    | 29.6     | 7,798.0     | 7,532.5     |
| Asset-backed securities:                     |            |            |          |             |             |
| Residential mortgage-backed                  | 0          | 377.1      | 67.1     | 444.2       | 471.3       |
| Commercial mortgage-backed                   | 0          | 1,837.9    | 21.8     | 1,859.7     | 1,826.2     |
| Other asset-backed                           | 0          | 1,276.1    | 3.6      | 1,279.7     | 1,265.5     |
| Subtotal asset-backed securities             | 0          | 3,491.1    | 92.5     | 3,583.6     | 3,563.0     |
| Redeemable preferred stocks:                 |            |            |          |             |             |
| Financials                                   | 24.1       | 118.0      | 0        | 142.1       | 136.7       |
| Utilities                                    | 0          | 68.6       | 0        | 68.6        | 70.8        |
| Industrials                                  | 0          | 223.3      | 0        | 223.3       | 228.9       |
| Subtotal redeemable preferred stocks         | 24.1       | 409.9      | 0        | 434.0       | 436.4       |
| Total fixed maturities                       | 3,074.8    | 8,618.7    | 122.1    | 11,815.6    | 11,531.9    |
| Equity securities:                           |            |            |          |             |             |
| Nonredeemable preferred stocks:              |            |            |          |             |             |
| Financials                                   | 332.3      | 487.6      | 0        | 819.9       | 453.6       |
| Utilities                                    | 0          | 53.1       | 0        | 53.1        | 40.0        |
| Industrials                                  | 0          | 0          | 0        | 0           | 0           |
| Subtotal nonredeemable preferred stocks      | 332.3      | 540.7      | 0        | 873.0       | 493.6       |
| Common equities:                             |            |            |          |             |             |
| Common stocks <sup>1</sup>                   | 1,587.7    | 0          | 0        | 1,587.7     | 1,387.4     |
| Other equity-like investments                | 0          | 0          | 11.8     | 11.8        | 4.1         |
| Subtotal common equities                     | 1,587.7    | 0          | 11.8     | 1,599.5     | 1,391.5     |
| Total fixed maturities and equity securities | \$ 4,994.8 | \$ 9,159.4 | \$ 133.9 | 14,288.1    | 13,417.0    |
| Short-term investments:                      |            |            |          |             |             |
| Other short-term investments <sup>2</sup>    |            |            |          | 1,699.7     | 1,699.7     |
| Total portfolio                              |            |            |          | \$ 15,987.8 | \$ 15,116.7 |
| Debt <sup>3</sup>                            |            |            |          | \$ 2,605.8  | \$ 2,443.9  |

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| (millions)  | Fair Value        |                   |                 | Total              | Cost               |
|---|-------------------|-------------------|-----------------|--------------------|--------------------|
|   | Level 1           | Level 2           | Level 3         |                    |                    |
| <b>September 30, 2010</b>                           |                   |                   |                 |                    |                    |
| Fixed maturities:                                   |                   |                   |                 |                    |                    |
| U.S. government obligations                         | \$ 3,521.7        | \$ 0              | \$ 0            | \$ 3,521.7         | \$ 3,411.7         |
| State and local government obligations              | 0                 | 1,932.3           | 0               | 1,932.3            | 1,865.1            |
| Corporate debt securities                           | 0                 | 2,476.2           | 29.6            | 2,505.8            | 2,392.6            |
| Subtotal  | 3,521.7           | 4,408.5           | 29.6            | 7,959.8            | 7,669.4            |
| Asset-backed securities:                            |                   |                   |                 |                    |                    |
| Residential mortgage-backed                         | 0                 | 462.1             | 104.6           | 566.7              | 576.8              |
| Commercial mortgage-backed                          | 0                 | 1,842.2           | 25.4            | 1,867.6            | 1,801.0            |
| Other asset-backed                                  | 0                 | 1,086.2           | 5.6             | 1,091.8            | 1,077.2            |
| Subtotal asset-backed securities                    | 0                 | 3,390.5           | 135.6           | 3,526.1            | 3,455.0            |
| Redeemable preferred stocks:                        |                   |                   |                 |                    |                    |
| Financials  | 23.5              | 231.6             | 0               | 255.1              | 247.6              |
| Utilities   | 0                 | 69.9              | 0               | 69.9               | 69.9               |
| Industrials   | 0                 | 274.9             | 0               | 274.9              | 285.4              |
| Subtotal redeemable preferred stocks                | 23.5              | 576.4             | 0               | 599.9              | 602.9              |
| <b>Total fixed maturities</b>                       | <b>3,545.2</b>    | <b>8,375.4</b>    | <b>165.2</b>    | <b>12,085.8</b>    | <b>11,727.3</b>    |
| Equity securities:                                  |                   |                   |                 |                    |                    |
| Nonredeemable preferred stocks:                     |                   |                   |                 |                    |                    |
| Financials  | 608.9             | 478.2             | 0               | 1,087.1            | 523.6              |
| Utilities   | 0                 | 67.0              | 0               | 67.0               | 50.8               |
| Industrials   | 0                 | 35.3              | 0               | 35.3               | 36.2               |
| Subtotal nonredeemable preferred stocks             | 608.9             | 580.5             | 0               | 1,189.4            | 610.6              |
| Common equities:                                    |                   |                   |                 |                    |                    |
| Common stocks <sup>1</sup>                          | 1,272.8           | 0                 | 0               | 1,272.8            | 1,010.0            |
| Other equity-like investments                       | 0                 | 0                 | 12.5            | 12.5               | 4.7                |
| Subtotal common equities                            | 1,272.8           | 0                 | 12.5            | 1,285.3            | 1,014.7            |
| <b>Total fixed maturities and equity securities</b> | <b>\$ 5,426.9</b> | <b>\$ 8,955.9</b> | <b>\$ 177.7</b> | <b>14,560.5</b>    | <b>13,352.6</b>    |
| Short-term investments:                             |                   |                   |                 |                    |                    |
| Other short-term investments <sup>2</sup>           |                   |                   |                 | 1,815.5            | 1,815.5            |
| <b>Total portfolio</b>                              |                   |                   |                 | <b>\$ 16,376.0</b> | <b>\$ 15,168.1</b> |
| Debt <sup>3</sup>                                   |                   |                   |                 | \$ 2,091.2         | \$ 1,957.8         |

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| (millions)  | Fair Value        |                   |                 | Total              | Cost               |
|---|-------------------|-------------------|-----------------|--------------------|--------------------|
|   | Level 1           | Level 2           | Level 3         |                    |                    |
| <b>December 31, 2010</b>                            |                   |                   |                 |                    |                    |
| Fixed maturities:                                   |                   |                   |                 |                    |                    |
| U.S. government obligations                         | \$ 3,242.6        | \$ 0              | \$ 0            | \$ 3,242.6         | \$ 3,203.2         |
| State and local government obligations              | 0                 | 1,989.1           | 0               | 1,989.1            | 1,955.5            |
| Corporate debt securities                           | 0                 | 2,616.6           | 29.5            | 2,646.1            | 2,579.0            |
| Subtotal  | 3,242.6           | 4,605.7           | 29.5            | 7,877.8            | 7,737.7            |
| Asset-backed securities:                            |                   |                   |                 |                    |                    |
| Residential mortgage-backed                         | 0                 | 466.9             | 96.7            | 563.6              | 567.1              |
| Commercial mortgage-backed                          | 0                 | 1,804.6           | 27.5            | 1,832.1            | 1,772.1            |
| Other asset-backed                                  | 0                 | 1,069.0           | 5.0             | 1,074.0            | 1,063.9            |
| Subtotal asset-backed securities                    | 0                 | 3,340.5           | 129.2           | 3,469.7            | 3,403.1            |
| Redeemable preferred stocks:                        |                   |                   |                 |                    |                    |
| Financials  | 23.4              | 172.4             | 0               | 195.8              | 183.8              |
| Utilities   | 0                 | 71.4              | 0               | 71.4               | 70.2               |
| Industrials   | 0                 | 235.3             | 0               | 235.3              | 236.0              |
| Subtotal redeemable preferred stocks                | 23.4              | 479.1             | 0               | 502.5              | 490.0              |
| <b>Total fixed maturities</b>                       | <b>3,266.0</b>    | <b>8,425.3</b>    | <b>158.7</b>    | <b>11,850.0</b>    | <b>11,630.8</b>    |
| Equity securities:                                  |                   |                   |                 |                    |                    |
| Nonredeemable preferred stocks:                     |                   |                   |                 |                    |                    |
| Financials  | 490.2             | 565.1             | 0               | 1,055.3            | 514.3              |
| Utilities   | 0                 | 67.9              | 0               | 67.9               | 50.8               |
| Industrials   | 0                 | 34.4              | 0               | 34.4               | 36.2               |
| Subtotal nonredeemable preferred stocks             | 490.2             | 667.4             | 0               | 1,157.6            | 601.3              |
| Common equities:                                    |                   |                   |                 |                    |                    |
| Common stocks <sup>1</sup>                          | 1,413.2           | 0                 | 0               | 1,413.2            | 1,017.6            |
| Other equity-like investments                       | 0                 | 0                 | 11.8            | 11.8               | 4.1                |
| Subtotal common equities                            | 1,413.2           | 0                 | 11.8            | 1,425.0            | 1,021.7            |
| <b>Total fixed maturities and equity securities</b> | <b>\$ 5,169.4</b> | <b>\$ 9,092.7</b> | <b>\$ 170.5</b> | <b>14,432.6</b>    | <b>13,253.8</b>    |
| Short-term investments:                             |                   |                   |                 |                    |                    |
| Other short-term investments <sup>2</sup>           |                   |                   |                 | 1,090.8            | 1,090.8            |
| <b>Total portfolio</b>                              |                   |                   |                 | <b>\$ 15,523.4</b> | <b>\$ 14,344.6</b> |
| Debt <sup>3</sup>                                   |                   |                   |                 | \$ 2,105.7         | \$ 1,958.2         |

<sup>1</sup> Common stocks are managed externally to track the Russell 1000 Index. Therefore, a break-out by major sector type is not provided.

<sup>2</sup> Due to the underlying nature of these securities, cost approximates fair value.

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<sup>3</sup> Debt is not subject to measurement at fair value in the Consolidated Balance Sheets. Therefore, it is not broken out by hierarchy level; fair values are obtained from external sources.

Our portfolio valuations classified as either Level 1 or Level 2 in the above tables are priced exclusively by external sources, including: pricing vendors, dealers/market makers, and exchange-quoted prices. We did not have any transfers between Level 1 and Level 2 during the third quarter 2011. During the first quarter, we had two nonredeemable preferred securities with a value of \$71.2 million that were transferred from Level 2 into Level 1 due to the availability of exchange pricing. In the second quarter, the securities (then valued at \$74.9 million) were transferred back into Level 2 due to the lack of a consistent daily exchange-quoted price. The securities will remain in Level 2 permanently until a daily exchange price is evident. We did not have any transfers between Level 1 and Level 2 for the three and nine months ended September 30, 2010 and December 31, 2010.

With limited exceptions, our Level 3 securities are also priced externally; however, due to several factors (e.g., nature of the securities, level of activity, lack of similar securities trading to obtain observable market level inputs), these valuations are more subjective in nature. Certain private-equity and fixed-income investments included in the Level 3 securities are valued using external pricing supplemented by internal review and analysis.

At September 30, 2011, vendor-quoted prices represented 61% of our Level 1 classifications, compared to 65% at September 30, 2010 and 63% at December 31, 2010. The securities quoted by vendors in Level 1 represent holdings in our U.S. Treasury Notes, which are frequently traded and the quotes are considered similar to exchange-quoted prices. The balance of our Level 1 pricing comes from quotes obtained directly from trades made on an active exchange.

At September 30, 2011, vendor-quoted prices comprised 94% of our Level 2 classifications, compared to 91% at September 30, 2010 and 94% at December 31, 2010. We reviewed independent documentation detailing the pricing techniques, models, and methodologies used by these pricing vendors and believe that their policies adequately consider market activity, either based on

specific transactions for the issue valued or based on modeling of securities with similar credit quality, duration, yield, and structure that were recently transacted. We continue to monitor any changes or modifications to the processes employed by the pricing vendors. We reviewed each sector of the fixed-income portfolio for transaction volumes and determined that sufficient activity and liquidity existed to provide a credible source for market level valuations, despite being below historical averages, for all periods presented.

Broker/dealer-quoted prices represent the balance of our Level 2 classifications. In these instances, we typically use broker/dealers because the security we hold is not widely held or frequently traded and thus is not serviced by the pricing vendors. We reviewed independent documentation detailing the pricing techniques, models, and methodologies used by broker/dealers and determined that they used the same pricing techniques as the external vendor pricing sources discussed above. The broker/dealers maintain back office pricing desks, separate from the day-to-day traders that buy and sell the securities. This process creates uniformity in pricing when they quote externally to their various customers. The broker/dealer valuations are quoted in terms of spreads to various indices and the spreads are based off recent transactions adjusted for movements since the last trade or based off similar securities currently trading in the market. These quotes are not considered binding offers to transact. From time to time, we will obtain more than one broker/dealer quote for a security, and we will also obtain a broker/dealer quote for those securities priced by vendors as further evaluation of market price. We believe these additional steps help to ensure that we are reporting the most representative price and validate our pricing methodology.

To the extent the inputs used by external pricing sources are determined to not contain sufficient observable market information, we will reclassify the affected security valuations to Level 3. At September 30, 2011 and 2010, and December 31, 2010, securities in our fixed-maturity portfolio listed as Level 3 were comprised substantially of securities that were either (i) private placement deals, (ii) thinly held and/or traded securities, or (iii) non-investment-grade securities with little liquidity. Based on these factors, it was difficult to independently verify observable market inputs that were used to generate the external valuations we received. At September 30, 2011 and 2010, as well as December 31, 2010, one private common equity security with an aggregate value of \$10.2 million was priced internally. Additionally, at September 30, 2011 and 2010, as well as December 31, 2010, we had two fixed-maturity securities with an aggregate value of \$0.5 million that were priced internally.

During each valuation period, we create internal estimations of portfolio valuation (performance returns), based on current market-related activity (i.e., interest rate and credit spread movements and other credit-related factors) within each major sector of our portfolio. We compare our internally generated portfolio results for all levels of financial instruments with those generated based on quotes we received externally and research material valuation differences.

Based on the criteria described above, we believe that the current level classifications are appropriate based on the valuation techniques used and that our fair values accurately reflect current market assumptions in the aggregate.



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The following tables provide a summary of changes in fair value associated with Level 3 assets for the three and nine months ended September 30, 2011 and 2010:

| (millions)                    | Level 3 Fair Value<br>Three months ended September 30, 2011 |                                   |           |       |                                |                        |                                 | Fair<br>value<br>at Sept. 30,<br>2011 |
|-------------------------------|---|-----------------------------------|-----------|-------|--------------------------------|------------------------|---------------------------------|---------------------------------------|
|                               | Fair Value<br>at June 30,<br>2011                           | Calls/<br>Maturities/<br>Paydowns | Purchases | Sales | Net<br>Realized<br>(gain)/loss | Change in<br>Valuation | Net<br>Transfers<br>in<br>(out) |                                       |
| Fixed maturities:             |   |                                   |           |       |                                |                        |                                 |                                       |
| Asset-backed securities:      |   |                                   |           |       |                                |                        |                                 |                                       |
| Residential mortgage-backed   | \$ 71.5   | \$ (4.9)                          | \$ 0      | \$ 0  | \$ 0                           | \$ .5                  | \$ 0                            | \$ 67.1                               |
| Commercial mortgage-backed    | 26.5  | (.1)                              | 0         | 0     | 0                              | (4.6)                  | 0                               | 21.8                                  |
| Other asset-backed            | 4.5   | (.8)                              | 0         | 0     | 0                              | (.1)                   | 0                               | 3.6                                   |
| Total asset-backed securities | 102.5   | (5.8)                             | 0         | 0     | 0                              | (4.2)                  | 0                               | 92.5                                  |
| Corporate debt securities     | 29.8  | 0                                 | 0         | 0     | 0                              | (.2)                   | 0                               | 29.6                                  |
| Other debt obligations        | 0   | 0                                 | 0         | 0     | 0                              | 0                      | 0                               | 0                                     |
| Redeemable preferred stocks:  |   |                                   |           |       |                                |                        |                                 |                                       |
| Industrials                   | 0   | 0                                 | 0         | 0     | 0                              | 0                      | 0                               | 0                                     |
| Total fixed maturities        | 132.3   | (5.8)                             | 0         | 0     | 0                              | (4.4)                  | 0                               | 122.1                                 |
| Equity securities:            |   |                                   |           |       |                                |                        |                                 |                                       |
| Common equities:              |   |                                   |           |       |                                |                        |                                 |                                       |
| Other equity-like investments | 11.9  | 0                                 | 0         | 0     | 0                              | (.1)                   | 0                               | 11.8                                  |
| Total Level 3 securities      | \$ 144.2  | \$ (5.8)                          | \$ 0      | \$ 0  | \$ 0                           | \$ (4.5)               | \$ 0                            | \$ 133.9                              |

| (millions)                    | Level 3 Fair Value<br>Nine months ended September 30, 2011 |                                   |           |       |                                |                        |   | Fair value<br>at Sept. 30,<br>2011 |
|-------------------------------|--|-----------------------------------|-----------|-------|--------------------------------|------------------------|---|------------------------------------|
|                               | Fair Value<br>at Dec.<br>31,<br>2010                       | Calls/<br>Maturities/<br>Paydowns | Purchases | Sales | Net<br>Realized<br>(gain)/loss | Change in<br>Valuation | Net<br>Transfers<br>in (out) <sup>1</sup> |                                    |
| Fixed maturities:             |  |                                   |           |       |                                |                        |   |                                    |
| Asset-backed securities:      |  |                                   |           |       |                                |                        |   |                                    |
| Residential mortgage-backed   | \$ 96.7  | \$ (14.7)                         | \$ 0      | \$ 0  | \$ 0                           | \$ .5                  | \$ (15.4)                                 | \$ 67.1                            |
| Commercial mortgage-backed    | 27.5   | (.2)                              | 0         | 0     | 0                              | (5.5)                  | 0   | 21.8                               |
| Other asset-backed            | 5.0  | (1.7)                             | 0         | 0     | 0                              | .3                     | 0   | 3.6                                |
| Total asset-backed securities | 129.2  | (16.6)                            | 0         | 0     | 0                              | (4.7)                  | (15.4)                                    | 92.5                               |
| Corporate debt securities     | 29.5   | 0                                 | 0         | 0     | 0                              | .1                     | 0   | 29.6                               |
| Other debt obligations        | 0  | 0                                 | 0         | 0     | 0                              | 0                      | 0   | 0                                  |
| Redeemable preferred stocks:  |  |                                   |           |       |                                |                        |   |                                    |
| Industrials                   | 0  | 0                                 | 0         | 0     | 0                              | 0                      | 0   | 0                                  |
| Total fixed maturities        | 158.7  | (16.6)                            | 0         | 0     | 0                              | (4.6)                  | (15.4)                                    | 122.1                              |
| Equity securities:            |  |                                   |           |       |                                |                        |   |                                    |
| Common equities:              |  |                                   |           |       |                                |                        |   |                                    |
| Other equity-like investments | 11.8   | 0                                 | 0         | 0     | 0                              | 0                      | 0   | 11.8                               |

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|                          |          |           |      |      |      |          |           |          |
|--------------------------|----------|-----------|------|------|------|----------|-----------|----------|
| Total Level 3 securities | \$ 170.5 | \$ (16.6) | \$ 0 | \$ 0 | \$ 0 | \$ (4.6) | \$ (15.4) | \$ 133.9 |
|--------------------------|----------|-----------|------|------|------|----------|-----------|----------|

- <sup>1</sup> The \$(15.4) million was transferred out of Level 3 into Level 2 due to the availability of vendor pricing on a residential mortgage-backed security.

