



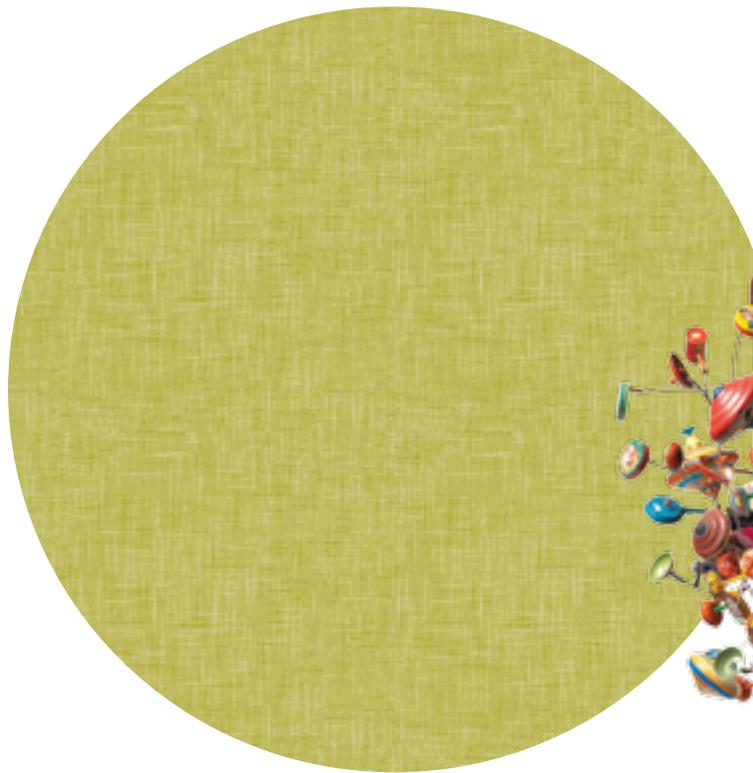
# The Progressive Corporation

Annual Report 2012

> **The Progressive Group of Insurance Companies,** in business since 1937, is one of the country's largest auto insurance groups, the largest seller of motorcycle policies, and a market leader in commercial auto insurance based on premiums written. Progressive is committed to becoming consumers' #1 choice for auto insurance by providing competitive rates and innovative products and services that meet drivers' needs throughout their lifetimes, including superior online and in-person customer service, and best-in-class, 24-hour claims service, such as its concierge level of claims service available at service centers located in major metropolitan areas throughout the United States.

Progressive companies offer consumers choices in how to shop for, buy, and manage their auto insurance policies. Progressive offers its products, including personal and commercial auto, motorcycle, boat, and recreational vehicle insurance, through more than 35,000 independent insurance agencies throughout the U.S. and directly from the Company online, by phone, or on a mobile device.

As our name demands, Progressive is always looking for ways to delight customers with unique product and service experiences. This means challenging every aspect of all we do in an attempt to provide the customer with greater value. For this reason, we chose "challenging the status quo" as the theme for this year's annual report. Sculptor and performance artist Nick Cave's extraordinary "sound suits" also challenge boundaries, provoke thought and highlight details. A selection of Cave's sound suits will join Progressive's growing collection of contemporary art.



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(billions-except per share amounts)

	> 2012	2011	2010	2009	2008
<b>For the Year</b>					
Net premiums written	\$ 16.4	\$ 15.1	\$ 14.5	\$ 14.0	\$ 13.6
Growth over prior year	8%	5%	3%	3%	(1)%
Net premiums earned	\$ 16.0	\$ 14.9	\$ 14.3	\$ 14.0	\$ 13.6
Growth over prior year	7%	4%	2%	3%	(2)%
Total revenues	\$ 17.1	\$ 15.8	\$ 15.2	\$ 14.8	\$ 13.0
Net income (loss)	\$ .90	\$ 1.02	\$ 1.07	\$ 1.06	\$ (.07)
Per share <sup>1</sup>	\$ 1.48	\$ 1.59	\$ 1.61	\$ 1.57	\$ (.10)
Underwriting margin	4.4%	7.0%	7.6%	8.4%	5.4%