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| (millions)                    | Level 3 Fair Value          |                             |                                       |         |                          |                     |                                     |                              |
|-------------------------------|-----------------------------|-----------------------------|---------------------------------------|---------|--------------------------|---------------------|-------------------------------------|------------------------------|
|                               | Fair Value at June 30, 2010 | Calls/ Maturities/ Paydowns | Three months ended September 30, 2010 |         |                          |                     | Net Transfers in (out) <sup>1</sup> | Fair value at Sept. 30, 2010 |
|                               | 2010                        |                             | Purchases                             | Sales   | Net Realized (gain)/loss | Change in Valuation |                                     | 2010                         |
| Fixed maturities:             |                             |                             |                                       |         |                          |                     |                                     |                              |
| Asset-backed securities:      |                             |                             |                                       |         |                          |                     |                                     |                              |
| Residential mortgage-backed   | \$ 88.5                     | \$ (5.5)                    | \$ 21.3                               | \$ 0    | \$ 0                     | \$ .3               | \$ 0                                | \$ 104.6                     |
| Commercial mortgage-backed    | 22.6                        | 0                           | 0                                     | 0       | 0                        | 2.5                 | .3                                  | 25.4                         |
| Other asset-backed            | 6.4                         | (.8)                        | 0                                     | 0       | 0                        | 0                   | 0                                   | 5.6                          |
| Total asset-backed securities | 117.5                       | (6.3)                       | 21.3                                  | 0       | 0                        | 2.8                 | .3                                  | 135.6                        |
| Corporate debt securities     | 29.0                        | 0                           | 0                                     | 0       | 0                        | .6                  | 0                                   | 29.6                         |
| Other debt obligations        | 0                           | 0                           | 0                                     | 0       | 0                        | 0                   | 0                                   | 0                            |
| Redeemable preferred stocks:  |                             |                             |                                       |         |                          |                     |                                     |                              |
| Industrials                   | 0                           | 0                           | 0                                     | 0       | 0                        | 0                   | 0                                   | 0                            |
| Total fixed maturities        | 146.5                       | (6.3)                       | 21.3                                  | 0       | 0                        | 3.4                 | .3                                  | 165.2                        |
| Equity securities:            |                             |                             |                                       |         |                          |                     |                                     |                              |
| Common equities:              |                             |                             |                                       |         |                          |                     |                                     |                              |
| Other equity-like investments | 12.7                        | 0                           | 0                                     | (.3)    | .3                       | (.2)                | 0                                   | 12.5                         |
| Total Level 3 securities      | \$ 159.2                    | \$ (6.3)                    | \$ 21.3                               | \$ (.3) | \$ .3                    | \$ 3.2              | \$ .3                               | \$ 177.7                     |

<sup>1</sup> The \$0.3 million was transferred from Level 2 into Level 3 due to a lack of trade volume and liquidity.

| (millions)                    | Level 3 Fair Value          |                             |                                      |         |                          |                     |                                     |                              |
|-------------------------------|-----------------------------|-----------------------------|--------------------------------------|---------|--------------------------|---------------------|-------------------------------------|------------------------------|
|                               | Fair Value at Dec. 31, 2009 | Calls/ Maturities/ Paydowns | Nine months ended September 30, 2010 |         |                          |                     | Net Transfers in (out) <sup>1</sup> | Fair value at Sept. 30, 2010 |
|                               | 2009                        |                             | Purchases                            | Sales   | Net Realized (gain)/loss | Change in Valuation |                                     | 2010                         |
| Fixed maturities:             |                             |                             |                                      |         |                          |                     |                                     |                              |
| Asset-backed securities:      |                             |                             |                                      |         |                          |                     |                                     |                              |
| Residential mortgage-backed   | \$ 46.1                     | \$ (13.0)                   | \$ 55.6                              | \$ 0    | \$ 0                     | \$ 3.8              | 12.1                                | \$ 104.6                     |
| Commercial mortgage-backed    | 21.6                        | 0                           | 0                                    | 0       | 0                        | 3.5                 | .3                                  | 25.4                         |
| Other asset-backed            | 7.8                         | (2.0)                       | 0                                    | 0       | 0                        | (.2)                | 0                                   | 5.6                          |
| Total asset-backed securities | 75.5                        | (15.0)                      | 55.6                                 | 0       | 0                        | 7.1                 | 12.4                                | 135.6                        |
| Corporate debt securities     | 28.2                        | 0                           | 0                                    | 0       | 0                        | 1.4                 | 0                                   | 29.6                         |
| Other debt obligations        | 1.1                         | 0                           | 0                                    | 0       | 0                        | (1.1)               | 0                                   | 0                            |
| Redeemable preferred stocks:  |                             |                             |                                      |         |                          |                     |                                     |                              |
| Industrials                   | 53.1                        | 0                           | 0                                    | 0       | 0                        | 0                   | (53.1)                              | 0                            |
| Total fixed maturities        | 157.9                       | (15.0)                      | 55.6                                 | 0       | 0                        | 7.4                 | (40.7)                              | 165.2                        |
| Equity securities:            |                             |                             |                                      |         |                          |                     |                                     |                              |
| Common equities:              |                             |                             |                                      |         |                          |                     |                                     |                              |
| Other equity-like investments | 12.9                        | (.6)                        | 0                                    | (.3)    | .3                       | .2                  | 0                                   | 12.5                         |
| Total Level 3 securities      | \$ 170.8                    | \$ (15.6)                   | \$ 55.6                              | \$ (.3) | \$ .3                    | \$ 7.6              | \$ (40.7)                           | \$ 177.7                     |

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<sup>1</sup> The \$12.1 million was transferred from Level 2 into Level 3 due to a lack of trade volume and the \$(53.1) million was transferred out of Level 3 into Level 2 due to the availability of vendor pricing on a redeemable preferred stock.

**Note 4 Debt** Debt consisted of:

| (millions)   | September 30, 2011 |                   | September 30, 2010 |                   | December 31, 2010 |                   |
|--|--------------------|-------------------|--------------------|-------------------|-------------------|-------------------|
|  | Carrying Value     | Fair Value        | Carrying Value     | Fair Value        | Carrying Value    | Fair Value        |
| 6.375% Senior Notes due 2012   | \$ 349.9           | \$ 354.4          | \$ 349.5           | \$ 376.3          | \$ 349.6          | \$ 369.3          |
| 7% Notes due 2013  | 149.7              | 164.2             | 149.5              | 167.1             | 149.6             | 165.0             |
| 3.75% Senior Notes due 2021  | 497.0              | 511.8             | 0                  | 0                 | 0                 | 0                 |
| 6 5/8% Senior Notes due 2029   | 294.9              | 354.1             | 294.8              | 342.5             | 294.8             | 329.9             |
| 6.25% Senior Notes due 2032  | 394.3              | 462.6             | 394.2              | 443.7             | 394.2             | 433.3             |
| 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 | 758.1              | 758.7             | 769.8              | 761.6             | 770.0             | 808.2             |
| <b>Total</b>   | <b>\$ 2,443.9</b>  | <b>\$ 2,605.8</b> | <b>\$ 1,957.8</b>  | <b>\$ 2,091.2</b> | <b>\$ 1,958.2</b> | <b>\$ 2,105.7</b> |

On December 31, 2010, we entered into an amendment to the 364-Day Secured Liquidity Credit Facility Agreement ( Credit Facility Agreement ) with PNC Bank, National Association (PNC), which extended the expiration date of our outstanding credit facility agreement until December 31, 2011, unless earlier terminated pursuant to the terms of the agreement. Under this agreement, we may borrow up to \$125 million, which may be increased to \$150 million at our request but subject to PNC's discretion. The purpose of the credit facility is to provide liquidity in the event of disruptions in our cash management operations, such as disruptions in the financial markets or related facilities that affect our ability to transfer or receive funds. Under this credit facility, we may borrow funds, on a revolving basis, either in the form of Eurodollar Loans or Base Rate Loans. Eurodollar Loans will bear interest at one-, two-, three-, or six-month LIBOR (as selected by us) plus 50 basis points for the selected period. Base Rate Loans will bear daily interest at the greater of (a) PNC's prime rate for such day, (b) the federal funds effective rate for such day plus 1/2% per annum, or (c) one-month LIBOR plus 2% per annum. Any borrowings under this agreement will be secured by a lien on certain marketable securities held in our investment portfolio. We had no borrowings under this arrangement in 2010 or through the first nine months of 2011.

On August 22, 2011, we issued \$500 million of 3.75% Senior Notes due 2021 (the 3.75% Senior Notes ). We received proceeds of \$497 million, after deducting underwriter's discounts and commissions, and we incurred an additional \$1.0 million of expenses related to the issuance. In addition, upon issuance of the 3.75% Senior Notes, we closed a forecasted debt issuance hedge, which was entered into to hedge against a possible rise in interest rates, and recognized a \$5.1 million pretax loss as part of accumulated other comprehensive income (loss); the loss will be recognized as an adjustment to interest expense and amortized over the life of the 3.75% Senior Notes.

During the third quarter 2011, we repurchased \$12.7 million in aggregate principal amount of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 (the 6.70% Debentures ), resulting in a net loss on these extinguishments of \$0.1 million. In addition, we reclassified \$0.3 million, on a pretax basis, from accumulated other comprehensive income on the balance sheet to net realized gains (losses) on securities on the income statement, reflecting the portion of the unrealized gain on forecasted transactions that was related to the portion of the debt extinguished during the quarter.

In September 2011, we entered into an agreement with The Bank of New York Mellon Trust Company, N.A., as trustee, modifying the terms of our 6.70% Debentures. Pursuant to that agreement, among other changes, we surrendered our right to temporarily defer the payment of interest on the 6.70% Debentures and terminated a related obligation to reserve up to 250 million of our unissued common shares as a source of potential funding to pay any such deferred interest. The changes were effective immediately upon execution of the agreement.

In June 2010, we commenced an offer to purchase for cash (the Tender Offer ) up to \$350 million in aggregate principal amount of our 6.70% Debentures. The Tender Offer expired on July 8, 2010. We received valid tenders from holders of the 6.70% Debentures in the aggregate principal amount of \$222.9 million. All of the tendering holders validly tendered by the early tender date of June 23, 2010 and received consideration of \$950 per \$1,000 principal amount of the 6.70% Debentures accepted for purchase, which included an early tender payment of \$50 per \$1,000 principal amount of 6.70% Debentures accepted. We recognized a net gain on the debt extinguishment of \$6.4 million, after deducting expenses and fees associated with the Tender Offer and related Consent Solicitation discussed below.

As a condition of the Tender Offer, we solicited consents (the Consent Solicitation ) from the holders of our 6.25% Senior Notes due 2032 (the 6.25% Senior Notes ) to terminate the Replacement Capital Covenant (the RCC ) relating to the 6.25% Senior Notes. The RCC was originally entered into by Progressive in June 2007 for the benefit of the holders of the 6.25% Senior Notes in connection with the issuance of the 6.70% Debentures. Under the RCC, we agreed that we would not repay, redeem, defease, or purchase all or any part of the 6.70% Debentures before June 15, 2047, unless Progressive was to obtain a specified portion of the funds used in the transaction through the sale of its common shares or certain other equity or equity-like securities. The RCC was terminated on June



23, 2010, the expiration date of the Consent Solicitation, at which time we had received the consent of holders of a majority of the outstanding aggregate principal amount of the 6.25% Senior Notes. Those holders who validly delivered their consent by the expiration date received a consent fee of \$5.00 for each \$1,000 principal amount of their 6.25% Senior Notes.

**Note 5 Income Taxes** At September 30, 2011 and 2010 and December 31, 2010, we determined that we did not need a valuation allowance on our deferred tax asset. Although realization of the deferred tax asset is not assured, management believes it is more likely than not that the gross deferred tax asset will be realized based on our expectation that we will be able to fully utilize the deductions that are ultimately recognized for tax purposes. For the nine months ended September 30, 2011, there have been no material changes in our uncertain tax positions.

The effective tax rate for the three months ended September 30, 2011 was 28%, compared with 32% for the same period last year, reflecting \$6.3 million of elective tax credits, primarily related to the 2007-2009 tax years, recognized during the third quarter 2011.

**Note 6 Supplemental Cash Flow Information** Cash includes only bank demand deposits. We paid the following in the respective time periods:

| (millions)                   | Nine Months Ended September 30, |          |
|------------------------------|---------------------------------|----------|
|                              | 2011                            | 2010     |
| Income taxes, net of refunds | \$ 348.0                        | \$ 299.0 |
| Interest                     | 86.1                            | 94.6     |

**Note 7 Segment Information** Our Personal Lines segment writes insurance for personal autos and recreational vehicles. Our Commercial Auto segment writes primary liability, physical damage, and other auto-related insurance for automobiles and trucks owned by small businesses in the business auto and truck markets. Our other indemnity businesses manage our run-off businesses, including the run-off of our professional liability insurance program for community banks, which was sold in 2010. Our service businesses provide insurance-related services, including processing Commercial Auto Insurance Procedures/Plans ( CAIP ) business and serving as an agent for homeowners insurance through our programs with three unaffiliated homeowner insurance companies. All revenues are generated from external customers.

Following are the operating results for the respective periods:

| (millions)                                | Three Months Ended September 30, |                      |            |                      | Nine Months Ended September 30, |                      |             |                      |
|---|----------------------------------|----------------------|------------|----------------------|---------------------------------|----------------------|-------------|----------------------|
|   | 2011                             |                      | 2010       |                      | 2011                            |                      | 2010        |                      |
|   | Revenues                         | Pretax Profit (Loss) | Revenues   | Pretax Profit (Loss) | Revenues                        | Pretax Profit (Loss) | Revenues    | Pretax Profit (Loss) |
| Personal Lines                            |                                  |                      |            |                      |                                 |                      |             |                      |
| Agency                                    | \$ 1,910.7                       | \$ 112.8             | \$ 1,859.6 | \$ 127.6             | \$ 5,704.4                      | \$ 442.3             | \$ 5,550.4  | \$ 462.6             |
| Direct                                    | 1,458.8                          | 52.0                 | 1,367.3    | 72.0                 | 4,329.8                         | 248.4                | 4,019.0     | 226.2                |
| Total Personal Lines <sup>1</sup>         | 3,369.5                          | 164.8                | 3,226.9    | 199.6                | 10,034.2                        | 690.7                | 9,569.4     | 688.8                |
| Commercial Auto                           | 370.5                            | 18.4                 | 369.9      | 55.9                 | 1,087.8                         | 93.6                 | 1,110.4     | 138.9                |
| Other indemnity                           | .7                               | (2.5)                | 3.1        | (.5)                 | 3.9                             | (3.1)                | 11.4        | 7.4                  |
| Total underwriting operations             | 3,740.7                          | 180.7                | 3,599.9    | 255.0                | 11,125.9                        | 781.2                | 10,691.2    | 835.1                |
| Service businesses                        | 5.6                              | .5                   | 4.8        | (.4)                 | 16.8                            | 2.9                  | 14.0        | (1.9)                |
| Investments <sup>2</sup>                  | 64.8                             | 60.8                 | 158.4      | 158.1                | 434.6                           | 424.0                | 410.1       | 401.6                |
| Net gain (loss) on extinguishment of debt | (.1)                             | (.1)                 | 6.4        | 6.4                  | (.1)                            | (.1)                 | 6.4         | 6.4                  |
| Interest expense                          | NA                               | (33.4)               | NA         | (31.9)               | NA                              | (96.4)               | NA          | (102.2)              |
| Consolidated total                        | \$ 3,811.0                       | \$ 208.5             | \$ 3,769.5 | \$ 387.2             | \$ 11,577.2                     | \$ 1,111.6           | \$ 11,121.7 | \$ 1,139.0           |

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Personal auto insurance accounted for 91% of the total Personal Lines segment net premiums earned in the both the third quarter 2011 and 2010 and the first nine months of 2011, compared to 90% for the first nine months last year; insurance for our special lines products (e.g., motorcycles, ATVs, RVs, mobile homes, watercraft, and snowmobiles) accounted for the balance of the Personal Lines net premiums earned.

- 2 Revenues represent recurring investment income and total net realized gains (losses) on securities; pretax profit is net of investment expenses.

NA = Not Applicable



Progressive's management uses underwriting margin and combined ratio as primary measures of underwriting profitability. The underwriting margin is the pretax underwriting profit (loss) expressed as a percentage of net premiums earned (i.e., revenues from insurance operations). Combined ratio is the complement of the underwriting margin. Following are the underwriting margins and combined ratios for our underwriting operations:

|                               | Three Months Ended September 30, |                |                      |                | Nine Months Ended September 30, |                |                      |                |
|-------------------------------|----------------------------------|----------------|----------------------|----------------|---------------------------------|----------------|----------------------|----------------|
|                               | 2011                             |                | 2010                 |                | 2011                            |                | 2010                 |                |
|                               | Under-writing Margin             | Combined Ratio | Under-writing Margin | Combined Ratio | Under-writing Margin            | Combined Ratio | Under-writing Margin | Combined Ratio |
| Personal Lines                |                                  |                |                      |                |                                 |                |                      |                |
| Agency                        | 5.9 %                            | 94.1           | 6.9 %                | 93.1           | 7.8 %                           | 92.2           | 8.3 %                | 91.7           |
| Direct                        | 3.6                              | 96.4           | 5.3                  | 94.7           | 5.7                             | 94.3           | 5.6                  | 94.4           |
| Total Personal Lines          | 4.9                              | 95.1           | 6.2                  | 93.8           | 6.9                             | 93.1           | 7.2                  | 92.8           |
| Commercial Auto               | 5.0                              | 95.0           | 15.1                 | 84.9           | 8.6                             | 91.4           | 12.5                 | 87.5           |
| Other indemnity <sup>1</sup>  | NM                               | NM             | NM                   | NM             | NM                              | NM             | NM                   | NM             |
| Total underwriting operations | 4.8                              | 95.2           | 7.1                  | 92.9           | 7.0                             | 93.0           | 7.8                  | 92.2           |

<sup>1</sup> Underwriting margins and combined ratios are not meaningful (NM) for our other indemnity businesses due to the low level of premiums earned by, and the variability of loss costs in, such businesses.

**Note 8 Comprehensive Income (Loss)** Total comprehensive income (loss) was:

| (millions)  | Three Months Ended |                    | Nine Months Ended  |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| Net income  | \$ 150.7           | \$ 261.6           | \$ 758.8           | \$ 769.1           |
| After-tax changes in:   |                    |                    |                    |                    |
| Non-credit related OTTI losses <sup>1</sup>   | 0                  | 0                  | (1.7)              | (6.2)              |
| Additional credit-related OTTI losses recognized on previously recorded non-credit losses | 0                  | .1                 | 1.1                | 2.7                |
| Net non-credit related OTTI losses <sup>2</sup>   | 0                  | .1                 | (.6)               | (3.5)              |
| Sales/valuation changes on previously recorded non-credit related losses                  | (1.4)              | 2.8                | (3.9)              | 16.1               |
| Net non-credit related OTTI losses, adjusted for valuation changes                        | (1.4)              | 2.9                | (4.5)              | 12.6               |
| Other net unrealized gains (losses) on securities   | (280.9)            | 225.8              | (196.9)            | 339.9              |
| Total net unrealized gains (losses) on securities   | (282.3)            | 228.7              | (201.4)            | 352.5              |
| Net unrealized gains on forecasted transactions   | (4.4)              | (4.6)              | (6.0)              | (6.2)              |
| Foreign currency translation adjustment   | (.2)               | .5                 | .3                 | (.3)               |
| Comprehensive income (loss)   | \$ (136.2)         | \$ 486.2           | \$ 551.7           | \$ 1,115.1         |

<sup>1</sup> Amounts represent the portion of OTTI losses recognized in other comprehensive income (loss) during the period.

<sup>2</sup> A positive amount for the period reflects credit losses reclassified from other comprehensive income that exceeded the amount of non-credit OTTI losses recognized in other comprehensive income during the period.



**Note 9 Dividends** Progressive maintains a policy of paying an annual variable dividend that, if declared, would be payable shortly after the close of the year. This annual variable dividend is based on a target percentage of after-tax underwriting income multiplied by a companywide performance factor ( Gainshare factor ), subject to the limitations discussed below. The target percentage is determined by our Board of Directors on an annual basis and announced to shareholders and the public. For 2011, the Board has determined the target percentage to be 33-1/3% of annual after-tax underwriting income.

The Gainshare factor can range from zero to two and is determined by comparing our operating performance for the year to certain predetermined profitability and growth objectives approved in advance by the Board. This Gainshare factor is also used in the variable cash incentive program currently in place for our employees (referred to as our Gainsharing program ). Although recalibrated every year, the structure of the Gainsharing program generally remains the same. On a year-to-date basis, as of September 30, 2011, the Gainshare factor was 1.07. Since the final factor will be determined based on our results for the full year, the final factor may vary from the current factor.

Our annual variable dividend program is subject to certain limitations. If the Gainshare factor is zero or if our after-tax comprehensive income (see Note 8 Comprehensive Income) is less than after-tax underwriting income, no dividend will be paid. Nevertheless, the declaration of the dividend remains within the Board's discretion and is subject to the above limitations. If a dividend for 2011 will be paid, the Board would likely declare the 2011 annual dividend in December 2011, with a record date in January 2012 and payment shortly thereafter. For the nine months ended September 30, 2011, our after-tax comprehensive income was \$551.7 million, which is higher than the \$507.8 million of after-tax underwriting income for the same period.