(billions – except shares outstanding, per share amounts, and policies in force)

	> 2012	2011	2010	2009	2008
<b>At Year-End</b>					
Common shares outstanding (millions)	604.6	613.0	662.4	672.6	676.5
Book value per share	\$ 9.94	\$ 9.47	\$ 9.13	\$ 8.55	\$ 6.23
Consolidated shareholders' equity	\$ 6.0	\$ 5.8	\$ 6.0	\$ 5.7	\$ 4.2
Market capitalization	\$ 12.8	\$ 12.0	\$ 13.2	\$ 12.1	\$ 10.0
Return on average shareholders' equity					
Net income	14.5%	16.5%	17.1%	21.4%	(1.5)%
Comprehensive income	17.4%	15.0%	22.3%	35.5%	(13.3)%
Policies in force (thousands)					
Personal Lines					
Agency-auto	4,790.4	4,648.5	4,480.1	4,299.2	4,288.6
Direct-auto	4,000.1	3,844.5	3,610.4	3,201.1	2,824.0
Special lines	3,944.8	3,790.8	3,612.2	3,440.3	3,352.3
Total Personal Lines	12,735.3	12,283.8	11,702.7	10,940.6	10,464.9
Growth over prior year	4%	5%	7%	5%	3%
Commercial Auto	519.6	509.1	510.4	512.8	539.4
Growth over prior year	2%	0%	0%	(5)%	0%
Industry net premiums written <sup>2</sup>	NA	\$ 163.0	\$ 160.1	\$ 157.2	\$ 158.5
Market share <sup>3</sup>	NA	8.2%	7.9%	7.7%	7.3%

**Stock Price Appreciation<sup>4</sup>**

	1-Year	3-Year	5-Year
Progressive	15.4%	10.7%	5.1%
S&P 500	15.9%	10.9%	1.7%

<sup>1</sup>Since we reported a net loss for 2008, the calculated diluted earnings per share was antidilutive; therefore, basic earnings per share is disclosed. For all other periods, diluted earnings per share is disclosed.

<sup>2</sup>Represents private passenger auto insurance market net premiums written as reported by A.M. Best Company, Inc.

<sup>3</sup>Represents Progressive's private passenger auto business, including motorcycle insurance, as a percent of the private passenger auto insurance market.

<sup>4</sup>Represents average annual compounded rate of increase and assumes dividend reinvestment.

NA = Final comparable industry data will not be available until our third quarter report.



> **more than**  
2 miles of thread  
90,000 mixed buttons  
2 pound wood and  
metal abacus  
280 working hours  
35 pounds



**aspire**



### Vision

We seek to be an excellent, innovative, growing, and enduring business by cost-effectively and profitably reducing the human trauma and economic costs of auto accidents and other mishaps, and by building a recognized, trusted, admired, business-generating brand. We seek to maximize shareholder value and to provide a positive environment that attracts quality people who develop and achieve ambitious growth plans.

### Customer Value Proposition

Our Customer Value Proposition provides a litmus test for customer interactions and relationships and innovation.

> **Fast, Fair, Better** That's what you can expect from Progressive. Everything we do recognizes the needs of busy consumers, who are cost-conscious, increasingly savvy about insurance, and ready for new, easy ways to quote, buy, and manage their policies, including claims service that respects their time and reduces the trauma and inconvenience of loss.

Communicating a clear picture of Progressive by stating what we try to achieve (Vision), how we interact with customers (Customer Value Proposition), and what guides our behavior (Core Values) permits all people associated with us to understand what we expect of ourselves and each other and how we conduct our business.

### Core Values

Progressive's Core Values serve as the foundation for our corporate culture. They govern our decisions and define the manner in which we conduct our business and how we interact with all interested parties. We want them understood and embraced by all Progressive people. Growth and change provide new perspective, requiring regular refinement of our Core Values.

> **Integrity** We revere honesty. We adhere to high ethical standards, provide timely, accurate, and complete financial reporting, encourage disclosing bad news, and welcome disagreement.

> **Golden Rule** We respect all people, value the differences among them, and deal with them in the way we want to be dealt with. This requires us to know ourselves and to try to understand others.

> **Objectives** We strive to communicate clearly Progressive's ambitious objectives and our people's personal and team objectives. We evaluate performance against all these objectives.

> **Excellence** We strive constantly to improve in order to meet and exceed the highest expectations of our customers, agents, shareholders, and people. We teach and encourage our people to improve performance and to reduce the costs of what they do for customers. We base their rewards on results and promotion on ability.

> **Profit** We seek to earn a profit by offering consumers products and services they want. Profit is how the free-enterprise system motivates investment and rewards companies that consistently create value.



individualistic



> **more than**  
360 yards of human hair,  
dyed in China  
40 working hours  
20 pounds

empowered smart driven



**perform**

When late-season, named storms start with letters deep into the alphabet, there's a good chance it's been an eventful year for the auto insurance industry; and it was, with the trump card as the finale—Sandy.

Named storms capture headlines, but damage from hail, an exposed vehicle's worst nightmare, and other wind, flood, and fire events were all at remarkable levels for 2012, and collectively our highest ever number of claims from catastrophes—quite a statement considering the trifecta of Rita, Wilma, and Katrina in 2005. These types of events are ever present reminders that serve to reinforce our raison d'être and the value we are uniquely positioned to provide our customers at such times. So often we find ourselves acting on behalf of our customers and their liability interests, but in these events, fault is rarely the issue, and we get to deal with our customers directly and devote our full attention to getting them back on a path to normalcy. During 2012, we responded to 28 separately declared catastrophes, asking close to 1,300 of our people to stop doing what they had otherwise planned, reassign their work, and immediately travel to the scene of the damage to help our customers alongside our core catastrophe response team. While most measures are relative, and matter most to those in direct management of the situation, to help the reader with an order of magnitude, it's reasonable to suggest we dedicated close to half a million hours in 2012 helping our customers who experienced the unexpected.

Often the logistics of response are challenging—gas, Internet, and hotels, among many things, just don't work the way we have come to expect, but the gratitude of customers, often with many more issues yet to resolve, provides a sobering perspective. We resolved 94% of all our Sandy related claims before year end and will not be deep into 2013 before completion. Speed is essential and, balanced with good process and economic consideration, highly valued by customers, who once again rewarded us with extremely high Net Promoter® scores (NPS) post our catastrophe responses. This is our time to count and the satisfaction of customers is a clear indication of whether we're meeting or exceeding their expectations and earning their intention to stay.





Performance is our consumer product; performing well while growing and meeting our economic objectives is our challenge. I reported last year that we straddled a new high of \$15 billion with written premiums just over and earned just under. This year I can report both written and earned premiums cleared \$16 billion. At a growth rate of 8%, our gain in written premiums did not reach the heights of the 2002–2004 period, but our 2012 growth in written premiums of \$1.23 billion pleasingly topped all others. (Industry observers will note that CAGR for auto insurance for the last five years rounds to zero, while the prior five is closer to 5%\*). Growth without requisite profitability in our business generally does not lead anywhere good and we had our work cut out for us in 2012 to meet or exceed our very clear profitability expectation of a 96 combined ratio or better, most notably in the closing months courtesy of our aforementioned friend Sandy, but we did so ending the year at a combined ratio of 95.6.

Never becoming comfortable is a critical part of who we are, but if “the take home report card for the year” is growth of 8%, a 95.6 combined ratio, and a total return for the portfolio of 6.8%, we might be permitted a moment to say OK – not bad, and then get back at it with renewed enthusiasm.