In February 2011, Progressive paid a dividend of \$.3987 per common share, pursuant to a December 2010 declaration by the Board of Directors under our annual variable dividend policy. In February 2010, Progressive paid a dividend of \$.1613 per common share, pursuant to a December 2009 declaration by the Board. In addition to the annual variable dividend, Progressive paid a \$1.00 per common share extraordinary dividend in December 2010, pursuant to an October 2010 declaration by the Board.

**Note 10 Litigation** The Progressive Corporation and/or its insurance subsidiaries are named as defendants in various lawsuits arising out of claims made under insurance policies issued by our subsidiaries in the ordinary course of their businesses. All legal actions relating to such insurance claims are considered by us in establishing our loss and loss adjustment expense reserves.

In addition, various Progressive entities are named as defendants in various class action or individual lawsuits arising out of the operations of our insurance subsidiaries. These cases include those alleging damages as a result of our practices in evaluating or paying medical or injury claims or benefits, including, but not limited to, personal injury protection, medical payments, and bodily injury benefits; the utilization, content, or appearance of policy documents; labor rates paid to auto body repair shops; and cases challenging other aspects of our claims or marketing practices or other business operations. Other insurance companies face many of these same issues.

We plan to contest the outstanding suits vigorously, but may pursue settlement negotiations in some cases, if appropriate. In accordance with accounting principles generally accepted in the United States of America (GAAP), we establish accruals for lawsuits when it is probable that a loss has been incurred and we can reasonably estimate its potential exposure. Pursuant to GAAP, we have not established accruals for those lawsuits for which a loss is not probable and/or we are currently unable to estimate our potential exposure. If any one or more of these lawsuits results in a judgment against, or settlement by, our insurance subsidiaries for an amount that is significantly greater than the amount, if any, so accrued, the resulting liability could have a material effect on our financial condition, cash flows, and results of operations.

For a further discussion on our pending litigation, see Note 12 Litigation in our Annual Report to Shareholders for the year ended December 31, 2010.

**Note 11 New Accounting Standard** During 2010, the Financial Accounting Standards Board issued an accounting standard update related to the accounting for the deferral of costs associated with the successful acquisition or renewal of insurance contracts. This standard is intended to help reduce diversity in practice and is effective for fiscal years beginning after December 15, 2011 (January 2012 for calendar-year companies). Upon adoption, we anticipate that we will defer less acquisition costs under this new standard. We currently estimate that we will have about \$20-\$25 million of deferred acquisition costs that will no longer meet the criteria for deferral as of January 1, 2012. Pursuant to the guidance, we will elect to adopt this standard on a prospective basis and, therefore, will recognize the effect of this accounting change into income primarily over the first six months of 2012, consistent with our insurance policy terms.

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### I. OVERVIEW

In the third quarter 2011, The Progressive Corporation's insurance subsidiaries generated net premiums written and policies in force growth of 4% and 5%, respectively. Underwriting profitability for the quarter was 4.8%, or \$180.7 million, and our investment operations produced investment income of \$117.4 million. We also recognized \$52.6 million of net realized losses on securities during the quarter. Overall, we reported net income of \$150.7 million, or \$.24 per share, for the third quarter 2011. Our total capital position (debt plus equity) decreased \$48.4 million during the quarter, to \$8.3 billion at September 30, 2011.

#### A. Operations

During the third quarter 2011, we realized a year-over-year increase in net premiums written of 4% on a companywide basis. Our Agency and Direct Personal Lines businesses grew 2% and 5%, respectively, and our Commercial Auto business grew 10%. Premium growth reflects a combination of new business applications (i.e., issued policies), premium per policy (i.e., rates), and customer retention.

On a quarter-over-prior-year quarter basis, Personal Lines new applications decreased 1%; our Commercial Auto new applications increased 2%, led by an increase in our for-hire transportation business market tier. Our advertising and media placement remain a critical component of our new customer generation and we will continue to take advantage of the brand assets we have developed in both Flo and the Messenger campaigns.

Both our Agency and Direct businesses contributed to the 6% increase in our Personal Lines renewal applications. Our Commercial Auto business experienced a decline of 1% in renewal applications, reflecting the prior year reduction in new business. The Personal Lines increase in part reflects our retention efforts (e.g., rate stability and loyalty programs). In addition, we are working to expand our penetration of multi-product households, which we believe will strengthen policyholder retention in certain tiers. The multi-product quoting application that we introduced in the first quarter 2011 is available countrywide, helping to improve the efficiency of quoting and buying a combination of Personal Lines products.

Our efforts remain focused on several initiatives we have put in place that are designed to help stimulate growth and provide consumers with distinctive new insurance options. These initiatives include:

the national advertising and continued expansion of Snapshot<sup>®</sup>, our usage-based insurance product,

new product models in both our Personal Lines and Commercial Auto businesses, which are designed to help improve competitiveness with advanced segmentation and product features, and

additional functionality in the mobile device space, including the third quarter 2011 launch of a feature that enables customers in certain states to purchase insurance directly from their mobile device after receiving a quote and the nationwide rollout of a mobile quoting application for our Commercial Auto business.

In addition, Name Your Price<sup>®</sup> remains a key initiative. This program provides our Direct auto customers a tool that allows them to name or select the price they would like to pay for auto insurance and match it to a range of coverage combinations. We completed the countrywide rollout of this program in 2010.

On a year-over-year basis, for the third quarter 2011, written premium per policy remained relatively flat in our Agency auto business, but decreased about 1% in Direct auto. Commercial Auto saw premiums per policy increase about 7% for the third quarter 2011, compared to decreases throughout 2010, primarily reflecting rate increases taken earlier in 2011 and shifts in our mix of business. Average written premium for our special lines products was down 4%, driven largely by older average model years of motorcycles insured. Adjusting rates is an ongoing process, and we will continue to evaluate future rate needs and react quickly as we recognize changing trends.

On a companywide basis, year-over-year, we grew policies in force 5%, with Personal Lines growing 5% and Commercial Auto decreasing 1%. Our Direct auto business continues to be the biggest contributor to this increase with policies in force growth of 7%, or 235,700 additional policies. In our Agency auto business, policies in force grew 3%, or 145,200 policies, over last September. With a 5% increase in our special lines policies over last year, we ended the third quarter with nearly 12.3 million Personal Lines policyholders.

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To continue to grow policies in force, it is critical that we retain our customers for longer periods, which is why increasing retention remains one of our most important priorities and why we have stepped up our efforts to increase the number of multi-product households. Policy life expectancy, which is our actuarial estimate of the average length of time that a policy will remain in force before cancellation or lapse in coverage, is one measure of customer retention. Policy life expectancy for our Agency auto business increased about 6% over the same time last year and in our Direct auto business decreased about 3%. Our policy life expectancy in our Commercial Auto business remained relatively flat and in our special lines products was down about 2%.

Our 4.8% companywide underwriting profit margin for the third quarter 2011 exceeded our target of 4%. On a year-over-year basis, our margin decreased 2.3 percentage points for the third quarter. We incurred catastrophe losses of about \$63 million during the quarter, or 1.7 loss ratio points, including about \$20 million related to Hurricane Irene. In the third quarter 2010, we had \$23 million, or 0.6 points, from catastrophe losses. In addition, during the third quarter 2011, we experienced \$72.5 million, or 1.9 points, of favorable prior accident year reserve development, compared to 3.0 points of favorable reserve development in the third quarter last year. About 74% of the development reflected in our 2011 results was in our Personal Lines business, with the balance primarily in Commercial Auto. On a year-over-year basis, for the third quarter 2011, our personal auto business, excluding comprehensive coverage, experienced an aggregate increase in incurred severity of about 3%, while frequency declined about 3%, which is the approximate result across each of the five coverages.

## B. Investments and Capital Management

The fair value of our investment portfolio was \$16.0 billion at September 30, 2011. Our portfolio was allocated 20% to Group I securities and 80% to Group II at September 30, 2011, which is within our asset allocation strategy to maintain 0-25% of our portfolio in Group I securities, with the balance (75%-100%) of our portfolio in Group II securities. We define Group I securities to include: common equities; nonredeemable preferred stocks; redeemable preferred stocks, except for 50% of investment-grade redeemable preferred stocks with cumulative dividends; and all other non-investment-grade fixed-maturity securities. Group II securities include short-term securities and all other fixed-maturity securities. In determining the allocation between Group I and II, residential and commercial mortgage-backed securities derive their credit ratings from models provided by the National Association of Insurance Commissioners (NAIC), while all other debt securities derive their credit ratings from external vendors.

Our investment portfolio produced a fully taxable equivalent (FTE) total return of (2.2)% for the third quarter 2011. We experienced losses in both our fixed-income and common stock portfolios, with FTE total returns of (0.6)% and (14.4)%, respectively. At September 30, 2011, the fixed-income portfolio had a weighted average credit quality of AA-. We continue to maintain our fixed-income portfolio strategy of investing in high-quality securities. At September 30, 2011, our duration was 1.7 years to limit the potential loss of capital in the event of an increase in interest rates from their present low levels.

At September 30, 2011, our total capital (debt plus equity) was \$8.3 billion, compared to \$8.0 billion at December 31, 2010, and our debt-to-total capital ratio was 29.6%. During the quarter, we issued \$500 million of 3.75% Senior Notes due 2021; see *Note 4 Debt* and the *Financial Condition* section below for further discussion. In addition, we repurchased \$411.2 million of our common stock and \$12.7 million of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 (the 6.70% Debentures ).

## II. FINANCIAL CONDITION

### A. Liquidity and Capital Resources

Progressive's insurance operations create liquidity by collecting and investing premiums from new and renewal business in advance of paying claims. For the nine months ended September 30, 2011 and 2010, operations generated positive cash flows of \$1.5 billion and \$1.7 billion, respectively. The year-over-year decrease primarily reflects larger tax payments, greater advertising expenditures, and higher employee-related costs in 2011.

In August 2011, we issued \$500 million of 3.75% Senior Notes due 2021 (the 3.75% Senior Notes ). We received proceeds of \$497 million, after deducting underwriter's discounts and commissions, and incurred an additional \$1.0 million of expenses related to the issuance. In addition, upon issuance of the 3.75% Senior Notes, we closed a forecasted debt issuance hedge, which was entered into to hedge against a possible rise in interest rates, and recognized a \$5.1 million pretax loss as part of accumulated other comprehensive income (loss); the loss will be recognized as an adjustment to interest expense and amortized over the life of the 3.75% Senior Notes.

During the third quarter 2011, we repurchased 22.2 million of our common shares at a total cost of \$411.2 million (average cost of \$18.53 per share). Year-to-date, we have repurchased 42.3 million common shares at a total cost of \$832.1 million (average cost of \$19.67 per share).

In September 2011, we entered into an agreement with The Bank of New York Mellon Trust Company, N.A., as trustee, modifying the terms of our 6.70% Debentures. Pursuant to that agreement, we surrendered our right to temporarily defer the payment of interest on the 6.70% Debentures, which had been an unexercised feature of the 6.70% Debentures since they were issued in 2007. By surrendering that right, we were able to terminate the related obligation to set aside up to 250 million of our unissued common shares by June 2012; we were required to reserve these shares as a source of potential funding to pay deferred interest in the event we were ever to exercise our right to temporarily defer the payment of interest under the 6.70% Debentures. As a result of this agreement, we surrendered a right that we had no intention to use and preserved flexibility over a significant amount of our unissued shares, which we determined to be in the best interests of the company and its shareholders. These changes were effective immediately upon execution of the agreement.



In June 2011, the Board of Directors approved a new authorization to repurchase up to 75 million common shares, to be used in addition to, and after completion of, the remaining repurchases available under the June 2009 authorization; repurchases of the remaining shares under the 2009 authorization were completed during the third quarter 2011. We have 59.7 million shares remaining under our 2011 authorization.

From time to time, we also may elect to repurchase our outstanding debt securities in the open market or in privately negotiated transactions, when management believes that such securities are attractively priced and capital is available for such a purpose. During the third quarter 2011, we repurchased \$12.7 million in aggregate principal amount of our 6.70% Debentures at or near par in the open market, resulting in a net loss on these debt extinguishments of \$0.1 million. In addition, we reclassified \$0.3 million, on a pretax basis, from accumulated other comprehensive income on the balance sheet to net realized gains on securities on the income statement, reflecting the portion of the unrealized gain on forecasted transactions that was related to these debt extinguishments. In July 2010, we repurchased \$222.9 million in the aggregate principal amount of our 6.70% Debentures pursuant to a tender offer (See *Note 4 Debt* for additional information).

Based upon our capital planning and forecasting efforts, we believe that we have sufficient capital resources, cash flows from operations, and borrowing capacity to support our current and anticipated business needs, scheduled principal and interest payments on our debt, and expected capital requirements. Our next scheduled debt maturity will be in January 2012 in the amount of \$350 million, and we believe we have sufficient funds available to retire that indebtedness at maturity. The covenants on our existing debt securities do not include any rating or credit triggers that would require an adjustment of the interest rates or an acceleration of principal payments in the event our securities are downgraded by a rating agency.

Progressive seeks to deploy capital in a prudent manner and uses multiple data sources and modeling tools to estimate the frequency, severity, and correlation of identified exposures, including, but not limited to, catastrophic losses, natural disasters, and other significant business interruptions to estimate our potential capital needs.

Management views our capital position as consisting of three layers, each with a specific size and purpose. The first layer of capital, which we refer to as regulatory capital, is the amount of capital we need to satisfy state insurance regulatory requirements and support our objective of writing all the business we can write and service, consistent with our underwriting discipline of achieving a 96 combined ratio. This capital is held in our various insurance entities.

The second layer of capital we call extreme contingency. While our regulatory capital is, by definition, a cushion for absorbing financial consequences of adverse events, such as loss reserve development, litigation, weather catastrophes, or investment market corrections, we view that as a base and hold additional capital for even more extreme conditions. The modeling used to quantify capital needs for these conditions is quite extensive, including tens of thousands of simulations, representing our best estimates of such contingencies based on historical experience. This capital is held either in a non-insurance subsidiary of the holding company or in our insurance entities, where it is potentially eligible for a dividend up to the holding company. Regulatory restrictions on subsidiary dividends are discussed in *Note 8 Statutory Financial Information* in our Annual Report to Shareholders for the year ended December 31, 2010.

The third layer of capital is capital in excess of the sum of the first two layers and provides maximum flexibility to repurchase stock or other securities, consider acquisitions, and pay dividends to shareholders, among other purposes. This capital is largely held at a non-insurance subsidiary of the holding company.

At all times during 2010 and the first nine months of 2011, our total capital exceeded the sum of our regulatory capital layer plus our self-constructed extreme contingency load. At September 30, 2011, we held total capital (debt plus equity) of \$8.3 billion at book value, compared to \$8.0 billion at December 31, 2010 and \$8.7 billion at September 30, 2010.

#### ***Short-Term Borrowings***

During the nine months ended September 30, 2011 and 2010, we did not engage in short-term borrowings to fund our operations. As discussed above, our insurance operations create liquidity by collecting and investing insurance premiums in advance of paying claims. Information concerning our insurance operations can be found below under *Results of Operations Underwriting*, and details about our investment portfolio can be found below under *Results of Operations Investments*. In addition, we have \$125 million available under a secured line of credit that is described in further detail in *Note 4 Debt*. The line of credit is intended to provide liquidity in the event of disruptions in our cash management operations; we have never borrowed under this line of credit.

We did not engage in any repurchase agreements during the third quarter 2011 and had no open repurchase commitments at September 30, 2011.



**B. Commitments and Contingencies****Contractual Obligations**

During the first nine months of 2011, our contractual obligations have not changed materially from those discussed in our Annual Report on Form 10-K for the year ended December 31, 2010.

**Off-Balance-Sheet Arrangements**

Our off-balance-sheet leverage includes derivative positions, operating leases, and purchase obligations. See the *Derivative Instruments* section of *Note 2 Investments* and of this *Management's Discussion and Analysis* for a summary of our derivative activity since year-end 2010. There have been no material changes in the other off-balance-sheet items since the discussion in the notes to the financial statements in Progressive's Annual Report on Form 10-K for the year ended December 31, 2010.

**III. RESULTS OF OPERATIONS - UNDERWRITING****A. Growth**

| (\$ in millions)              | Three Months Ended September 30, |            |             | Nine Months Ended September 30, |             |             |
|-------------------------------|----------------------------------|------------|-------------|---------------------------------|-------------|-------------|
|                               | 2011                             | 2010       | %<br>Change | 2011                            | 2010        | %<br>Change |
| <b>NET PREMIUMS WRITTEN</b>   |                                  |            |             |                                 |             |             |
| Personal Lines                |                                  |            |             |                                 |             |             |
| Agency                        | \$ 1,957.2                       | \$ 1,914.1 | 2           | \$ 5,901.0                      | \$ 5,791.6  | 2           |
| Direct                        | 1,531.7                          | 1,454.1    | 5           | 4,537.0                         | 4,272.6     | 6           |
| Total Personal Lines          | 3,488.9                          | 3,368.2    | 4           | 10,438.0                        | 10,064.2    | 4           |
| Commercial Auto               | 382.5                            | 347.0      | 10          | 1,170.4                         | 1,133.7     | 3           |
| Other indemnity               | .1                               | .2         | (50)        | .1                              | 2.9         | (97)        |
| Total underwriting operations | \$ 3,871.5                       | \$ 3,715.4 | 4           | \$ 11,608.5                     | \$ 11,200.8 | 4           |
| <b>NET PREMIUMS EARNED</b>    |                                  |            |             |                                 |             |             |
| Personal Lines                |                                  |            |             |                                 |             |             |
| Agency                        | \$ 1,910.7                       | \$ 1,859.6 | 3           | \$ 5,704.4                      | \$ 5,550.4  | 3           |
| Direct                        | 1,458.8                          | 1,367.3    | 7           | 4,329.8                         | 4,019.0     | 8           |
| Total Personal Lines          | 3,369.5                          | 3,226.9    | 4           | 10,034.2                        | 9,569.4     | 5           |
| Commercial Auto               | 370.5                            | 369.9      | 0           | 1,087.8                         | 1,110.4     | (2)         |
| Other indemnity               | .7                               | 3.1        | (77)        | 3.9                             | 11.4        | (66)        |
| Total underwriting operations | \$ 3,740.7                       | \$ 3,599.9 | 4           | \$ 11,125.9                     | \$ 10,691.2 | 4           |

Net premiums written represent the premiums generated from policies written during the period less any premiums ceded to reinsurers. Net premiums earned, which are a function of the premiums written in the current and prior periods, are earned as revenue over the life of the policy using a daily earnings convention.

Policies in force, our preferred measure of growth, represents all policies under which coverage was in effect as of the end of the period specified. As of September 30, our policies in force were:

| (thousands)                 | 2011            | 2010            | %<br>Change |
|-----------------------------|-----------------|-----------------|-------------|
| <b>POLICIES IN FORCE</b>    |                 |                 |             |
| Personal Lines:             |                 |                 |             |
| Agency auto                 | 4,612.2         | 4,467.0         | 3           |
| Direct auto                 | 3,801.1         | 3,565.4         | 7           |
| <b>Total auto</b>           | <b>8,413.3</b>  | <b>8,032.4</b>  | <b>5</b>    |
| Special lines <sup>1</sup>  | 3,837.7         | 3,662.1         | 5           |
| <b>Total Personal Lines</b> | <b>12,251.0</b> | <b>11,694.5</b> | <b>5</b>    |
| Commercial Auto             | 513.8           | 518.4           | (1)         |

<sup>1</sup> Includes insurance for motorcycles, ATVs, RVs, mobile homes, watercraft, snowmobiles, and similar items, as well as a personal umbrella product.