Underwriting profitability is **the** necessary condition to drive all else at Progressive. In 2012, our post tax underwriting profit was \$461 million, less than last year, and also with less assistance from favorable prior year development, but clearly consistent with our self-imposed objectives. Our post tax recurring contribution primarily from investments, less interest expense, was a further \$441 million, for a total net income of \$902 million, or \$1.48 per share. That said, notwithstanding some very impressive results on the investment front in 2012, some yet unrealized, the current investment climate is not one that favors strong interest-rate-based returns and a valid strategic question could be to challenge the expected ratio of income from underwriting versus investments, or more simply put: is our 96 combined ratio objective the optimal calibration at this time?

\*Compound annual growth rate (CAGR) was computed using data from A.M. Best Company, Inc.

**Our Business Model**

For us a 96 combined ratio is not a “solve for” variable in our business model equation, but rather a constant that provides direction to each and every product and marketing decision and a cultural tipping point that ensures zero ambiguity as to how to act in certain situations. Set at a level, we believe, creates a fair balance between attractive profitability and consumer competitiveness, it’s deeply ingrained and central to our culture, and for me a primary reason our underwriting performance has consistently matched or exceeded any in the industry.

With clarity as to our business constant, we seek to maximize all other important variables and support with appropriate axioms:

> **Grow as fast as we can** subject to our ability to provide high-quality service. Our preferred measure of growth is in customers, best measured by policies in force. Other factors affect aggregate written premium growth, including rate level adjustments, geographic mix of policies, and policy-type distributions, but premium growth is a reasonable proxy and most generally used in market share determination. Market share moves more slowly than I might like, but over reasonable time periods ours has been impressive.

> **Extend policy life expectancy.** Our preference is for the flexibility of shorter policy periods, highlighting however, the importance of retaining customers at policy renewal. Our work is fully inclusive of all points throughout a customer’s tenure and is a never-ending focus, tailored for every customer segment. Our use of Net Promoter scoring provides for a much more dynamic, but highly correlated, measure of policy life expectancy and is an internally acceptable proxy for our ultimate goal of extended life expectancy. Necessary rate increases, many taken in 2012, work against improving either measure; whereas, extraordinary claims response serves to enhance both. Progress sometimes can feel like two steps forward and one step back, but that’s our challenge to accept. Becoming a “destination” insurance company for customers has been a major transformation in the last decade and much work remains, but equally much has been accomplished.

The operations summaries included in this report for Personal Lines and Commercial Auto provide more commentary on our numerous activities to maximize these business drivers and Figure 1 provides them in tabular form for 2012 and over time.

Clarity as to our objective means other elements of the business model must be appropriately designed to strongly support, but not necessarily amplify, the risk of maximizing all things at the same time. Our articulation of our most critical investment objective is a good example:

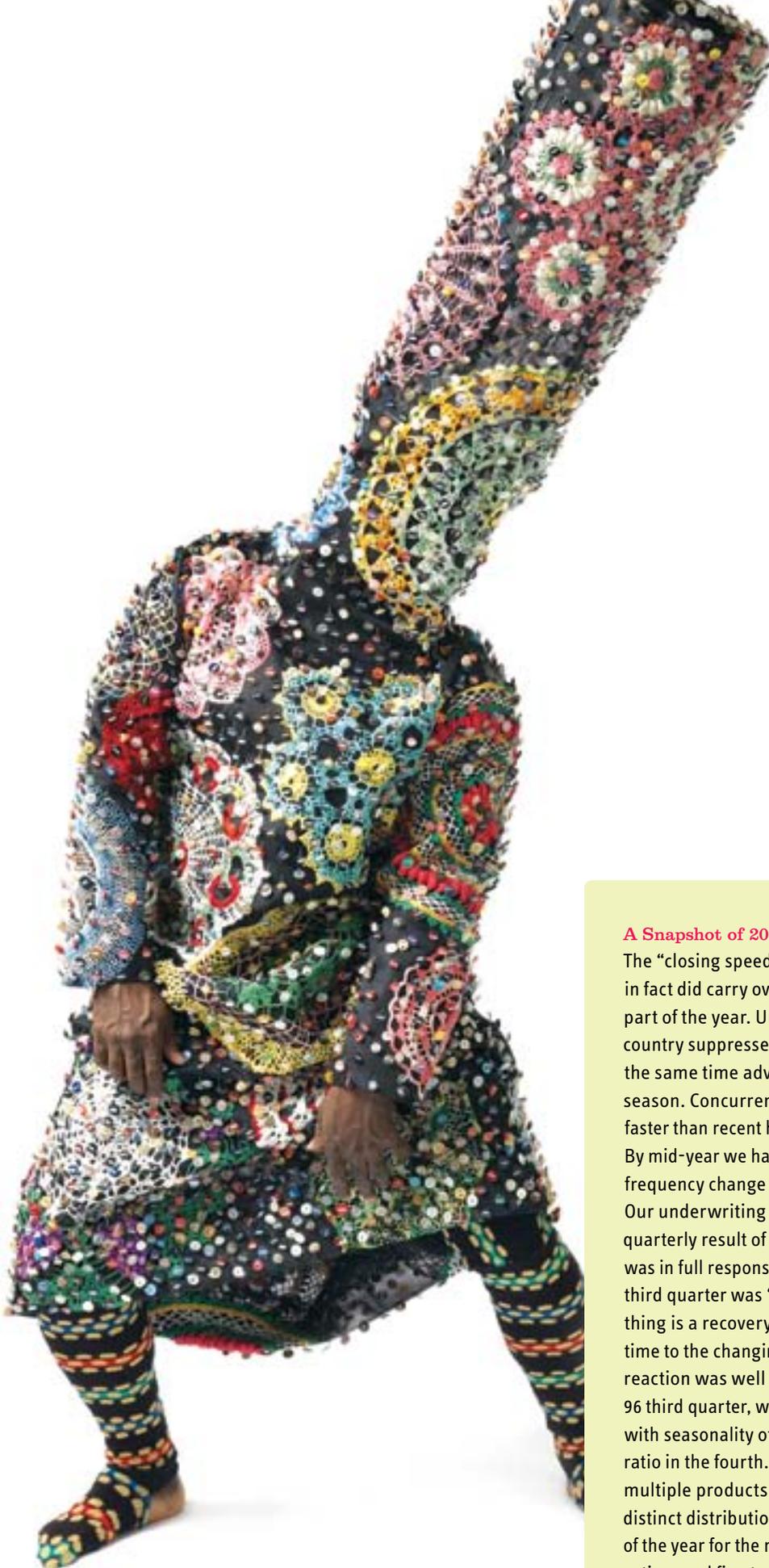
> **Invest in a manner that does not constrain our ability to underwrite all the profitable insurance available to us at an efficient premiums-to-surplus leverage.** We often refer to underwriting capacity as the protected asset and for us it is a clear determination of where the risk of leverage is best allocated. We have every reason to be proud of our investment performance, but relative comparisons often lack similar context or constraints on liquidity and risk.

The importance of net income, earnings per share, and return on equity is never lost on us, but we view achieving strong, long-term performance of these measures as stemming from our consistent focus on the primary elements of our business model.



Figure 1

	1-Year	3-Year	5-Year
<b>Policies in Force</b>			
Personal lines	3.7%	5.2%	4.7%
Commercial auto	2.1%	0.4%	(0.7)%
<b>Policy Life Expectancy</b>			
Personal auto	(0.6)%	2.1%	3.7%
Commercial auto	0.3%	6.3%	10.7%



“Snapshot<sup>®</sup>, our usage-based insurance program, continues to be the most exciting breakthrough in rating in my career and more than deserved the considerable attention devoted to it in this letter last year.”