To analyze growth, we review new policies, rate levels, and the retention characteristics of our books of business. The following table shows our year-over-year changes in new and renewal applications (i.e., issued policies):

|                     | Growth Over Prior Year |      |              |      |
|---------------------|------------------------|------|--------------|------|
|                     | Quarter                |      | Year-to-date |      |
|                     | 2011                   | 2010 | 2011         | 2010 |
| <b>APPLICATIONS</b> |                        |      |              |      |
| Personal Lines:     |                        |      |              |      |
| New                 | (1)%                   | 4 %  | (2)%         | 11 % |
| Renewal             | 6 %                    | 7 %  | 7 %          | 8 %  |
| Commercial Auto:    |                        |      |              |      |
| New                 | 2 %                    | (1)% | (3)%         | 1 %  |
| Renewal             | (1)%                   | (1)% | (1)%         | (3)% |

Our Personal Lines business had a decline in new applications for both the third quarter and first nine months of 2011, compared to the same periods last year, in both our Direct and Agency auto businesses. The decline in 2011 is due in large part to the growth in new applications we experienced in the first half of 2010, including the effect of mandatory insurance laws in Wisconsin on June 1, 2010, and an apparent decline in the level of consumers shopping for auto insurance this year. We remain committed to our advertising campaigns, product enhancements, and brand-building efforts in order to stimulate new business. Our Commercial Auto business experienced an increase in new applications for the third quarter 2011, driven by an increase in new applications in our for-hire transportation business market tier, compared to the same period last year. Our total Commercial Auto new applications are down year-to-date as this business continues to be affected by the economic downturn, particularly in the housing and construction sectors.

We continue to pursue initiatives aimed at providing consumers with distinctive new auto insurance options. During the third quarter 2011, we continued the rollout of new personal auto product models, which further refine our segmentation and incorporate the best design elements of the Agency and Direct auto products. As of September 30, 2011, this product has been rolled out to 39 jurisdictions. We plan to continue the rollout to about five additional states during the remainder of 2011 and throughout 2012.

In the first quarter 2011, we launched the national advertising of Snapshot<sup>®</sup>, our usage-based insurance product. During the third quarter 2011, Snapshot was made available in two more states, bringing the total number of markets to 40; Agency auto customers have access to Snapshot in 31 of those 40 jurisdictions. We plan to continue expansion of Snapshot into about three additional states, depending on regulatory approval and business results, over the remainder of 2011 and into early 2012.

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We are also continuing with our efforts to further penetrate customer households through cross-selling products. Progressive Home Advantage<sup>®</sup>, the program in which we bundle our auto product with property insurance provided by one of three unaffiliated insurance carriers, is becoming an integral part of our consumer offerings. The program is currently available to Agency customers in 44 states, Direct customers in 48 states, and is available to both Agency and Direct customers in the District of Columbia; this program is not available to customers in Florida and Alaska. In addition, we continue to focus on selling auto policies to our special lines customers and vice versa. These multi-product customers are an important part of our strategic agenda, since they tend to stay with us longer, have better loss experience, and represent a sizable segment of the market.

We continue to work on improving our presence in the mobile space. As of September 30, 2011, customers have the ability to obtain a quote for auto insurance on our mobile website in 41 states and the District of Columbia, including eight jurisdictions that were added during the third quarter 2011. In addition, policyholders are able to make payments and certain endorsements from their mobile device, as well as receive identification cards and severe weather text alerts. In early July, we further enhanced our mobile site by launching a feature that enables customers to purchase certain policies via their mobile devices; this feature is available to customers in 29 states. We plan to continue the expansion of the mobile buy capability into about 13 additional states over the remainder of the year. We will continue to add new functionality to our mobile site such as quoting for multi-vehicle households, additional endorsement capabilities, and agent-facing solutions, through the end of the year and continuing into 2012.

We also began the national rollout of a new product model in our Commercial Auto business during the third quarter 2011. This new model, which expands our coverage offerings, simplifies the quoting and claims experience, and provides incentives for customers to stay with us longer, is currently available in nine states. We plan to have this product model in about five additional states by the end of 2011.

We experienced the following changes in written premium per policy:

|                                   | Growth Over Prior Year |      |              |      |
|-----------------------------------|------------------------|------|--------------|------|
|                                   | Quarter                |      | Year-to-date |      |
|                                   | 2011                   | 2010 | 2011         | 2010 |
| <b>WRITTEN PREMIUM PER POLICY</b> |                        |      |              |      |
| Personal Lines auto               | 0 %                    | (1)% | (1)%         | (2)% |
| Commercial Auto                   | 7 %                    | (6)% | 4 %          | (7)% |

During both the third quarter and first nine months of 2011, written premium per policy for our personal auto business remained relatively flat. For our Commercial Auto business, written premium per policy increased, primarily reflecting rate changes taken earlier in 2011 and shifts in our mix of business. Adjusting rates is a continuous process and we will continue to evaluate future rate needs and react quickly as we recognize changing trends. See below for additional discussion on written premium per policy for our Agency and Direct auto channels and our Commercial Auto business.

Another important element affecting growth is customer retention. One measure of retention is policy life expectancy, which is our actuarial estimate of the average length of time that a policy (including any renewals) will remain in force before cancellation or lapse in coverage. The following table shows year-over-year changes in policy life expectancy:

|                               | Growth Over Prior Year |      |
|-------------------------------|------------------------|------|
|                               | 2011                   | 2010 |
| <b>POLICY LIFE EXPECTANCY</b> |                        |      |
| Personal Lines:               |                        |      |
| Auto                          | 2 %                    | 5 %  |
| Special lines                 | (2)%                   | (4)% |
| Commercial Auto               | 0 %                    | 0 %  |

The lengthening policy life expectancies in our personal auto business in part reflects our efforts to stabilize rates at renewal, the greater penetration of the multi-product offerings, and improved loyalty programs. Our policy life expectancy for our Commercial Auto business remained flat and was down for our special lines products, compared to the end of the third quarter 2010. Realizing the importance that retention has on our ability to continue to grow profitably, we continue to emphasize competitive pricing, quality service, and other retention initiatives for our customers.

**B. Profitability**

Profitability for our underwriting operations is defined by pretax underwriting profit, which is calculated as net premiums earned less losses and loss adjustment expenses, policy acquisition costs, and other underwriting expenses. We also use underwriting profit margin, which is underwriting profit expressed as a percentage of net premiums earned, to analyze our results. For the respective periods, our underwriting profitability results were as follows:

| (\$ in millions)              | Three Months Ended September 30, |        |                            |        | Nine Months Ended September 30, |        |                            |        |
|-------------------------------|----------------------------------|--------|----------------------------|--------|---------------------------------|--------|----------------------------|--------|
|                               | 2011                             |        | 2010                       |        | 2011                            |        | 2010                       |        |
|                               | Underwriting Profit (Loss)       |        | Underwriting Profit (Loss) |        | Underwriting Profit (Loss)      |        | Underwriting Profit (Loss) |        |
|                               | \$                               | Margin | \$                         | Margin | \$                              | Margin | \$                         | Margin |
| Personal Lines                |                                  |        |                            |        |                                 |        |                            |        |
| Agency                        | \$ 112.8                         | 5.9 %  | \$ 127.6                   | 6.9 %  | \$ 442.3                        | 7.8 %  | \$ 462.6                   | 8.3 %  |
| Direct                        | 52.0                             | 3.6    | 72.0                       | 5.3    | 248.4                           | 5.7    | 226.2                      | 5.6    |
| Total Personal Lines          | 164.8                            | 4.9    | 199.6                      | 6.2    | 690.7                           | 6.9    | 688.8                      | 7.2    |
| Commercial Auto               | 18.4                             | 5.0    | 55.9                       | 15.1   | 93.6                            | 8.6    | 138.9                      | 12.5   |
| Other indemnity <sup>1</sup>  | (2.5)                            | NM     | (.5)                       | NM     | (3.1)                           | NM     | 7.4                        | NM     |
| Total underwriting operations | \$ 180.7                         | 4.8 %  | \$ 255.0                   | 7.1 %  | \$ 781.2                        | 7.0 %  | \$ 835.1                   | 7.8 %  |

<sup>1</sup> Underwriting margins for our other indemnity businesses are not meaningful (NM) due to the low level of premiums earned by, and the variability of loss costs in, such businesses.

Our underwriting profit margin continued to exceed our long-term profitability target of 4%. On a year-over-year basis, our margin decreased 2.3 percentage points for the third quarter 2011 and decreased 0.8 percentage points for the first nine months of 2011. Higher catastrophe losses and less favorable loss reserve development in both the third quarter and first nine months of 2011, compared to last year, contributed to the decrease in underwriting profitability in both periods.

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Further underwriting results for our Personal Lines business, including its channel components, the Commercial Auto business, and our underwriting operations in total, were as follows:

|   | Three Months Ended<br>September 30, |      |            | Nine Months Ended<br>September 30, |      |           |
|---|-------------------------------------|------|------------|------------------------------------|------|-----------|
|   | 2011                                | 2010 | Change     | 2011                               | 2010 | Change    |
| <b>Underwriting Performance<sup>1</sup></b>                     |                                     |      |            |                                    |      |           |
| <b>Personal Lines Agency</b>                                    |                                     |      |            |                                    |      |           |
| Loss & loss adjustment expense ratio                            | 73.5                                | 71.5 | 2.0 pts.   | 71.3                               | 70.2 | 1.1 pts.  |
| Underwriting expense ratio                                      | 20.6                                | 21.6 | (1.0) pts. | 20.9                               | 21.5 | (.6) pts. |
| Combined ratio  | 94.1                                | 93.1 | 1.0 pts.   | 92.2                               | 91.7 | .5 pts.   |
| <b>Personal Lines Direct</b>                                    |                                     |      |            |                                    |      |           |
| Loss & loss adjustment expense ratio                            | 73.3                                | 71.6 | 1.7 pts.   | 71.4                               | 71.7 | (.3) pts. |
| Underwriting expense ratio                                      | 23.1                                | 23.1 | 0 pts.     | 22.9                               | 22.7 | .2 pts.   |
| Combined ratio  | 96.4                                | 94.7 | 1.7 pts.   | 94.3                               | 94.4 | (.1) pts. |
| <b>Total Personal Lines</b>                                     |                                     |      |            |                                    |      |           |
| Loss & loss adjustment expense ratio                            | 73.4                                | 71.6 | 1.8 pts.   | 71.3                               | 70.8 | .5 pts.   |
| Underwriting expense ratio                                      | 21.7                                | 22.2 | (.5) pts.  | 21.8                               | 22.0 | (.2) pts. |
| Combined ratio  | 95.1                                | 93.8 | 1.3 pts.   | 93.1                               | 92.8 | .3 pts.   |
| <b>Commercial Auto</b>  |                                     |      |            |                                    |      |           |
| Loss & loss adjustment expense ratio                            | 73.4                                | 62.5 | 10.9 pts.  | 69.3                               | 65.0 | 4.3 pts.  |
| Underwriting expense ratio                                      | 21.6                                | 22.4 | (.8) pts.  | 22.1                               | 22.5 | (.4) pts. |
| Combined ratio  | 95.0                                | 84.9 | 10.1 pts.  | 91.4                               | 87.5 | 3.9 pts.  |
| <b>Total Underwriting Operations<sup>2</sup></b>                |                                     |      |            |                                    |      |           |
| Loss & loss adjustment expense ratio                            | 73.5                                | 70.6 | 2.9 pts.   | 71.2                               | 70.3 | .9 pts.   |
| Underwriting expense ratio                                      | 21.7                                | 22.3 | (.6) pts.  | 21.8                               | 21.9 | (.1) pts. |
| Combined ratio  | 95.2                                | 92.9 | 2.3 pts.   | 93.0                               | 92.2 | .8 pts.   |
| Accident year loss & loss adjustment expense ratio <sup>3</sup> | 75.4                                | 73.6 | 1.8 pts.   | 73.2                               | 72.8 | .4 pts.   |

<sup>1</sup> Ratios are expressed as a percentage of net premiums earned.

<sup>2</sup> Combined ratios for the other indemnity businesses are not presented separately due to the low level of premiums earned by, and the variability of loss costs in, such businesses. These businesses generated an underwriting profit (loss) of \$(2.5) million and \$(0.5) million for the three months ended September 30, 2011 and 2010, respectively, and \$(3.1) million and \$7.4 million for the nine months ended September 30, 2011 and 2010, respectively; see the *Other Indemnity* section of this *Management's Discussion and Analysis* for further discussion.

<sup>3</sup> The accident year ratio includes only the losses that occurred during the period noted. As a result, accident period results will change over time as our estimates of loss costs improve or deteriorate when payments are made or reserves for that accident period are reviewed.

**Losses and Loss Adjustment Expenses (LAE)**

| (millions) | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|------------|-------------------------------------|------|------------------------------------|------|
|            | 2011                                | 2010 | 2011                               | 2010 |

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|                                      |                   |                   |                   |                   |
|--------------------------------------|-------------------|-------------------|-------------------|-------------------|
| Change in net loss and LAE reserves  | \$ 94.0           | \$ 57.1           | \$ 128.3          | \$ 179.0          |
| Paid losses and LAE                  | 2,655.3           | 2,486.3           | 7,790.0           | 7,331.0           |
| <b>Total incurred losses and LAE</b> | <b>\$ 2,749.3</b> | <b>\$ 2,543.4</b> | <b>\$ 7,918.3</b> | <b>\$ 7,510.0</b> |

Claims costs, our most significant expense, represent payments made, and estimated future payments to be made, to or on behalf of our policyholders, including expenses needed to adjust or settle claims. Claims costs are a function of loss severity and frequency and are influenced by inflation and driving patterns, among other factors. Accordingly, anticipated changes in these factors are taken into account when we establish premium rates and loss reserves. Our reserves would differ if the underlying assumptions were changed.

Our total loss and loss adjustment expense ratio increased 2.9 points for the third quarter and 0.9 points on a year-to-date basis, compared to the same periods last year. The increase in both the third quarter and year-to-date 2011 loss and loss adjustment expense ratio is due to higher catastrophe losses and less favorable loss reserve development in 2011, compared to the same periods in 2010. On an accident year basis, our companywide loss and loss adjustment expense ratio increased 1.8 points and 0.4 points for the third quarter and year-to-date 2011, respectively.

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For our Commercial Auto business, the increase in the loss and LAE ratio reflects about 6 points of less favorable loss reserve development in the third quarter 2011, compared to the same period last year. In addition, we experienced an increase in both frequency and severity in our truck business, which is a growing part of our Commercial Auto business.

The following table shows the catastrophe losses incurred during the periods:

| (millions)                  | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|-----------------------------|-------------------------------------|---------|------------------------------------|---------|
|                             | 2011                                | 2010    | 2011                               | 2010    |
| Catastrophe losses incurred | \$ 63.3                             | \$ 22.8 | \$ 198.3                           | \$ 77.4 |
| Increase to combined ratio  | 1.7 pts.                            | .6 pts. | 1.8 pts.                           | .7 pts. |

The following discussion of our severity and frequency trends excludes comprehensive coverage. Comprehensive coverage insures against damages to a customer's vehicle due to various causes (other than collision), such as windstorm, hail, theft, falling objects, and glass breakage. This coverage is excluded from the discussion because of its inherent volatility, as it is typically linked to adverse weather and other catastrophic losses.

Total personal auto incurred severity (i.e., average cost per claim, including both paid losses and the change in reserves) increased about 3% for the third quarter 2011, compared to the third quarter 2010, with increases in severity for our bodily injury, property damage, and collision coverages. Severity in our personal injury protection (PIP) coverage decreased about 3.5% for the third quarter 2011.

On a year-to-date basis, total personal auto incurred severity was relatively flat in 2011, compared to 2010. We experienced slight increases in our bodily injury and property damage coverages, while severity for our PIP coverage was down about 4.5% and collision coverage was flat. It is difficult to estimate future severity, especially for bodily injury and PIP claims, but we continue to monitor changes in the underlying costs, such as medical costs, health care reform, jury verdicts, and regulatory changes, which may affect severity. The severity we experience will also vary with changes in our mix of business by policy limits and coverages.

Our incurred frequency of auto accidents, on a calendar year basis, decreased about 2%-3% for both the third quarter and first nine months of 2011, compared to the corresponding periods last year. Frequency for our collision coverage remained relatively flat for the third quarter and year-to-date, while frequency for the other coverages decreased in both periods. We cannot predict with any certainty the degree or direction of frequency change that we will experience in the future. We continue to analyze trends to distinguish changes in our experience from external factors, such as changes in the number of vehicles per household, miles driven, gasoline prices, greater vehicle safety, and unemployment rates, versus those resulting from shifts in the mix of our business, to allow us to reserve more accurately for our loss exposure.

The table below presents the actuarial adjustments implemented and the loss reserve development experienced in the following periods:

| (millions)                              | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|----------|------------------------------------|----------|
|   | 2011                                | 2010     | 2011                               | 2010     |
| <b>ACTUARIAL ADJUSTMENTS</b>            |                                     |          |                                    |          |
| Reserve decrease/(increase)             |                                     |          |                                    |          |
| Prior accident years                    | \$ 36.8                             | \$ 43.4  | \$ 129.3                           | \$ 116.1 |
| Current accident year                   | 4.5                                 | 15.3     | 29.3                               | 51.7     |
| Calendar year actuarial adjustment      | \$ 41.3                             | \$ 58.7  | \$ 158.6                           | \$ 167.8 |
| <b>PRIOR ACCIDENT YEARS DEVELOPMENT</b> |                                     |          |                                    |          |
| Favorable/(Unfavorable)                 |                                     |          |                                    |          |
| Actuarial adjustment                    | \$ 36.8                             | \$ 43.4  | \$ 129.3                           | \$ 116.1 |
| All other development                   | 35.7                                | 65.9     | 94.2                               | 155.1    |
| Total development                       | \$ 72.5                             | \$ 109.3 | \$ 223.5                           | \$ 271.2 |



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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Decrease to calendar year combined ratio | 1.9 pts. | 3.0 pts. | 2.0 pts. | 2.5 pts. |
|--|----------|----------|----------|----------|

Total development consists of both actuarial adjustments and all other development. The actuarial adjustments represent the net changes made by our actuarial department to both current and prior accident year reserves based on regularly scheduled reviews. Through these reviews, the actuaries have the ability to identify and measure variances in frequency and severity trends and adjust the reserves to reflect the current costs. We report these actuarial adjustments separately for the current and prior accident years to show the impact of these changes on the prior accident years' development.

All other development represents claims settling for more or less than reserved, emergence of unrecorded claims at rates different than anticipated in our incurred but not recorded (IBNR) reserves, and changes in reserve estimates on specific claims. Although we believe that the development from both the actuarial adjustments and all other development generally results from the same factors, as discussed below, we are unable to quantify the portion of the reserve development that might be applicable to any one or more of those underlying factors.

Our objective is to establish case and IBNR reserves that are adequate to cover all loss costs, while sustaining minimal variation from the date that the reserves are initially established until losses are fully developed. As reflected in the table above, we experienced favorable development in both the three- and nine-month periods ended September 30, 2011 and 2010. About 40% of the favorable development in 2011 was attributable to accident year 2010, while the remainder was primarily related to accident years 2008 and prior. In contrast, nearly 80% of the 2010 favorable year-to-date prior year reserve development was attributable to accident year 2009.

For the first nine months of 2011 and 2010, 74% and 71%, respectively, of our favorable development was in our Personal Lines business, with the remainder primarily in our Commercial Auto business. In both years, the development reflected favorable settlement of claims with high limits (e.g., claims settling for less than reserved) and favorable development of our defense and cost containment expense reserves, primarily reflecting a greater percentage of litigated claims being handled in a more cost-effective manner by our in-house counsel. In 2011, we have also experienced favorable development in our collision reserves, as we are seeing an increase in the amount of salvage being recovered, and in our PIP reserves, reflecting a reduction in severity, due to changes in our mix of business by policy limits and coverages; this development was partially offset by our total IBNR reserves, which are developing unfavorably due to an increase in the number of late emerging claims.

We continue to focus on our loss reserve analysis, attempting to enhance accuracy and to further our understanding of our loss costs. A detailed discussion of our loss reserving practices can be found in our *Report on Loss Reserving Practices*, which was filed in a Form 8-K on June 30, 2011.

### **Underwriting Expenses**

Progressive's other underwriting expenses and policy acquisition costs as a percentage of premiums earned decreased 0.6 points for the third quarter 2011 and remained relatively unchanged for the first nine months of 2011, compared to the same periods last year. A lower estimated Gainsharing payout for 2011 compared to 2010 contributed to the lower expense ratio for the quarter.

### **C. Personal Lines**

|                                     | Growth over prior year |              |
|-------------------------------------|------------------------|--------------|
|                                     | Quarter                | Year-to-date |
| Net premiums written                | 4 %                    | 4 %          |
| Net premiums earned                 | 4 %                    | 5 %          |
| Policies in force (at September 30) |                        | 5 %          |

Progressive's Personal Lines business writes insurance for personal autos and recreational vehicles and represented 90% of our total net premiums written in both the third quarter and first nine months of 2011, compared to 91% and 90% for the third quarter and first nine months of 2010, respectively. We currently write our Personal Lines products in all 50 states. We also offer our personal auto product (not special lines products) in the District of Columbia and on an Internet-only basis in Australia.

Personal auto represented 90% of our total Personal Lines net premiums written in both the third quarter and first nine months of 2011, respectively, compared to 91% and 89%, respectively, for the corresponding periods in 2010. These auto policies are primarily written for 6-month terms. The remaining Personal Lines business is comprised of special lines products (e.g., motorcycles, watercraft, and RVs), which are written for 12-month terms. Compared to September 30, 2010, policies in force grew 5% for both auto and special lines products. In addition, on a year-over-year basis, for the third quarter and first nine months of 2011, net premiums written increased 3% and 4%, respectively, for auto, and net premiums written for our special lines products increased 5% and 1%, respectively.

Our total Personal Lines business generated combined ratios of 95.1 and 93.1 for the third quarter and first nine months of 2011, respectively, compared to 93.8 and 92.8, respectively, last year. In the third quarter 2011, 39 states and the District of Columbia were



profitable, including 9 of our 10 largest states; 44 states and the District of Columbia were profitable year-to-date 2011, including 9 of 10 of our largest states. The special lines products had an unfavorable effect of 1.3 points on the total Personal Lines combined ratio for both the third quarters of 2011 and 2010, compared to a favorable effect of 0.4 points and 0.8 points for the first nine months of 2011 and 2010, respectively. The special lines products are typically used more during the warmer weather months and, therefore, historically our Personal Lines combined ratio is higher during the second and third quarters.

The Personal Lines business is comprised of the Agency business and the Direct business.

### *The Agency Business*

|   | Growth over prior year |              |
|---|------------------------|--------------|
|   | Quarter                | Year-to-date |
| Net premiums written                      | 2 %                    | 2 %          |
| Net premiums earned                       | 3 %                    | 3 %          |
| Auto: policies in force (at September 30) |                        | 3 %          |
| new applications                          | (2)%                   | (4)%         |
| renewal applications                      | 3 %                    | 4 %          |
| written premium per policy                | 0 %                    | 0 %          |
| policy life expectancy (at September 30)  |                        | 6 %          |

The Agency business includes business written by the more than 30,000 independent insurance agencies that represent Progressive, as well as brokerages in New York and California. Although total new Agency application growth was down on a year-over-year basis in the three- and nine-month periods ended September 30, 2011, we generated new Agency auto application growth in 13 and 14 states, respectively. Four of our top 10 Agency auto states, based on written premium volume, experienced an increase for both the quarter and year to date. California, Florida, and New Jersey experienced significant new application growth, primarily reflecting actions taken in late 2010 and early 2011 to make our rates more competitive in those states. For both the third quarter and first nine months of 2011, as compared to the same periods last year, written premium per policy for Agency auto new business increased 2% 3% and was down 1% for renewal business. The increase in retention in our Agency auto business (measured by policy life expectancy) in part reflects our improved loyalty programs and efforts to stabilize rates at renewal.

On a year-over-year basis, for the third quarter 2011, Agency auto quotes were relatively flat, while we saw a slight decrease in quotes for the first nine months of 2011. Our Agency auto rate of conversion (i.e., converting a quote to a sale) decreased slightly for both the third quarter and first nine months of 2011, compared to the same periods last year.

### *The Direct Business*

|   | Growth over prior year |              |
|---|------------------------|--------------|
|   | Quarter                | Year-to-date |
| Net premiums written                      | 5 %                    | 6 %          |
| Net premiums earned                       | 7 %                    | 8 %          |
| Auto: policies in force (at September 30) |                        | 7 %          |
| new applications                          | (3)%                   | (4)%         |
| renewal applications                      | 8 %                    | 11 %         |
| written premium per policy                | (1)%                   | (1)%         |
| policy life expectancy (at September 30)  |                        | (3)%         |

The Direct business includes business written directly by Progressive online and over the phone. Similar to the Agency channel, we were unable to generate new business growth in our Direct business. For the third quarter 2011, we experienced a year-over-year increase in new Direct auto applications in 14 states and for the first nine months, 12 states had an increase in new application growth. Out of our top 10 volume states, four states experienced new application growth in both the third quarter and first nine months of 2011, with Florida and New Jersey having the largest year-over-year increases.

Written premium per policy for total Direct auto was down about 1% for both the three- and nine-month periods ended September 30, 2011, compared to the same periods last year, driven by a decline of about 2% for renewal business in both periods; written premium per policy increased 1% 2% on new business.



Direct business quotes decreased 3% and 4% for the third quarter and first nine months of 2011, respectively, reflecting decreases in both Internet quotes and quotes generated via the phone. Significant quoting activity in the first half of 2010 and an apparent decline in the level of consumers shopping for auto insurance this year had an effect on the year-over-year comparisons. The overall Direct business conversion rate was flat for both the third quarter and first nine months of 2011, compared to the same periods last year; conversion rates for our Internet-initiated business were down for both the third quarter 2011 and year to date, while conversion rates for our business initiated over the phone experienced a solid increase for both periods.

On a year-over-year basis, for the third quarter 2011, our advertising expenses increased at rates comparable to our Direct business earned premiums. We remain focused on establishing a well-respected brand and added to our inventory of television commercials and Internet advertising. We continue to use Flo to provide fresh and engaging messages, and during the first quarter 2011, we debuted a complementary campaign with the Messenger. In addition, during 2011, we have invested in the infrastructure of both our mobile capabilities and our usage-based insurance products.

#### D. Commercial Auto

|  | Growth over prior year |              |
|--|------------------------|--------------|
|  | Quarter                | Year-to-date |
| Net premiums written                     | 10 %                   | 3 %          |
| Net premiums earned                      | 0 %                    | (2)%         |
| Policies in force (at September 30)      |                        | (1)%         |
| New applications                         | 2 %                    | (3)%         |
| Renewal applications                     | (1)%                   | (1)%         |
| Written premium per policy               | 7 %                    | 4 %          |
| Policy life expectancy (at September 30) |                        | 0 %          |

Progressive's Commercial Auto business writes primary liability, physical damage, and other auto-related insurance for automobiles and trucks owned by small businesses, with the majority of our customers insuring three or fewer vehicles. For both the third quarter and first nine months of 2011, the Commercial Auto business represented 10% of our total net premiums written, compared to 9% and 10%, respectively, for the same periods last year. This business is primarily distributed through independent agents and operates in the business auto and truck markets. The business auto market, which accounts for about half of our total Commercial Auto premiums and approximately 60% of the vehicles we insure in this business, includes autos, vans, and pick-up trucks used by small businesses, such as contractors, landscapers, and plumbers. The remainder is in the truck commercial auto market, which includes dump trucks, logging trucks, tow trucks, local cartage, and other short-haul commercial vehicles. Both of these markets have been significantly affected by the downturn in the economy, as well as increased competition in the commercial auto business.

We currently write our Commercial Auto business in 49 states; we do not write Commercial Auto in Hawaii or the District of Columbia. The majority of our policies in this business are written for 12-month terms.

On a year-over-year basis, total written premium per policy increased 7% and 4% for the third quarter and first nine months of 2011, respectively. The increase in written premium per policy for our Commercial Auto business in 2011 is primarily due to rate increases taken during the year and a shift in our mix of business toward both states and business market tiers with higher average premium. Policy life expectancy at September 30, 2011 for our Commercial Auto business was flat compared to the same period last year.

#### E. Other Indemnity

Our other indemnity businesses consist of managing our run-off businesses, which includes the run-off of our professional liability businesses, principally directors and officers liability insurance for community banks.

The other businesses generated an underwriting loss of \$3.1 million for the first nine months of 2011, compared to an underwriting profit of \$7.4 million for the same period last year. The 2010 profit primarily reflected the sale of our professional liability insurance businesses to an affiliate of the American Bankers Association during the first quarter. Pursuant to our agreement with the purchaser of these businesses, we will continue to write policies for an agreed upon period after the closing of the sale. As of September 30, 2011, we are continuing to write business in only two states; beginning in July 2010, all new and renewal business is 100% reinsured. Prior to July 2010, only a very small portion of this business was not 100% reinsured.



## **F. Service Businesses**

Our service businesses provide insurance-related services, represent less than 1% of our total revenues, and do not have a material effect on our overall operations.

Our service businesses provide policy issuance and claims adjusting services for the Commercial Auto Insurance Procedures/Plans (CAIP), which are state-supervised plans serving the involuntary market. We are the sole nationwide servicing carrier for CAIP.

Our service businesses also include our alliance with three unaffiliated homeowner's insurance companies. Through Progressive Home Advantage<sup>®</sup>, we offer, either directly or through our network of independent agents, new and existing Agency and Direct customers home, condo, and renters insurance underwritten by these unaffiliated insurance companies. For the policies written in our Direct business, we receive commissions, which are used to reduce the expenses associated with maintaining this program. This program is available to our Personal Lines customers in 48 states and the District of Columbia; it is not currently available in Alaska or Florida.

Our service businesses generated an operating profit of \$0.5 million and \$2.9 million for the third quarter and first nine months of 2011, respectively, compared to operating losses of \$0.4 million and \$1.9 million, respectively, for the same periods last year, reflecting the minimum servicing fee agreement we reached with AIPSO (the national organization responsible for administering the involuntary insurance market) during the fourth quarter 2010.

## **G. Income Taxes**

As reported in the balance sheets, income taxes are comprised of net current income taxes payable/recoverable and net deferred tax assets and liabilities. A deferred tax asset/liability is a tax benefit/expense that is expected to be realized in a future tax return. At September 30, 2011 and 2010, and at December 31, 2010, our income taxes were in a net asset position.

Our net deferred tax asset was \$306.5 million at September 30, 2011, compared to \$223.4 million at September 30, 2010, and \$178.2 million at December 31, 2010. The increase in the deferred tax asset since September 30, 2010 and December 31, 2010 is primarily due to the decrease in net unrealized gains in our investment portfolio.

At September 30, 2011 and 2010, and at December 31, 2010, we determined that we did not need a valuation allowance on our deferred tax asset. In evaluating the need for a valuation allowance, we have to determine if it is more likely than not that the gross deferred tax asset will be realized and that we will be able to fully use the deductions that are ultimately recognized for tax purposes. Our analysis revolves around the reversal of existing temporary differences and our tax planning strategies. Although realization of the deferred tax asset is not assured, management believes it is more likely than not that the gross deferred tax asset will be realized based on our expectation that we will be able to fully utilize the deductions that are ultimately recognized for tax purposes.

The effective tax rate for the three months ended September 30, 2011 was 28%, compared with 32% for the same period last year, reflecting \$6.3 million of elective tax credits, primarily related to the 2007-2009 tax years, recognized during the third quarter 2011.

There have been no material changes in our uncertain tax positions during the quarter ended September 30, 2011.



**IV. RESULTS OF OPERATIONS INVESTMENTS****A. Portfolio Allocation**

The composition of the investment portfolio was:

| (\$ in millions)                     | Fair Value         | % of Total Portfolio | Duration (years) | Rating <sup>1</sup> |
|--------------------------------------|--------------------|----------------------|------------------|---------------------|
| <b>September 30, 2011</b>            |                    |                      |                  |                     |
| Fixed maturities                     | \$ 11,815.6        | 73.9 %               | 2.0              | AA                  |
| Nonredeemable preferred stocks       | 873.0              | 5.5                  | .9               | BBB-                |
| Short-term investments other         | 1,699.7            | 10.6                 | <.1              | AAA-                |
| <b>Total fixed-income securities</b> | <b>14,388.3</b>    | <b>90.0</b>          | <b>1.7</b>       | <b>AA-</b>          |
| Common equities                      | 1,599.5            | 10.0                 | na               | na                  |
| <b>Total portfolio<sup>2,3</sup></b> | <b>\$ 15,987.8</b> | <b>100.0 %</b>       | <b>1.7</b>       | <b>AA-</b>          |
| <b>September 30, 2010</b>            |                    |                      |                  |                     |
| Fixed maturities                     | \$ 12,085.8        | 73.8 %               | 2.4              | AA                  |
| Nonredeemable preferred stocks       | 1,189.4            | 7.3                  | 1.2              | BBB                 |
| Short-term investments other         | 1,815.5            | 11.1                 | <.1              | AAA-                |
| <b>Total fixed-income securities</b> | <b>15,090.7</b>    | <b>92.2</b>          | <b>2.0</b>       | <b>AA</b>           |
| Common equities                      | 1,285.3            | 7.8                  | na               | na                  |
| <b>Total portfolio<sup>2,3</sup></b> | <b>\$ 16,376.0</b> | <b>100.0 %</b>       | <b>2.0</b>       | <b>AA</b>           |
| <b>December 31, 2010</b>             |                    |                      |                  |                     |
| Fixed maturities                     | \$ 11,850.0        | 76.3 %               | 2.3              | AA                  |
| Nonredeemable preferred stocks       | 1,157.6            | 7.5                  | 1.2              | BBB-                |
| Short-term investments other         | 1,090.8            | 7.0                  | <.1              | AAA-                |
| <b>Total fixed-income securities</b> | <b>14,098.4</b>    | <b>90.8</b>          | <b>2.0</b>       | <b>AA-</b>          |
| Common equities                      | 1,425.0            | 9.2                  | na               | na                  |
| <b>Total portfolio<sup>2,3</sup></b> | <b>\$ 15,523.4</b> | <b>100.0 %</b>       | <b>2.0</b>       | <b>AA-</b>          |

na = not applicable

<sup>1</sup> Represents ratings at period end. Credit quality ratings are assigned by nationally recognized securities rating organizations. To calculate the weighted average credit quality ratings, we weight individual securities based on fair value and assign a numeric score of 0-5, with non-investment-grade and non-rated securities assigned a score of 0-1. To the extent the weighted average of the ratings falls between AAA and AA+, we assign an internal rating of AAA-.

<sup>2</sup> At September 30, 2011, we had \$60.5 million of net unsettled security transactions included in other assets, compared to \$46.3 million at December 31, 2010; at September 30, 2010, we had \$54.9 million of net unsettled security transactions included in other liabilities.

<sup>3</sup> The total fair value of the portfolio at September 30, 2011 and 2010, and December 31, 2010 included \$1.7 billion, \$1.6 billion, and \$2.2 billion, respectively, of securities held in a consolidated, non-insurance subsidiary of the holding company, net of any unsettled security transactions.

Our asset allocation strategy is to maintain 0-25% of our portfolio in Group I securities, with the balance (75%-100%) of our portfolio in Group II securities. In April 2011, we changed our definition of Group I and Group II securities. Group I securities include: common equities;

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nonredeemable preferred stocks; redeemable preferred stocks, except for 50% of investment-grade redeemable preferred stocks with cumulative dividends; and all other non-investment-grade fixed-maturity securities. Group II securities include short-term securities and all other fixed-maturity securities. In determining the allocation between Group I and II, residential and commercial mortgage-backed securities derive their credit ratings from models provided by the National Association of Insurance Commissioners (NAIC), while all other debt securities derive their credit ratings from external vendors.

Prior to April 2011, Group I securities were defined as common equities, redeemable and nonredeemable preferred stocks (preferred stocks) and non-investment-grade and non-rated fixed maturities, while Group II securities were identified as all other fixed-maturity securities, including U.S. Treasury Notes, municipal bonds, asset-backed securities, and corporate debt, as well as short-term investments. We believe the changes made during the second quarter 2011 allow our asset allocation strategy to more accurately reflect our risk for these particular securities and be in line with our primary regulator's treatment of these securities for capital purposes.

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The following tables show the composition of our Group I and Group II securities at September 30, 2011 and December 31, 2010 under the definitions adopted during the second quarter 2011; the comparable asset allocation for September 30, 2010 is not provided since certain external data is not available:

| (\$ in millions)                         | Fair Value         | % of<br>Total<br>Portfolio |
|--|--------------------|----------------------------|
| <b>September 30, 2011</b>                |                    |                            |
| Group I securities:                      |                    |                            |
| Non-investment-grade fixed maturities    | \$ 408.6           | 2.6 %                      |
| Redeemable preferred stocks <sup>1</sup> | 319.8              | 2.0                        |
| Nonredeemable preferred stocks           | 873.0              | 5.5                        |
| Common equities                          | 1,599.5            | 10.0                       |
| <b>Total Group I securities</b>          | <b>3,200.9</b>     | <b>20.1</b>                |
| Group II securities:                     |                    |                            |
| Other fixed maturities <sup>2</sup>      | 11,087.2           | 69.3                       |
| Short-term investments other             | 1,699.7            | 10.6                       |
| <b>Total Group II securities</b>         | <b>12,786.9</b>    | <b>79.9</b>                |
| <b>Total portfolio</b>                   | <b>\$ 15,987.8</b> | <b>100.0 %</b>             |

| (\$ in millions)                         | Fair Value         | % of<br>Total<br>Portfolio |
|--|--------------------|----------------------------|
| <b>December 31, 2010</b>                 |                    |                            |
| Group I securities:                      |                    |                            |
| Non-investment-grade fixed maturities    | \$ 421.1           | 2.7 %                      |
| Redeemable preferred stocks <sup>1</sup> | 367.9              | 2.3                        |
| Nonredeemable preferred stocks           | 1,157.6            | 7.5                        |
| Common equities                          | 1,425.0            | 9.2                        |
| <b>Total Group I securities</b>          | <b>3,371.6</b>     | <b>21.7</b>                |
| Group II securities:                     |                    |                            |
| Other fixed maturities <sup>2</sup>      | 11,061.0           | 71.3                       |
| Short-term investments other             | 1,090.8            | 7.0                        |
| <b>Total Group II securities</b>         | <b>12,151.8</b>    | <b>78.3</b>                |
| <b>Total portfolio</b>                   | <b>\$ 15,523.4</b> | <b>100.0 %</b>             |

<sup>1</sup> Includes non-investment-grade redeemable preferred stocks of \$205.6 million at September 30, 2011 and \$233.3 million at December 31, 2010.

<sup>2</sup> Includes investment-grade redeemable preferred stocks, with cumulative dividends, of \$114.2 million at September 30, 2011 and \$134.6 million at December 31, 2010.

Progressive's asset allocation strategy remains based on our need to maintain capital adequate to support our insurance operations, recognizing that our outstanding claim obligations are typically short in duration. Investments in our portfolio have varying degrees of risk. We evaluate the risk/reward trade-offs of investment opportunities, measuring their effects on stability, diversity, overall quality and liquidity, and the potential return of the investment portfolio.

*Unrealized Gains and Losses*

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As of September 30, 2011, our portfolio had pretax net unrealized gains, recorded as part of accumulated other comprehensive income, of \$870.6 million, compared to \$1,204.2 million and \$1,180.5 million at September 30, 2010 and December 31, 2010, respectively.

Since December 31, 2010 and September 30, 2010, our fixed-income portfolio's valuation decreased \$114.6 million and \$271.0 million, respectively, and our common stock portfolio's valuation decreased \$195.3 million and \$62.6 million, respectively. Adjusted for sale activity, the decreases for both periods are primarily due to price depreciation due to the overall economic uncertainty affecting equities, both preferred and common, as well as spread widening (i.e., the risk premium paid above the comparable Treasury rate) in some fixed-income sectors.

See *Note 2 Investments* for a further break-out of our gross unrealized gains and losses.

**Fixed-Income Securities**

The fixed-income portfolio is managed internally and includes fixed-maturity securities, short-term investments, and nonredeemable preferred stocks. The fixed-maturity securities (including redeemable preferred stocks) and short-term securities, as reported on the balance sheets, were comprised of the following:

| (\$ in millions)                                   | Fixed Maturity Securities |                |                    |                |                    |                |
|--|---------------------------|----------------|--------------------|----------------|--------------------|----------------|
|  | September 30, 2011        |                | September 30, 2010 |                | December 31, 2010  |                |
|  | Fair Value                | % of Total     | Fair Value         | % of Total     | Fair Value         | % of Total     |
| Investment-grade fixed maturities: <sup>1</sup>    |                           |                |                    |                |                    |                |
| Short/intermediate term                            | \$ 12,719.5               | 94.1 %         | \$ 13,023.1        | 93.7 %         | \$ 12,037.2        | 93.0 %         |
| Long term  | 44.8                      | .3             | 38.3               | .3             | 38.4               | .3             |
| Non-investment-grade fixed maturities <sup>2</sup> | 751.0                     | 5.6            | 839.9              | 6.0            | 865.2              | 6.7            |
| <b>Total</b>                                       | <b>\$ 13,515.3</b>        | <b>100.0 %</b> | <b>\$ 13,901.3</b> | <b>100.0 %</b> | <b>\$ 12,940.8</b> | <b>100.0 %</b> |

<sup>1</sup> Long term includes securities with expected liquidation dates of 10 years or greater. Asset-backed securities are reported at their weighted average maturity based upon their projected cash flows. All other securities that do not have a single expected maturity date are reported at average maturity.