#### A Snapshot of 2012

The “closing speed” with which I characterized the end of 2011 in fact did carry over into 2012 and volume was strong in the early part of the year. Unseasonably warm weather in much of the country suppressed winter automobile claim frequency, while at the same time advanced the motorcycle riding (and accident) season. Concurrently, we started to see claim severity increase faster than recent history—a combination I labeled as “dangerous.” By mid-year we had our answer and results had shown that the frequency change was not sustained but severity increases were. Our underwriting results had slipped to a “disappointing” quarterly result of 97.6 and thus our rate revision infrastructure was in full response mode. My more encouraging headline for the third quarter was “While better never to fumble, the next best thing is a recovery.” With the benefit of hindsight, our reaction time to the changing environment was too slow. That said, our reaction was well executed, leading to a marginally better than 96 third quarter, which was sustained and improved on, in part with seasonality of special lines products, with a 94.6 combined ratio in the fourth. Any attempt to simplify the combination of multiple products over 51 U.S. regulatory jurisdictions and two distinct distributions, is just that, a simplification, but the flavor of the year for the most part is captured in the fast start, corrective action, and fine tuning game plan outlined above.

Needless to say, momentum in new applications, policy life expectancy, and NPS all paralleled the rating track and often gains from the early part of the year were tempered and/or offset in the latter. We reduced our advertising spend in the second half of the year, ending on a full-year basis, for media and creative development, only slightly ahead of last year. We are more than willing to spend any amount on advertising we feel is supported by our yield expectations, but only when rate level is expected to match our profitability targets. Happily as we end 2012 and enter 2013, we see no reason to adjust our spending based on rate level. We do however appreciate that market competitiveness is a function of the actions of others and our conversion rates are something we watch very closely and, in many cases, we have not yet seen them return to early 2012 levels.

While advertising levels may have been down, we believe the messages were strong.

Snapshot<sup>®</sup>, our usage-based insurance program, continues to be the most exciting breakthrough in rating in my career and more than deserved the considerable attention devoted to it in this letter last year.

The annual premium of customers accepting the Snapshot challenge to improve their insurance rates based on their personal driving signature – something I've characterized as the "statistics of one" – now tops a billion dollars. Every bit as valuable is the data collected that allows for constant refinement and improvement. Last year we commented that our cumulative miles of Snapshot driving experience was equivalent to multiple round trips to Mars; 2012 added a few more.