<sup>2</sup> Non-investment-grade fixed-maturity securities are non-rated or have a quality rating of an equivalent BB+ or lower, classified by the lowest rating from a nationally recognized rating agency.

A primary exposure for the fixed-income portfolio is interest rate risk, which is managed by maintaining the portfolio's duration between 1.5 and 5 years. Interest rate risk includes the change in value resulting from movements in the underlying market rates of debt securities held. The duration of the fixed-income portfolio was 1.7 years at September 30, 2011, compared to 2.0 years at September 30, 2010 and December 31, 2010. The distribution of duration and convexity (i.e., a measure of the speed at which the duration of a security is expected to change based on a rise or fall in interest rates) is monitored on a regular basis.

The duration distribution of our fixed-income portfolio, represented by the interest rate sensitivity of the comparable benchmark U.S. Treasury Notes, was:

| Duration Distribution               | September 30, 2011 | September 30, 2010 | December 31, 2010 |
|-------------------------------------|--------------------|--------------------|-------------------|
| 1 year                              | 21.0 %             | 25.9 %             | 34.6 %            |
| 2 years                             | 19.6               | 18.0               | 15.5              |
| 3 years                             | 28.7               | 21.7               | 23.4              |
| 5 years                             | 27.6               | 24.8               | 22.6              |
| 10 years                            | 3.1                | 9.6                | 3.9               |
| <b>Total fixed-income portfolio</b> | <b>100.0 %</b>     | <b>100.0 %</b>     | <b>100.0 %</b>    |

Another primary exposure related to the fixed-income portfolio is credit risk. This risk is managed by maintaining an A+ minimum average portfolio credit quality rating, as defined by nationally recognized rating agencies.

The credit quality distribution of the fixed-income portfolio was:

| Rating | September 30, 2011 | September 30, 2010 | December 31, 2010 |
|--------|--------------------|--------------------|-------------------|
| AAA    | 56.6 %             | 55.3 %             | 54.8 %            |
| AA     | 12.0               | 12.4               | 11.6              |
| A      | 7.7                | 8.4                | 6.8               |

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|                              |         |         |         |
|------------------------------|---------|---------|---------|
| BBB                          | 16.6    | 16.5    | 18.2    |
| Non-rated/other              | 7.1     | 7.4     | 8.6     |
| Total fixed-income portfolio | 100.0 % | 100.0 % | 100.0 % |

Our portfolio is also exposed to concentration risk. Our investment constraints limit investment in a single issuer, other than U.S. Treasury Notes or a state's general obligation bonds, to 2.5% of shareholders' equity, while the single issuer guideline on preferred stocks and/or non-investment-grade debt is 1.25% of shareholders' equity. Additionally, the guideline applicable to any state's general obligation bonds is 6% of shareholders' equity. As of September 30, 2011, our holdings of three short-term security issuers and one non-general obligation municipal security issuer each exceeded our guideline of 2.5% of shareholders' equity by less than 0.1%, as a result of the decline in shareholders' equity during the quarter. The short-term securities matured shortly after quarter end for full

value and a portion of the securities we hold of the municipal issuer was redeemed on November 1, 2011, after which we are in compliance with our internal guidelines. In addition, at quarter end, one of our preferred stocks represented 1.3% of shareholders' equity. Our credit risk guidelines limit single issuer exposure; however, we also consider sector concentration a risk, and we frequently evaluate the portfolio's sector allocation with regard to internal requirements and external market factors. Additionally, we consider concentration risk in the context of asset classes, including but not limited to common equities, residential and commercial mortgage-backed securities, municipal bonds, and high-yield bonds.

We also monitor prepayment and extension risk, especially in our structured product and preferred stock portfolios. Prepayment risk includes the risk of early redemption of security principal that may need to be reinvested at less attractive rates. Extension risk includes the risk that a security will not be redeemed when anticipated, and that the security that is extended has a lower yield than a security we might be able to obtain by reinvesting the expected redemption principal. The different types of structured debt and preferred securities, which are discussed in more detail below, help minimize this risk. During the first nine months of 2011, we did not experience significant prepayment or extension of principal relative to our cash flow expectations in the portfolio.

The pricing on the majority of our preferred stocks continues to reflect expectations that many issuers will not call such securities on the first call date, and hence reflects an assumption that the securities will remain outstanding for a period of time beyond such initial call date (extension risk). Five nonredeemable preferred stocks had their first call date during the first nine months of 2011; none of these securities were called. Extension risk on holding these securities is limited because they either convert from a fixed-rate coupon instrument to a variable rate coupon after the call date, or were variable rate coupon securities prior to the call date. Reinvestment risk is minimal since we are receiving the current prevailing market level coupon based on the financial instrument's characteristics.

We also face the risk that our preferred stock dividend payments could be deferred for one or more periods. As of September 30, 2011, all of our preferred securities continued to pay their dividends in full and on time.

Liquidity risk is another risk factor we monitor. Our overall portfolio remains very liquid and is sufficient to meet expected liquidity requirements. As of September 30, 2011 and 2010 and December 31, 2010, we held \$4.8 billion, \$5.3 billion, and \$4.3 billion, respectively, of U.S. Treasury and short-term securities. The short-to-intermediate duration of our portfolio provides an additional source of liquidity, as we expect approximately \$0.4 billion, or 4%, and \$1.5 billion, or 15% of our fixed-income portfolio, excluding U.S. Treasury Notes and short-term investments, to repay principal during the remainder of 2011 and all of 2012, respectively. Cash from interest and dividend payments provides an additional source of recurring liquidity.

Included in the fixed-income portfolio are U.S. government obligations, which include U.S. Treasury Notes and interest rate swaps. Although the interest rate swaps are not obligations of the U.S. government, they are recorded in this portfolio as the change in fair value is correlated to movements in the U.S. Treasury market. The duration of these securities was comprised of the following at September 30, 2011:

| (\$ in millions)  | Fair Value        | Duration (years) |
|---|-------------------|------------------|
| <b>U.S. Treasury Notes</b>                                |                   |                  |
| Less than two years                                       | \$ 297.3          | 1.6              |
| Two to five years   | 2,717.8           | 3.5              |
| Five to nine years  | 35.6              | 6.3              |
| <b>Total U.S. Treasury Notes</b>                          | <b>3,050.7</b>    | <b>3.4</b>       |
| <b>Interest Rate Swaps</b>                                |                   |                  |
| Two to five years (\$900 notional value)                  | 0                 | (4.7)            |
| Five to nine years (\$613 notional value)                 | 0                 | (6.5)            |
| <b>Total interest rate swaps (\$1,513 notional value)</b> | <b>0</b>          | <b>(5.4)</b>     |
| <b>Total U.S. government obligations</b>                  | <b>\$ 3,050.7</b> | <b>.9</b>        |

The interest rate swap positions show a fair value of zero as they are in an overall liability position, and the fair value is reported in the other liabilities section of the Consolidated Balance Sheets. The negative duration of the interest rate swaps is due to the positions being short interest-rate exposure (i.e., receiving a variable-rate coupon). In determining duration, we add the interest rate sensitivity of our interest rate swap positions to that of our Treasury holdings, but do not add the notional value of the swaps to our Treasury holdings in order to calculate an unlevered duration for the portfolio.





## ASSET-BACKED SECURITIES

Included in the fixed-income portfolio are asset-backed securities, which were comprised of the following at the balance sheet dates listed:

| (\$ in millions)                                      | Fair Value | Net Unrealized Gains (Losses) | % of Asset-Backed Securities | Duration (years) | Rating (at period end) |
|---|------------|-------------------------------|------------------------------|------------------|------------------------|
| <b>September 30, 2011</b>                             |            |                               |                              |                  |                        |
| Prime collateralized mortgage obligations             | \$ 244.1   | \$ (9.1)                      | 6.8 %                        | 1.3              | A                      |
| Alt-A collateralized mortgage obligations             | 44.8       | .8                            | 1.3                          | 1.3              | A-                     |
| Subtotal collateralized mortgage obligations          | 288.9      | (8.3)                         | 8.1                          | 1.3              | A-                     |
| Commercial mortgage-backed obligations                | 1,568.9    | 25.7                          | 43.8                         | 2.5              | AA+                    |
| Commercial mortgage-backed obligations: interest-only | 290.8      | 7.8                           | 8.1                          | 1.3              | AAA-                   |
| Subtotal commercial mortgage-backed obligations       | 1,859.7    | 33.5                          | 51.9                         | 2.3              | AA+                    |
| Other asset-backed securities:                        |            |                               |                              |                  |                        |
| Automobile  | 710.3      | 7.4                           | 19.8                         | 1.4              | AAA                    |
| Credit card   | 157.9      | 4.6                           | 4.4                          | 1.5              | AAA                    |
| Home equity (sub-prime bonds)                         | 155.3      | (18.8)                        | 4.3                          | < .1             | A-                     |
| Other <sup>1</sup>                                    | 411.5      | 1.5                           | 11.5                         | 1.2              | AAA-                   |
| Subtotal other asset-backed securities                | 1,435.0    | (5.3)                         | 40.0                         | 1.2              | AAA-                   |
| Total asset-backed securities                         | \$ 3,583.6 | \$ 19.9                       | 100.0 %                      | 1.8              | AA+                    |

| (\$ in millions)                                      | Fair Value | Net Unrealized Gains (Losses) | % of Asset-Backed Securities | Duration (years) | Rating (at period end) |
|---|------------|-------------------------------|------------------------------|------------------|------------------------|
| <b>September 30, 2010</b>                             |            |                               |                              |                  |                        |
| Prime collateralized mortgage obligations             | \$ 342.5   | \$ (2.0)                      | 9.7 %                        | .9               | A                      |
| Alt-A collateralized mortgage obligations             | 46.2       | 1.5                           | 1.3                          | 1.7              | A                      |
| Subtotal collateralized mortgage obligations          | 388.7      | (.5)                          | 11.0                         | 1.0              | A                      |
| Commercial mortgage-backed obligations                | 1,469.6    | 51.3                          | 41.7                         | 2.1              | AA+                    |
| Commercial mortgage-backed obligations: interest-only | 398.0      | 15.3                          | 11.3                         | 1.3              | AAA-                   |
| Subtotal commercial mortgage-backed obligations       | 1,867.6    | 66.6                          | 53.0                         | 1.9              | AA+                    |
| Other asset-backed securities:                        |            |                               |                              |                  |                        |
| Automobile  | 643.7      | 11.9                          | 18.3                         | 1.2              | AAA                    |
| Credit card   | 187.0      | 3.6                           | 5.3                          | 1.8              | AAA-                   |
| Home equity (sub-prime bonds)                         | 178.0      | (9.6)                         | 5.0                          | .1               | BBB+                   |
| Other <sup>1</sup>                                    | 261.1      | (.7)                          | 7.4                          | 1.0              | AAA-                   |
| Subtotal other asset-backed securities                | 1,269.8    | 5.2                           | 36.0                         | 1.1              | AA+                    |
| Total asset-backed securities                         | \$ 3,526.1 | \$ 71.3                       | 100.0 %                      | 1.5              | AA+                    |



| (\$ in millions)                                      | Fair Value | Net Unrealized Gains (Losses) | % of Asset-Backed Securities | Duration (years) | Rating (at period end) |
|---|------------|-------------------------------|------------------------------|------------------|------------------------|
| <b>December 31, 2010</b>                              |            |                               |                              |                  |                        |
| Prime collateralized mortgage obligations             | \$ 344.7   | \$ (3.1)                      | 9.9 %                        | 1.7              | A                      |
| Alt-A collateralized mortgage obligations             | 44.7       | 2.2                           | 1.3                          | 2.5              | A-                     |
| Subtotal collateralized mortgage obligations          | 389.4      | (.9)                          | 11.2                         | 1.8              | A                      |
| Commercial mortgage-backed obligations                | 1,440.3    | 46.0                          | 41.5                         | 2.1              | AA+                    |
| Commercial mortgage-backed obligations: interest-only | 391.8      | 14.0                          | 11.3                         | 1.2              | AAA-                   |
| Subtotal commercial mortgage-backed obligations       | 1,832.1    | 60.0                          | 52.8                         | 1.9              | AA+                    |
| Other asset-backed securities:                        |            |                               |                              |                  |                        |
| Automobile  | 636.9      | 7.9                           | 18.4                         | 1.3              | AAA                    |
| Credit card   | 185.7      | 2.4                           | 5.4                          | 1.6              | AAA-                   |
| Home equity (sub-prime bonds)                         | 174.2      | (2.6)                         | 5.0                          | .3               | A-                     |
| Other <sup>1</sup>                                    | 251.4      | (.1)                          | 7.2                          | .9               | AAA-                   |
| Subtotal other asset-backed securities                | 1,248.2    | 7.6                           | 36.0                         | 1.1              | AA+                    |
| Total asset-backed securities                         | \$ 3,469.7 | \$ 66.7                       | 100.0 %                      | 1.6              | AA+                    |

<sup>1</sup> Includes equipment leases, manufactured housing, and other types of structured debt. At September 30, 2011, September 30, 2010, and December 31, 2010, our asset-backed securities had net unrealized gains of \$19.9 million, \$71.3 million, and \$66.7 million, respectively. Substantially all of the asset-backed securities have widely available market quotes. As of September 30, 2011, approximately 6% of our asset-backed securities are exposed to non-prime mortgage loans (home equity and Alt-A). Consistent with our plan to add high-quality, short-maturity, fixed-income securities, we continue to purchase investment-grade structured securities, primarily in the commercial mortgage-backed and consumer asset-backed markets. These investments typically have a maturity profile of five years or less, and have substantial structural credit support (i.e., the amount of underlying principal balance that is available to absorb losses before our position begins to recognize losses due to further defaults). We reviewed all of our asset-backed securities for other-than-temporary impairment and yield or asset valuation adjustments under current accounting guidance, and we realized \$0.3 million and \$3.5 million in write-downs on these securities during the third quarter and first nine months of 2011, respectively, compared to \$1.3 million and \$12.9 million during the third quarter and first nine months of 2010, respectively.

Consistent with our plan to add high-quality, short-maturity, fixed-income securities, we continue to purchase investment-grade structured securities, primarily in the CMBS and consumer ABS markets. These investments typically have a maturity profile of five years or less, and have substantial structural credit support.

**Collateralized Mortgage Obligations** At September 30, 2011, 8.1% of our asset-backed securities were collateralized mortgage obligations (CMO), which are a component of our residential mortgage-backed securities. During the three and nine months ended September 30, 2011, we recorded \$0.1 million and \$2.7 million, respectively, in credit loss write-downs on our CMO portfolio due to estimated principal losses in our most recent cash flow projections. We did not have any write-downs on Alt-A securities during 2011. During the three and nine months ended September 30, 2010, we recorded \$0 and \$1.7 million, respectively, in credit loss write-downs on our CMO portfolio, including \$0.4 million of Alt-A securities. The following table details the credit quality rating and fair value of our collateralized mortgage obligations, along with the loan classification and comparison of the fair value at September 30, 2011 to our original investment value (adjusted for returns of principal, amortization, and write-downs):

**Collateralized Mortgage Obligations (at September 30, 2011)**

| (\$ in millions)              |          |         |         |         |          | Non-Investment<br>Grade | Total   | % of<br>Collateralized<br>Mortgage<br>Obligations |
|-------------------------------|----------|---------|---------|---------|----------|-------------------------|---------|---|
|                               | AAA      | AA      | A       | BBB     |          |                         |         |   |
| Category                      |          |         |         |         |          |                         |         |   |
| Non-agency prime <sup>1</sup> | \$ 88.1  | \$ 10.3 | \$ 16.3 | \$ 24.4 | \$ 82.8  | \$ 221.9                | 76.8 %  |   |
| Alt-A                         | .9       | 24.5    | 0       | 0       | 19.4     | 44.8                    | 15.5    |   |
| Government/GSE <sup>2</sup>   | 11.9     | 7.2     | 0       | 0       | 3.1      | 22.2                    | 7.7     |   |
| Total fair value              | \$ 100.9 | \$ 42.0 | \$ 16.3 | \$ 24.4 | \$ 105.3 | \$ 288.9                | 100.0 % |   |
| Increase (decrease) in value  | .4 %     | (1.7)%  | (6.4)%  | (6.2)%  | (4.8)%   | (2.8)%                  |         |   |

<sup>1</sup> Includes \$9.6 million of securities with mandatory redemption dates.

<sup>2</sup> The securities in this category are insured by a Government Sponsored Entity (GSE) and/or collateralized by mortgage loans insured by the Federal Housing Administration (FHA) or the U.S. Department of Veteran Affairs (VA).

**Commercial Mortgage-Backed Securities** At September 30, 2011, 43.8% of our asset-backed securities were commercial mortgage-backed securities (CMBS) and 8.1% were CMBS interest-only securities (IO). During the three and nine months ended September 30, 2011, we recorded \$0 and \$0.6 million, respectively, in write-downs on our IO portfolio, compared to \$0.5 million and \$1.8 million during the three and nine months ended September 30, 2010, respectively. No write-downs were recorded on our CMBS portfolio during the same periods. The following table details the credit quality rating and fair value of our CMBS and IO portfolios:

**Commercial Mortgage-Backed Securities (at September 30, 2011)**

| (\$ in millions)      |            |         |         |          |         | Non-Investment<br>Grade | Fair<br>Value | % of<br>Total<br>Exposure |
|-----------------------|------------|---------|---------|----------|---------|-------------------------|---------------|---------------------------|
|                       | AAA        | AA      | A       | BBB      |         |                         |               |                           |
| Category              |            |         |         |          |         |                         |               |                           |
| CMBS                  | \$ 1,286.0 | \$ 66.9 | \$ 83.0 | \$ 101.7 | \$ 31.3 | \$ 1,568.9              | 84.4 %        |                           |
| IO                    | 286.3      | 0       | 0       | 2.3      | 2.2     | 290.8                   | 15.6          |                           |
| Total fair value      | \$ 1,572.3 | \$ 66.9 | \$ 83.0 | \$ 104.0 | \$ 33.5 | \$ 1,859.7              | 100.0 %       |                           |
| % of Total fair value | 84.5 %     | 3.6 %   | 4.5 %   | 5.6 %    | 1.8 %   | 100.0 %                 |               |                           |

The CMBS portfolio contained 8.5% of securities that are rated BBB or lower, with a net unrealized gain of \$8.0 million at September 30, 2011, and an average duration of 2.3 years, compared to 2.5 years for the entire CMBS portfolio. Approximately 66% of our CMBS portfolio was originated in 2005 and earlier. As with many other asset-backed classes, the CMBS market saw more aggressive underwriting from 2005 to 2007. The BBB and non-investment-grade exposure includes \$81.5 million of cell tower securitizations. All of these bonds have a single borrower, are backed by a cross-collateralized pool of cell towers throughout the U.S., and have significant net cash flow relative to their interest payments.

Planned amortization class IOs comprised 73.4% of our IO portfolio. This is a class that is structured to provide bondholders with greater protection against loan prepayment, default, or extension risk. The bonds are at the top of the payment order for interest distributions and benefit

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from increased structural support over time as they repay. We have no 2007 to 2009 origination vintage exposure; these securities are viewed as having a higher risk profile due to the underwriting criteria that was in place at that time.

**Home-Equity Securities** At September 30, 2011, 4.3% of our asset-backed securities were home-equity securities, which are a component of our residential mortgage-backed securities. For both the three and nine months ended September 30, 2011, we recorded \$0.2 million in write-downs, compared to \$0.8 million and \$9.4 million, respectively, in write-downs during the same periods last year. The following table shows the credit quality rating of our home-equity securities, by deal origination year, along with a comparison of the fair value at September 30, 2011, to our original investment value (adjusted for returns of principal, amortization, and write-downs):

| Rating (date acquired)                     | Home-Equity Securities (at September 30, 2011) |         |          |         | Total    | % of Home-Equity Securities |
|--|--|---------|----------|---------|----------|-----------------------------|
|  | Deal Origination Year                          |         |          |         |          |                             |
|  | 2007   | 2006    | 2005     | 2004    |          |                             |
| AAA (January 2008-February 2011)           | \$ 0   | \$ 0    | \$ 44.2  | \$ 0    | \$ 44.2  | 28.4 %                      |
| AA (February 2008-April 2010)              | 0  | 0       | 10.4     | 4.2     | 14.6     | 9.4                         |
| A (March 2008- January 2011)               | 0  | 11.0    | 14.4     | 0       | 25.4     | 16.4                        |
| BBB (April 2008)                           | 0  | 0       | 3.4      | 0       | 3.4      | 2.2                         |
| Non-investment grade (March 2007-May 2008) | .4   | 22.9    | 34.8     | 9.6     | 67.7     | 43.6                        |
| Total                                      | \$ .4  | \$ 33.9 | \$ 107.2 | \$ 13.8 | \$ 155.3 | 100.0 %                     |
| Increase (decrease) in value               | (16.7)%  | (2.4)%  | (14.3)%  | .2 %    | (10.8)%  |                             |

#### MUNICIPAL SECURITIES

Included in the fixed-income portfolio at September 30, 2011 and 2010 and December 31, 2010, were \$1,985.9 million, \$1,932.3 million, and \$1,989.1 million, respectively, of state and local government obligations. These securities had a duration of 2.4 years and an overall credit quality of AA+ (excluding the benefit of credit support from bond insurance) at September 30, 2011, compared to 2.2 years and AA+ at September 30, 2010, and 2.3 years and AA+ at December 31, 2010. These securities had a net unrealized gain of \$55.3 million at September 30, 2011, compared to \$67.2 million and \$33.6 million at September 30, 2010 and December 31, 2010, respectively. During the three and nine months ended September 30, 2011 and 2010, we did not record any write-downs on our municipal portfolio. The following table details the credit quality rating of our municipal securities at September 30, 2011, without the benefit of credit or bond insurance:

| Rating             | Municipal Securities (at September 30, 2011) |               |            |
|--------------------|--|---------------|------------|
|                    | General Obligations                          | Revenue Bonds | Total      |
| AAA                | \$ 312.1                                     | \$ 543.4      | \$ 855.5   |
| AA                 | 472.4  | 598.0         | 1,070.4    |
| A                  | 32.4   | 10.2          | 42.6       |
| BBB                | 1.6  | 6.7           | 8.3        |
| Other <sup>1</sup> | 0  | 9.1           | 9.1        |
| Total              | \$ 818.5                                     | \$ 1,167.4    | \$ 1,985.9 |

<sup>1</sup> Includes non-investment-grade and non-rated securities.

Included in revenue bonds were \$843.2 million of single family housing revenue bonds issued by state housing finance agencies, of which \$371.6 million were supported by individual mortgages held by the state housing finance agencies and \$471.6 million were supported by mortgage-backed securities. Of the programs supported by mortgage-backed securities, approximately 30% were collateralized by Fannie Mae and Freddie Mac mortgages; the remaining 70% were collateralized by Ginnie Mae loans, which are fully guaranteed by the U.S. Government. Of the programs supported by individual mortgages held by the state housing finance agencies, the overall credit quality rating was AA. Most of these mortgages were supported by FHA, VA, or private mortgage insurance providers.

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Approximately 12%, or \$243.0 million, of our total municipal securities were insured general obligation (\$168.6 million) or revenue bonds (\$74.4 million), with an overall credit rating of AA- at September 30, 2011, excluding the benefit of credit insurance provided by municipal bond insurers. These securities had a net unrealized gain of \$10.7 million at September 30, 2011, compared to \$15.9 million and \$10.9 million at September 30, 2010 and December 31, 2010, respectively. We buy and hold these securities based on our evaluation of the underlying credit without reliance on the municipal bond insurance. Our investment policy does not require us to liquidate securities should the insurance provided by the municipal bond insurers cease to exist.

*CORPORATE SECURITIES*

Included in our fixed-income securities at September 30, 2011 and 2010 and December 31, 2010, were \$2,761.4 million, \$2,505.8 million, and \$2,646.1 million, respectively, of fixed-rate corporate securities. These securities had a duration of 3.3 years at September 30, 2011, compared to 3.4 years at September 30, 2010 and 3.3 years at December 31, 2010; the overall credit quality rating was BBB for all three periods. At September 30, 2011 and 2010, and December 31, 2010, these securities had net unrealized gains of \$76.0 million, \$108.1 million, and \$64.8 million, respectively. During the three and nine months ended September 30, 2011 and 2010, we did not record any write-downs on our corporate debt portfolio. The table below shows the exposure break-down by rating and sector:

**Corporate Securities (at September 30, 2011)**

| Sector             | AAA          | AA           | A             | BBB           | Non-<br>Investment<br>Grade | % of<br>Corporate<br>Securities |
|--------------------|--------------|--------------|---------------|---------------|-----------------------------|---------------------------------|
| Consumer           | 0 %          | 0 %          | 3.5 %         | 20.6 %        | 3.9 %                       | 28.0 %                          |
| Industrial         | 0            | 1.5          | 2.4           | 19.9          | 4.0                         | 27.8                            |
| Communications     | 0            | 0            | 4.1           | 13.9          | .3                          | 18.3                            |
| Financial Services | 0            | 3.2          | 5.9           | .8            | 3.3                         | 13.2                            |
| Technology         | 0            | 0            | 2.2           | .4            | 0                           | 2.6                             |
| Basic Materials    | 0            | 0            | 0             | 2.7           | .7                          | 3.4                             |
| Energy             | 1.4          | 0            | 2.5           | 2.2           | 0                           | 6.1                             |
| Other              | 0            | 0            | 0             | .6            | 0                           | .6                              |
| <b>Total</b>       | <b>1.4 %</b> | <b>4.7 %</b> | <b>20.6 %</b> | <b>61.1 %</b> | <b>12.2 %</b>               | <b>100.0 %</b>                  |



**PREFERRED STOCKS REDEEMABLE AND NONREDEEMABLE**

We hold both redeemable (i.e., mandatory redemption dates) and nonredeemable (i.e., perpetual with call dates) preferred stocks. At September 30, 2011, we held \$434.0 million in redeemable preferred stocks and \$873.0 million in nonredeemable preferred stocks, compared to \$599.9 million and \$1,189.4 million, respectively, at September 30, 2010 and \$502.5 million and \$1,157.6 million, respectively, at December 31, 2010. We made no additional investments in preferred stocks during the third quarter or nine months ended September 30, 2011.

At September 30, 2011 and 2010, and December 31, 2010, our preferred stock portfolio had net unrealized gains of \$382.4 million, \$577.0 million, and \$572.7 million, respectively. We did not have any write-downs during the nine months ended September 30, 2011 or 2010.

Our preferred stock portfolio had a duration of 1.5 years, which reflects the portfolio's exposure to changes in interest rates, at September 30, 2011, compared to 2.0 years at September 30, 2010 and 1.8 years at December 31, 2010. The overall credit quality rating was BBB- at September 30, 2011 and 2010, and December 31, 2010. Approximately 50% of our preferred stock securities are fixed-rate securities, while the remaining securities are floating-rate securities. All of our preferred securities have call or mandatory redemption features. Most of the securities are structured to provide some protection against extension risk in the event the issuer elects not to call such securities at their initial call date, by either paying a higher dividend amount or by paying floating-rate coupons. Of our fixed-rate securities, approximately 90% will convert to floating-rate dividend payments if not called at their initial call date. The interest rate duration of our preferred securities is calculated to reflect both the call and floating rate features. Although a preferred security may remain outstanding if not called, its interest rate duration will reflect the floating rate dividend structure of the security. The table below shows the exposure break-down by sector and rating, reflecting any changes in ratings since acquisition:

**Preferred Stocks (at September 30, 2011)**

| <b>Sector</b>                   | <b>A</b>      | <b>BBB</b>    | <b>Non-Investment Grade</b> | <b>% of Preferred Stock Portfolio</b> |
|---------------------------------|---------------|---------------|-----------------------------|---------------------------------------|
| <b>Financial Services</b>       |               |               |                             |                                       |
| U.S. banks                      | 26.5 %        | 12.9 %        | 15.2 %                      | 54.6 %                                |
| Foreign banks                   | 2.0           | 0             | 1.2                         | 3.2                                   |
| Insurance holdings              | 0             | 7.3           | 6.4                         | 13.7                                  |
| Other financial institutions    | 0             | 0             | 2.0                         | 2.0                                   |
| <b>Total financial services</b> | <b>28.5</b>   | <b>20.2</b>   | <b>24.8</b>                 | <b>73.5</b>                           |
| <b>Industrials</b>              | <b>0</b>      | <b>6.1</b>    | <b>11.1</b>                 | <b>17.2</b>                           |
| Utilities                       | 0             | 9.3           | 0                           | 9.3                                   |
| <b>Total</b>                    | <b>28.5 %</b> | <b>35.6 %</b> | <b>35.9 %</b>               | <b>100.0 %</b>                        |

Approximately 55% of our preferred stock securities pay dividends that have tax preferential characteristics, while the balance pay dividends that are fully taxable. In addition, the issuers of all our non-investment-grade preferred stock holdings maintain investment-grade senior debt ratings.

**Common Equities**

Common equities were comprised of the following:

| (\$ in millions)              | September 30, 2011 |                | September 30, 2010 |                | December 31, 2010 |                |
|-------------------------------|--------------------|----------------|--------------------|----------------|-------------------|----------------|
| Common stocks                 | \$ 1,587.7         | 99.3 %         | \$ 1,272.8         | 99.0 %         | \$ 1,413.2        | 99.2 %         |
| Other equity-like investments | 11.8               | .7             | 12.5               | 1.0            | 11.8              | .8             |
| <b>Total common equities</b>  | <b>\$ 1,599.5</b>  | <b>100.0 %</b> | <b>\$ 1,285.3</b>  | <b>100.0 %</b> | <b>\$ 1,425.0</b> | <b>100.0 %</b> |

At September 30, 2011, 10.0% of the total investment portfolio was in common equities, compared to 7.8% at September 30, 2010 and 9.2% at December 31, 2010. The increase from September 30, 2010 reflects our decision to continue to increase our exposure to equity securities, as we added \$350 million in new capital to the common stock portfolio during the first half of 2011; there was no significant addition to the common stock portfolio during the third quarter 2011. We recorded \$1.1 million and \$1.5 million in write-downs on our common equities for the three and nine months ended September 30, 2011, respectively, compared to \$0.8 million and \$0.9 million for the same periods in 2010.

Common stocks are managed externally to track the Russell 1000 Index with an anticipated annual tracking error of +/- 50 basis points. Our individual holdings are selected based on their contribution to the correlation with the index. For all three periods reported in the table above, the GAAP basis total return was within the desired tracking error. We held 757 out of 982, or 77%, of the common stocks comprising the Russell 1000 Index at September 30, 2011, which made up 94% of the total market capitalization of the index.

Other equity-like investments include private equity investments and limited partnership interests in private equity and mezzanine investment funds, which have no off-balance-sheet exposure or contingent obligations.

**Derivative Instruments**

We have invested in the following derivative exposures at various times: interest rate swaps, asset-backed credit default swaps, U.S. corporate debt credit default swaps, cash flow hedges, and equity options. See *Note 2 Investments* for further discussion of our derivative positions.

**INTEREST RATE SWAPS**

We invest in interest rate swaps primarily to manage the fixed-income portfolio duration. The following table summarizes our interest rate swap activity classified by the status (open vs. closed) of the swap position as of September 30, 2011:

| (millions)                  | Term | Date      |          | Coupon           | Notional Value |        | Net Realized Gains (Losses)      |                  |                                 |                   |
|-----------------------------|------|-----------|----------|------------------|----------------|--------|----------------------------------|------------------|---------------------------------|-------------------|
|                             |      | Effective | Maturity |                  | 2011           | 2010   | Three Months Ended September 30, |                  | Nine Months Ended September 30, |                   |
|                             |      |           |          |                  |                |        | 2011                             | 2010             | 2011                            | 2010              |
| <b>Open:</b>                |      |           |          |                  |                |        |                                  |                  |                                 |                   |
| 9-year                      |      | 12/2009   | 01/2019  | Receive variable | \$ 613         | \$ 713 | \$ (49.7)                        | \$ (34.3)        | \$ (69.3)                       | \$ (102.7)        |
| 5-year                      |      | 05/2011   | 05/2016  | Receive variable | 400            | 0      | (16.4)                           | 0                | (18.2)                          | 0                 |
| 5-year                      |      | 08/2011   | 08/2016  | Receive variable | 500            | 0      | (6.3)                            | 0                | (6.3)                           | 0                 |
| <b>Total open positions</b> |      |           |          |                  |                |        | <b>\$ (72.4)</b>                 | <b>\$ (34.3)</b> | <b>\$ (93.8)</b>                | <b>\$ (102.7)</b> |
| <b>Closed:</b>              |      |           |          |                  |                |        |                                  |                  |                                 |                   |
| 9-year                      |      | NA        | NA       | Receive variable | \$ 100         | \$ 0   | \$ 0                             | \$ 0             | \$ .5                           | \$ 0              |

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Total interest rate swaps \$ (72.4) \$ (34.3) \$ (93.3) \$ (102.7)

NA = Not Applicable

During October 2011, we closed \$250 million notional value of our \$613 million notional value 9-year interest rate swap position and will recognize a gain of \$2.4 million during the fourth quarter.

## CORPORATE CREDIT DEFAULT SWAPS

We invest in corporate credit default swaps primarily to manage the fixed-income portfolio credit risk. The following table summarizes our corporate credit default swap activity classified by the status of the swap position as of September 30, 2011:

| (millions)<br>Term         | Date      |          | Bought or<br>Sold<br>Protection | Notional Value |       | Net Realized<br>Gains (Losses)         |         |                                    |        |
|----------------------------|-----------|----------|---------------------------------|----------------|-------|--|---------|------------------------------------|--------|
|                            | Effective | Maturity |                                 | 2011           | 2010  | Three Months Ended<br>September<br>30, |         | Nine Months Ended<br>September 30, |        |
| Open:                      |           |          |                                 |                |       | 2011                                   | 2010    | 2011                               | 2010   |
| 5-year                     | 09/2008   | 09/2013  | Bought                          | \$ 25          | \$ 25 | \$ .5                                  | \$ (.6) | \$ (.1)                            | \$ .8  |
| <b>Closed:</b>             |           |          |                                 |                |       |  |         |                                    |        |
| 2-year                     | NA        | NA       | Bought                          | \$ 0           | \$ 10 | \$ 0                                   | \$ 0    | \$ 0                               | \$ 0   |
| 4-year                     | NA        | NA       | Bought                          | 0              | 15    | 0                                      | (.2)    | 0                                  | (.2)   |
| Corporate swap             | NA        | NA       | Sold                            | 10             | 10    | (.1)                                   | 1.0     | .2                                 | .3     |
| Treasury Note <sup>1</sup> | NA        | NA       |                                 | 10             | 10    | .2                                     | .2      | .3                                 | .6     |
| Total closed positions     |           |          |                                 |                |       | \$ .1                                  | \$ 1.0  | \$ .5                              | \$ .7  |
| Total corporate swaps      |           |          |                                 |                |       | \$ .6                                  | \$ .4   | \$ .4                              | \$ 1.5 |

NA = Not Applicable

<sup>1</sup> Used to replicate a long corporate bond position.

## CASH FLOW HEDGES

During the third quarter 2011, we issued \$500 million of 3.75% Senior Notes due 2021 and entered into a forecasted debt issuance hedge (cash flow hedge) against a possible rise in interest rates (see *Note 4 Debt* for further discussion). Upon issuance of the 3.75% Senior Notes, the hedge was closed and we recognized, as part of accumulated other comprehensive income, a pretax unrealized loss of \$5.1 million.

During the third quarter 2011, we repurchased \$12.7 million of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 at or near par in the open market (see *Note 4 Debt* for further discussion). We reclassified \$0.3 million (pretax) from accumulated other comprehensive income on the balance sheet to net realized gains (losses) on securities on the income statement, reflecting the portion of the unrealized gain on forecasted transactions that was related to these debt extinguishments.

During the third quarter 2010, we finalized the Tender Offer for, and purchased \$222.9 million of, the 6.70% Debentures discussed above (see *Note 4 Debt* for further discussion). We reclassified \$5.8 million (pretax) from accumulated other comprehensive income on the balance sheet to net realized gains (losses) on securities on the income statement, reflecting the portion of the unrealized gain on forecasted transactions that was related to the 6.70% Debentures that were extinguished pursuant to the Tender Offer.

**B. Investment Results**

We reported the following investment results for the periods ended September 30:

|  | Three Months |        | Nine Months |       |
|--|--------------|--------|-------------|-------|
|  | 2011         | 2010   | 2011        | 2010  |
| Pretax recurring investment book yield | 3.2 %        | 3.5 %  | 3.3 %       | 3.6 % |
| Weighted average FTE book yield        | 3.5 %        | 3.9 %  | 3.6 %       | 3.9 % |
| <b>FTE total return:</b>               |              |        |             |       |
| Fixed-income securities                | (.6)%        | 2.6 %  | 2.3 %       | 6.5 % |
| Common stocks                          | (14.4)%      | 11.7 % | (8.6)%      | 5.1 % |
| Total portfolio                        | (2.2)%       | 3.3 %  | 1.0 %       | 6.5 % |

Recurring investment income (interest and dividends, before investment and interest expenses) decreased 11% for the third quarter 2011 and 8% for the first nine months of 2011, compared to the same periods last year. The reduction is primarily the result of a decrease in investment yields for both periods.

We report total return to reflect more accurately the management philosophy governing the portfolio and our evaluation of investment results. The fully taxable equivalent (FTE) total return includes recurring investment income, net realized gains (losses) on securities, and changes in unrealized gains (losses) on investments.

A further break-down of our FTE total returns for our fixed-income securities, including the net gains (losses) on our derivative positions, for the periods ended September 30, follows:

|                                       | Three Months |       | Nine Months |        |
|---------------------------------------|--------------|-------|-------------|--------|
|                                       | 2011         | 2010  | 2011        | 2010   |
| <b>Fixed-income securities:</b>       |              |       |             |        |
| U.S. Treasury Notes                   | .1 %         | 1.4 % | 2.6 %       | 5.0 %  |
| Municipal bonds                       | 1.8 %        | 1.9 % | 5.2 %       | 5.8 %  |
| Corporate bonds                       | .7 %         | 3.5 % | 4.0 %       | 8.9 %  |
| Commercial mortgage-backed securities | (.1)%        | 2.3 % | 2.0 %       | 7.1 %  |
| Collateralized mortgage obligations   | (.1)%        | 3.0 % | 0 %         | 9.7 %  |
| Asset-backed securities               | .1 %         | 1.8 % | 1.0 %       | 6.2 %  |
| Preferred stocks                      | (9.8)%       | 8.5 % | (1.8)%      | 11.9 % |

Investment expenses were \$4.0 million for the third quarter 2011, compared to \$0.3 million for the same period last year. In 2011, we incurred \$1.0 million of expenses related to the issuance of our 3.75% Senior Notes, while 2010 results reflect \$2.0 million of fees related to our Consent Solicitation and Tender Offer that were incurred during the second quarter 2010 and reclassified to net gain on extinguishment of debt during the third quarter upon expiration of the Tender Offer (See *Note 4 Debt* for further discussion). On a year-to-date basis, investment expenses were \$10.6 million, compared to \$8.5 million, primarily reflecting the \$1.0 million debt offering expenses discussed above.

Interest expense for the first nine months of 2011 was \$96.4 million, compared to \$102.2 million for the same period last year. The decrease in interest expense during the first nine months reflects our July 2010 repurchase of \$222.9 million of our 6.70% Debentures, partially offset by expense incurred following the issuance of our 3.75% Senior Notes (see *Note 4 Debt* for further discussion).