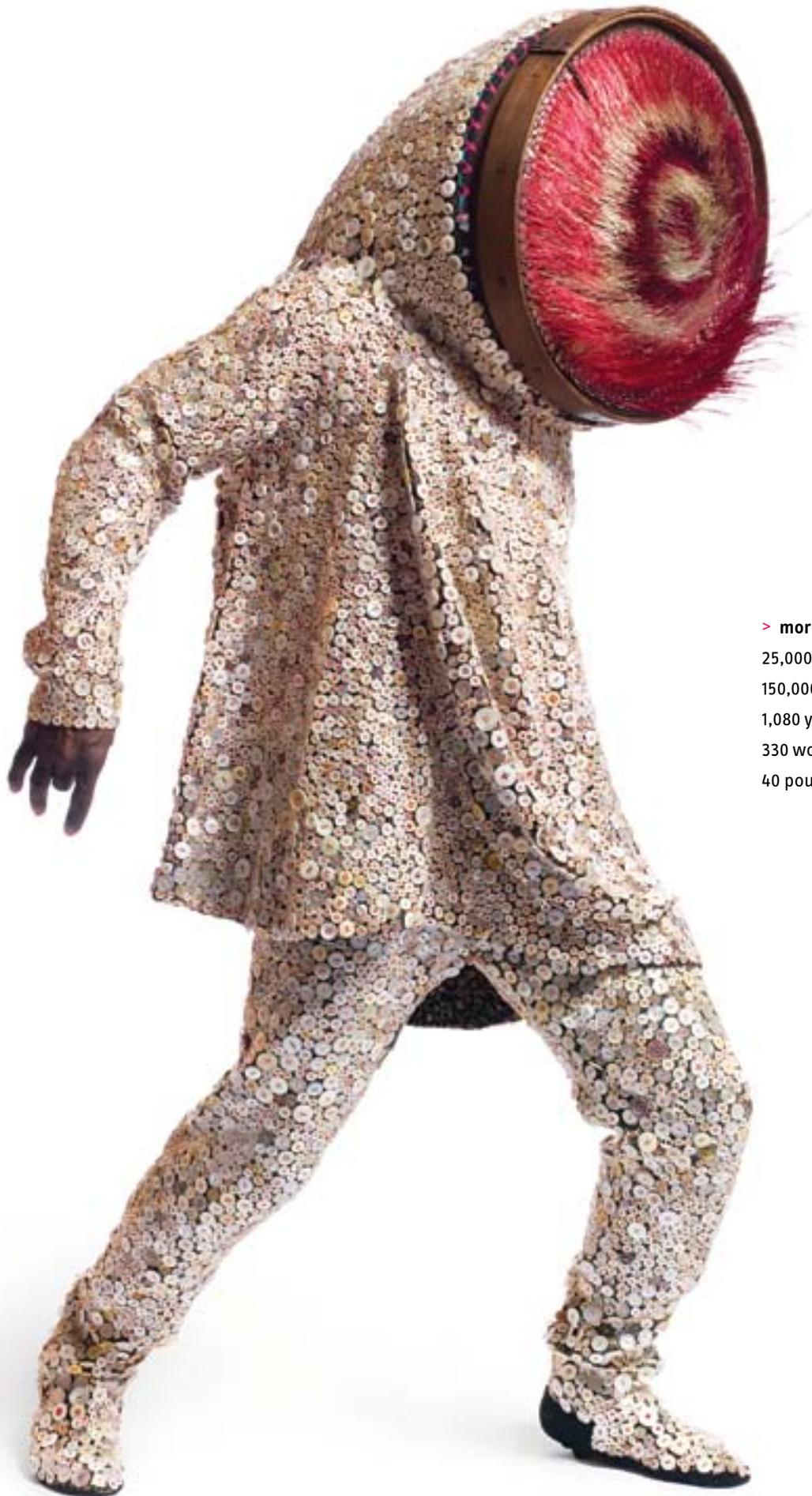
Another year confirmed, in no uncertain terms, that observed and measured driving behavior is an extraordinarily powerful basis for matching a rate with the risk presented. As such, we are way past the concept test. However, fully integrating with our existing product infrastructure, a process more detailed than suited for description in this letter, will be a challenge for some time to come and one we have fully embraced.

An inescapable reality of our business today is the massive amounts of data available for collection and analysis, perhaps highlighted by our Snapshot program but matched on other fronts, such as determining the effectiveness of online advertising served at staggering rates in different combinations on incredibly large numbers of websites. An initiative, which by designation



of our internal funding mechanism gets special oversight (loosely translated that means me), is in place to ensure that our skills and techniques in data acquisition, storage, and analysis are advancing consistent with the emerging science and field of "Big Data" capabilities, thus ensuring our ongoing ability to do what we do best.

2012 saw the awarding of our fourth, fifth, and sixth patents on usage-based insurance and while exclusivity has its place, we see many benefits to ourselves, consumers, and regulators to license our patents in the future to the broader industry for a fee, which we believe should be attractive to both parties. Pleasingly, consumer surveys report a 57% awareness of Snapshot, and an even more pleasing 82% attribution to Progressive. I would generally bet against consumers caring a great deal about insurance rating details, notwithstanding our advertising, but Snapshot seems to resonate with them as simply making sense. If we had any setbacks in 2012 for Snapshot, it would be that our free Snapshot challenge, "Test Drive," where consumers could participate and benefit themselves with the information without changing their current insurance and evaluate their options later, did not meet our expectations. In 2013, we will determine if it was our expectations or our messaging clarity that was off-base. Warning – New Snapshot Marketing Ahead.