**Realized Gains/Losses**

The components of net realized gains (losses) for the three and nine months ended September 30, were:

| (millions)  | Three Months |              | Nine Months   |               |
|---|--------------|--------------|---------------|---------------|
|   | 2011         | 2010         | 2011          | 2010          |
| <b>Gross realized gains on security sales</b>                 |              |              |               |               |
| Fixed maturities:   |              |              |               |               |
| U.S. government obligations                                   | \$ 11.3      | \$ 12.2      | \$ 46.2       | \$ 30.1       |
| State and local government obligations                        | 0            | 0            | 3.5           | 10.0          |
| Corporate and other debt securities                           | 3.9          | 19.4         | 21.3          | 23.5          |
| Residential mortgage-backed securities                        | 1.5          | 0            | 1.9           | 0             |
| Commercial mortgage-backed securities                         | 0            | 0            | 0             | 1.0           |
| Other asset-backed securities                                 | 1.1          | 0            | 2.1           | 0             |
| Redeemable preferred stocks                                   | 0            | .5           | 3.4           | 5.3           |
| <b>Total fixed maturities</b>                                 | <b>17.8</b>  | <b>32.1</b>  | <b>78.4</b>   | <b>69.9</b>   |
| Equity securities:  |              |              |               |               |
| Nonredeemable preferred stocks                                | 6.4          | 17.8         | 101.3         | 56.6          |
| Common equities   | 2.0          | 1.1          | 9.9           | 9.5           |
| <b>Subtotal gross realized gains on security sales</b>        | <b>26.2</b>  | <b>51.0</b>  | <b>189.6</b>  | <b>136.0</b>  |
| <b>Gross realized losses on security sales</b>                |              |              |               |               |
| Fixed maturities:   |              |              |               |               |
| U.S. government obligations                                   | 0            | (.5)         | (9.3)         | (12.5)        |
| Corporate and other debt securities                           | 0            | 0            | (3.4)         | (.5)          |
| Redeemable preferred stocks                                   | 0            | (.2)         | (2.2)         | (2.7)         |
| <b>Total fixed maturities</b>                                 | <b>0</b>     | <b>(.7)</b>  | <b>(14.9)</b> | <b>(15.7)</b> |
| Equity securities:  |              |              |               |               |
| Common equities   | 0            | (.3)         | (6.1)         | (4.1)         |
| <b>Subtotal gross realized losses on security sales</b>       | <b>0</b>     | <b>(1.0)</b> | <b>(21.0)</b> | <b>(19.8)</b> |
| <b>Net realized gains (losses) on security sales</b>          |              |              |               |               |
| Fixed maturities:   |              |              |               |               |
| U.S. government obligations                                   | 11.3         | 11.7         | 36.9          | 17.6          |
| State and local government obligations                        | 0            | 0            | 3.5           | 10.0          |
| Corporate and other debt securities                           | 3.9          | 19.4         | 17.9          | 23.0          |
| Residential mortgage-backed securities                        | 1.5          | 0            | 1.9           | 0             |
| Commercial mortgage-backed securities                         | 0            | 0            | 0             | 1.0           |
| Other asset-backed securities                                 | 1.1          | 0            | 2.1           | 0             |
| Redeemable preferred stocks                                   | 0            | .3           | 1.2           | 2.6           |
| <b>Total fixed maturities</b>                                 | <b>17.8</b>  | <b>31.4</b>  | <b>63.5</b>   | <b>54.2</b>   |
| Equity securities:  |              |              |               |               |
| Nonredeemable preferred stocks                                | 6.4          | 17.8         | 101.3         | 56.6          |
| Common equities   | 2.0          | .8           | 3.8           | 5.4           |
| <b>Subtotal net realized gains (losses) on security sales</b> | <b>26.2</b>  | <b>50.0</b>  | <b>168.6</b>  | <b>116.2</b>  |
| <b>Other-than-temporary impairment losses</b>                 |              |              |               |               |
| Fixed maturities:   |              |              |               |               |
| Residential mortgage-backed securities                        | (.3)         | (.8)         | (2.9)         | (11.1)        |
| Commercial mortgage-backed securities                         | 0            | (.5)         | (.6)          | (1.8)         |

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|   |           |         |         |         |
|---|-----------|---------|---------|---------|
| Total fixed maturities                          | (.3)      | (1.3)   | (3.5)   | (12.9)  |
| Equity securities:                              |           |         |         |         |
| Common equities                                 | (1.1)     | (.5)    | (1.2)   | (.6)    |
| Subtotal other-than-temporary impairment losses | (1.4)     | (1.8)   | (4.7)   | (13.5)  |
| Net holding period gains (losses)               |           |         |         |         |
| Hybrid securities                               | (5.9)     | 6.8     | 1.8     | 10.9    |
| Derivative instruments                          | (71.5)    | (28.1)  | (92.6)  | (95.4)  |
| Subtotal net holding period gains (losses)      | (77.4)    | (21.3)  | (90.8)  | (84.5)  |
| Total net realized gains (losses) on securities | \$ (52.6) | \$ 26.9 | \$ 73.1 | \$ 18.2 |

Gross realized gains and losses were the result of customary investment sales transactions in our fixed-income portfolio, affected by movements in credit spreads and interest rates, sales of common stocks, and holding period valuation changes on derivatives and hybrid preferred stocks. From time to time, gross realized losses also include write-downs for securities in our fixed-income and/or equity portfolios, which are determined to be other-than-temporarily impaired.

**Other-Than-Temporary Impairment (OTTI)**

Realized losses may include write-downs of securities determined to have had other-than-temporary declines in fair value. We routinely monitor our portfolio for pricing changes that might indicate potential impairments and perform detailed reviews of securities with unrealized losses based on predetermined guidelines. In such cases, changes in fair value are evaluated to determine the extent to which such changes are attributable to (i) fundamental factors specific to the issuer, such as financial conditions, business prospects, or other factors, (ii) market-related factors, such as interest rates or equity market declines (e.g., negative return at either a sector index level or at the broader market level), or (iii) credit-related losses where the present value of cash flows expected to be collected is lower than the amortized cost basis of the security.

Fixed-income securities and common equities with declines attributable to issuer-specific fundamentals are reviewed to identify all available evidence, circumstances, and influences to estimate the potential for, and timing of, recovery of the investment's impairment. An other-than-temporary impairment loss is deemed to have occurred when the potential for recovery does not satisfy the criteria set forth in the current accounting guidance.

For fixed-income investments with unrealized losses due to market- or sector-related declines, the losses are not deemed to qualify as other-than-temporary where we do not have the intent to sell the investments, and it is more likely than not that we will not be required to sell the investments, prior to the periods of time that we anticipate to be necessary for the investments to recover their cost bases. In general, our policy for common equity securities with market- or sector-related declines is to recognize impairment losses on individual securities with losses we cannot reasonably conclude will recover in the near term under historical conditions by the earlier of (i) when we are able to objectively determine that the loss is other-than-temporary, or (ii) when the security has been in such a loss position for three consecutive quarters.

When a security in our fixed-maturity portfolio has an unrealized loss and we intend to sell the security, or it is more likely than not that we will be required to sell the security, we write-down the security to its current fair value and recognize the entire unrealized loss through the income statement as a realized loss. If a fixed-maturity security has an unrealized loss and it is more likely than not that we will hold the debt security until recovery (which could be maturity), then we determine if any of the decline in value is due to a credit loss (i.e., where the present value of cash flows expected to be collected is lower than the amortized cost basis of the security) and, if so, we recognize that portion of the impairment in the income statement as a realized loss; any remaining unrealized loss on the security is considered to be due to other factors (e.g., interest rate and credit spread movements) and is reflected in shareholders' equity, along with unrealized gains or losses on securities that are not deemed to be other-than-temporarily impaired. The write-down activity recorded in the income statement was as follows:

| (millions)                             | Three Months Ended September 30, |   |   | Nine Months Ended September 30, |   |   |
|--|----------------------------------|---|---|---------------------------------|---|---|
|  | Total<br>Write-downs             | Write-downs<br>on<br>Securities<br>Sold | Write-downs<br>on<br>Securities<br>Held at<br>Period<br>End | Total<br>Write-downs            | Write-downs<br>on<br>Securities<br>Sold | Write-downs<br>on<br>Securities<br>Held at<br>Period<br>End |
| <b>2011</b>                            |                                  |   |   |                                 |   |   |
| Residential mortgage-backed securities | \$ .3                            | \$ 0                                    | \$ .3   | \$ 2.9                          | \$ 0                                    | \$ 2.9  |
| Commercial mortgage-backed securities  | 0                                | 0                                       | 0   | .6                              | 0                                       | .6  |
| Total fixed income                     | .3                               | 0                                       | .3  | 3.5                             | 0                                       | 3.5   |
| Common equities                        | 1.1                              | 0                                       | 1.1   | 1.5                             | (.3)                                    | 1.2   |
| Total portfolio                        | \$ 1.4                           | \$ 0                                    | \$ 1.4  | \$ 5.0                          | \$ (.3)                                 | \$ 4.7  |
| <b>2010</b>                            |                                  |   |   |                                 |   |   |
| Residential mortgage-backed securities | \$ .8                            | \$ 0                                    | \$ .8   | \$ 11.1                         | \$ 0                                    | \$ 11.1   |
| Commercial mortgage-backed securities  | .5                               | 0                                       | .5  | 1.8                             | 0                                       | 1.8   |
| Total fixed income                     | 1.3                              | 0                                       | 1.3   | 12.9                            | 0                                       | 12.9  |
| Common equities                        | .8                               | (.3)                                    | .5  | .9                              | (.3)                                    | .6  |
| Total portfolio                        | \$ 2.1                           | \$ (.3)                                 | \$ 1.8  | \$ 13.8                         | \$ (.3)                                 | \$ 13.5   |





The following table stratifies the gross unrealized losses in our fixed-income and common equity portfolios at September 30, 2011, by duration in a loss position and magnitude of the loss as a percentage of the cost of the security:

| (millions)                               | Fair Value        | Total Gross Unrealized Losses | Decline of Investment Value |                |                |               |
|--|-------------------|-------------------------------|-----------------------------|----------------|----------------|---------------|
|  |                   |                               | >15%                        | >25%           | >35%           | >45%          |
| <b>Fixed Income:</b>                     |                   |                               |                             |                |                |               |
| Unrealized loss for less than 12 months  | \$ 1,271.7        | \$ 24.0                       | \$ .1                       | \$ 0           | \$ 0           | \$ 0          |
| Unrealized loss for 12 months or greater | 648.1             | 60.2                          | 35.9                        | 14.6           | 14.6           | 5.8           |
| <b>Total</b>                             | <b>\$ 1,919.8</b> | <b>\$ 84.2</b>                | <b>\$ 36.0</b>              | <b>\$ 14.6</b> | <b>\$ 14.6</b> | <b>\$ 5.8</b> |
| <b>Common Equity:</b>                    |                   |                               |                             |                |                |               |
| Unrealized loss for less than 12 months  | \$ 407.3          | \$ 76.6                       | \$ 60.4                     | \$ 46.6        | \$ 11.6        | \$ 3.1        |
| Unrealized loss for 12 months or greater | 12.9              | 3.8                           | 3.8                         | .4             | .3             | 0             |
| <b>Total</b>                             | <b>\$ 420.2</b>   | <b>\$ 80.4</b>                | <b>\$ 64.2</b>              | <b>\$ 47.0</b> | <b>\$ 11.9</b> | <b>\$ 3.1</b> |

We completed a thorough review of the existing securities in these loss categories and determined that, applying the procedures and criteria discussed above, these securities were not other-than-temporarily impaired. We do not intend to sell these securities. We also determined that it is more likely than not that we will not be required to sell these securities for the periods of time necessary to recover their respective cost bases, and that there are no additional credit-related impairments on our debt securities.

Since total unrealized losses are already a component of other comprehensive income and included in shareholders' equity, any recognition of these losses as additional OTTI losses would have no effect on our comprehensive income, book value, or reported investment total return.

### C. Repurchase Transactions

From time to time we enter into reverse repurchase commitment transactions. In these transactions, we loan cash to accredited banks and receive U.S. Treasury Notes pledged as collateral against the cash borrowed. We choose to enter into these transactions as rates and credit quality are more attractive than other short-term rates available in the market. Our exposure to credit risk is limited due to the characteristics of the collateral (i.e., U.S. Treasury Notes) received. The income generated on these transactions is calculated at the then applicable general collateral rates on the value of U.S. Treasury securities received. We have counterparty exposure on reverse repurchase agreements in the event of a counterparty default to the extent the general collateral security's value is below the cash we delivered to acquire the collateral. The short-term duration of the transactions (primarily overnight investing) reduces that default exposure.

We earned income of less than \$0.1 million and \$0.3 million for the three and nine months ended September 30, 2011, respectively, compared to \$0.4 million and \$0.8 million for the same periods in 2010. We had \$549.5 million of open reverse repurchase commitments with two counterparties at September 30, 2011, compared to \$499.0 million open with two counterparties at September 30, 2010, and \$705.8 million with two counterparties at December 31, 2010. For the nine months ended September 30, 2011, our largest single outstanding balance of reverse repurchase commitments was \$975.0 million, which was open for four days; the average daily balance of reverse repurchase commitments was \$562.1 million.

Additionally, during the second quarter 2011 we entered into repurchase commitment transactions for a period of ten days. In these transactions, we loan U.S. Treasury securities to accredited brokerage firms in exchange for cash equal to the fair value of the securities. The cash proceeds were invested in unsecured commercial paper issued by large, high-quality institutions. These transactions were entered into as overnight arrangements, and we had no open repurchase commitments at September 30, 2011. During the period we invested in repurchase transactions, the largest single outstanding balance was \$43.6 million, which was open for one day; the average daily balance of repurchase commitments was \$43.5 million. We earned income of less than \$0.1 million during the period these transactions were open; we did not enter into any repurchase commitment transactions during the third quarter 2011 or the first nine months of 2010.

**Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995:** *Statements in this report that are not historical fact are forward-looking statements that are subject to certain risks and uncertainties that could cause actual events and results to differ materially from those discussed herein. These risks and uncertainties include, without limitation, uncertainties related to estimates, assumptions, and projections generally; inflation and changes in economic conditions (including changes in interest rates and financial markets); the possible failure of one or more governmental entities to make scheduled debt payments or satisfy other obligations; the potential or actual downgrading of governmental, corporate, or other securities by a rating agency; the financial condition of, and other issues relating to the strength of and liquidity available to, issuers of securities held in our investment portfolios and other companies with which we have ongoing business relationships, including counterparties to certain financial transactions; the accuracy and adequacy of our pricing and loss reserving methodologies; the competitiveness of our pricing and the effectiveness of our initiatives to retain more customers; initiatives by competitors and the effectiveness of our response; our ability to obtain regulatory approval for requested rate changes and the timing thereof; the effectiveness of our brand strategy and advertising campaigns relative to those of competitors; legislative and regulatory developments, including, but not limited to, health care reform and tax law changes; disputes relating to intellectual property rights; the outcome of litigation pending or that may be filed against us; weather conditions (including the severity and frequency of storms, hurricanes, snowfalls, hail, and winter conditions); changes in driving patterns and loss trends; acts of war and terrorist activities; our ability to maintain the uninterrupted operation of our facilities, systems (including information technology systems), and business functions; court decisions and trends in litigation and health care and auto repair costs; and other matters described from time to time in our releases and publications, and in our periodic reports and other documents filed with the United States Securities and Exchange Commission. In addition, investors should be aware that generally accepted accounting principles prescribe when a company may reserve for particular risks, including litigation exposures. Accordingly, results for a given reporting period could be significantly affected if and when a reserve is established for one or more contingencies. Also, our regular reserve reviews may result in adjustments of varying magnitude as additional information regarding claims activity becomes known. Reported results, therefore, may be volatile in certain accounting periods.*

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

The duration of the financial instruments held in our portfolios that are subject to interest rate risk was 1.7 years at September 30, 2011 and 2.0 years at December 31, 2010. The weighted average beta of the equity portfolio was 1.00 at September 30, 2011 and 1.08 at December 31, 2010. Although components of the portfolio have changed, no material changes have occurred in the total market risk since that which was reported in the tabular presentations of our market risk sensitive instruments in our Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 4. Controls and Procedures.**

Progressive, under the direction of the Chief Executive Officer and the Chief Financial Officer, has established disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. The disclosure controls and procedures are also intended to ensure that such information is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

The Chief Executive Officer and the Chief Financial Officer reviewed and evaluated Progressive's disclosure controls and procedures as of the end of the period covered by this report. Based on that review and evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that Progressive's disclosure controls and procedures are effectively serving the stated purposes as of the end of the period covered by this report.

There has been no change in Progressive's internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****Item 1A. Risk Factors.**

There have been no material changes in the risk factors that were discussed in our Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

(c) Share Repurchases

**ISSUER PURCHASES OF EQUITY SECURITIES**

| 2011                   |                                  |                              |  |  |
|------------------------|----------------------------------|------------------------------|--|--|
| Calendar               | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs |
| July <sup>1</sup>      | 4,050,000                        | \$ 20.15                     | 47,183,607   | 77,816,393   |
| August <sup>1</sup>    | 2,816,393                        | NM                           | 50,000,000   | 75,000,000   |
| August <sup>2</sup>    | 5,433,607                        | NM                           | 5,433,607  | 69,566,393   |
| August Total           | 8,250,000                        | 18.45                        | NM   | NM   |
| September <sup>2</sup> | 9,887,884                        | 17.93                        | 15,321,491   | 59,678,509   |
| Total                  | 22,187,884                       | \$ 18.53                     |  |  |

NM = Not Meaningful

<sup>1</sup> Purchases pursuant to the June 2009 authorization (discussed below)

<sup>2</sup> Purchases pursuant to the June 2011 authorization (discussed below)

In June 2009, the Board of Directors approved an authorization to repurchase up to 50 million common shares; repurchases of the remaining shares under this authorization were completed in August 2011. In June 2011, the Board approved a new authorization to repurchase up to 75 million common shares, to be used in addition to, and after completion of, the remaining repurchases available under the June 2009 authorization; this Board authorization does not have an expiration date. Shares repurchased under these authorizations may be accomplished through open market purchases or otherwise, and may include trading plans entered into with one or more brokerage firms in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934. In August 2011, we entered into a 10b5-1 trading plan to permit, under certain circumstances specified in the plan, the repurchase of our common shares during periods that are otherwise restricted under our internal policies; this plan expires in November 2011, unless sooner terminated by us. During the third quarter, we repurchased shares under the 10b5-1 plan and in the open market. Progressive's financial policies state that we will repurchase shares to neutralize dilution from equity-based compensation in the year of issuance and as an option to return underleveraged capital to investors.

**Item 5. Other Information.**

President and CEO Glenn M. Renwick's letter to shareholders with respect to our third quarter 2011 results is included as Exhibit 99 to this Quarterly Report on Form 10-Q. The letter is also posted on Progressive's website at [progressive.com/annualreport](http://progressive.com/annualreport).

**Item 6. Exhibits.**

See exhibit index beginning on page 56.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE PROGRESSIVE CORPORATION  
(Registrant)

Date: November 7, 2011

By: /s/ Brian C. Domeck  
Brian C. Domeck  
Vice President and Chief Financial Officer

**EXHIBIT INDEX**

| <b>Exhibit<br/>No. Under</b> |                           |  | <b>If Incorporated by Reference,<br/>Documents with Which Exhibit<br/>was Previously Filed with SEC</b> |
|------------------------------|---------------------------|--|---|
| <b>Reg. S-K,</b>             | <b>Form 10-Q</b>          | <b>Description of Exhibit</b>  |   |
| <b>Item 601</b>              | <b>Exhibit<br/>Number</b> |  |   |
| 4                            | 4.1                       | Sixth Supplemental Indenture between The Progressive Corporation and U.S. Bank National Association, as trustee  | Filed herewith  |
| 4                            | 4.2                       | Form of 3.75% Senior Notes due 2021  | Current Report on Form 8-K (filed with SEC on August 22, 2011; Exhibit 4.2 therein)                     |
| 4                            | 4.3                       | Second Supplemental Indenture dated September 2, 2011, to the Junior Subordinated Indenture dated June 21, 2007, between The Progressive Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee | Current Report on Form 8-K (filed with SEC on September 7, 2011; Exhibit 4 therein)                     |
| 31                           | 31.1                      | Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer, Glenn M. Renwick  | Filed herewith  |
| 31                           | 31.2                      | Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer, Brian C. Domeck   | Filed herewith  |
| 32                           | 32.1                      | Section 1350 Certification of the Principal Executive Officer, Glenn M. Renwick  | Furnished herewith  |
| 32                           | 32.2                      | Section 1350 Certification of the Principal Financial Officer, Brian C. Domeck   | Furnished herewith  |
| 99                           | 99                        | Letter to Shareholders from Glenn M. Renwick, President and Chief Executive Officer (Regulation FD Disclosure)   | Furnished herewith  |
| 101                          | 101.INS                   | XBRL Instance Document   | Filed herewith  |
| 101                          | 101.SCH                   | XBRL Taxonomy Extension Schema Document  | Filed herewith  |
| 101                          | 101.CAL                   | XBRL Taxonomy Extension Calculation Linkbase Document  | Filed herewith  |
| 101                          | 101.DEF                   | XBRL Taxonomy Extension Definition Linkbase Document   | Filed herewith  |
| 101                          | 101.LAB                   | XBRL Taxonomy Extension Label Linkbase Document  | Filed herewith  |
| 101                          | 101.PRE                   | XBRL Taxonomy Extension Presentation Linkbase Document   | Filed herewith  |