> **more than**  
25,000 wires and bugle beads  
150,000 white shell buttons  
1,080 yards of embroidery floss  
330 working hours  
40 pounds

Survival without a smartphone or similar device seems at times a hardship disproportionate to the time we have actually had them. Be that as it may, the breadth of transactions, services, and data retrieval available is only going in one direction. In 2012, we successfully built on our early work on mobile applications and services, overcoming prior limitations such as single vehicle quoting, to make the functionality of mobile devices more closely approximate the desktop capabilities of agents or websites and, where possible, to extend and exceed prior capabilities.

Our agents tested tablet versions of their primary interface with us and while broader use will take time, we, and they, see significant opportunities in the flexibility provided.

More and more of our direct quoting activity was from mobile devices, and now represents a meaningful transfer of what were once web-based transactions. Similarly, self-service and payment transactions have all materially increased year-over-year. In a relatively short time, our focus on mobile has gone from new and high potential to mainstream and we're very pleased with our market positioning, in-place capabilities, and commitment to early development.

“Access to home and renters insurance is essential. Our brand has become compelling enough for our customers, that when their needs change they look to us to fulfill them. A significant percentage of our placed home and renters coverage comes from current relationships.”

Our third notable multi-year initiative is Progressive Home Advantage®. To aspire to policy life expectancies far in excess of our current experience rests in part on having products and services available to meet consumer needs at any stage of their insurable life. Access to home and renters insurance is essential. Our brand has become compelling enough for our customers, that when their needs change they look to us to fulfill them. A significant percentage of our placed home and renters coverage comes from current relationships. Equally, more and more customers are starting their relationship with us with multiple products and the depth of offerings we have available is an important consideration in meeting their needs.

We've been very happy with the options available for those of our customers choosing to deal with us directly, but struggled in the early years of the initiative to find a combination of home insurance to match our auto and special lines products that suited the needs of our agents and their customers. Our relationship with American Strategic Insurance (ASI) and their home insurance offering has gone a long way to resolving that void, and, in 2012, we took a significant step to cement our already strong relationship by acquiring a non-controlling interest in the company. While the investment is important, this is much more a statement of their, and our, commitment to bringing independent agents a well-integrated home and auto offering from providers they respect in their product fields with features only possible in such a relationship. Independent agents over-index in their share of bundled home and auto offerings and it's often the need for that combination of products that influences the consumer to choose an agent. The ASI offering is not available to agents in all states, but that number has been steadily increasing.

The percent of our customers who are multi-product customers today is in the low teens, something we're quite proud of given our starting position, but clearly recognize the potential. Whether those multi-products are some combination of Progressive's auto, commercial auto, motorcycle, RV, or boat, or the home or renters product of a business partner, these are the customers that are viewing Progressive as their insurance destination.

Insurance operations for 2012 were very solid and singling out a couple of highlights leaves many more important contributions unheralded, at least in this letter.

### Claims in the Spotlight

Our claims organization, in addition to responding to catastrophes, continued a long streak of extraordinary results in claim resolution quality and making it even more notable this year they did so notching our lowest ever run rate of loss adjustment expense. While an attractive combination, it would be completely unacceptable if declines in employee or customer satisfaction were the balancing items – and without doubt they were not. Our relentless focus on improving process efficiency and the customer experience is now realizing what is sometimes the illusive IRR of long-term efforts; and we're not done yet. The spotlight has been, in part, directed on the delivery of our concierge level of claims service, at our 54 service centers, to see what stones have been left unturned that might yet take usage, of what all parties agree is our best customer option, to even higher levels. Early work suggests that manageable changes for us to be even more responsive to customer time preferences may move the needle to very exciting levels. More to follow...

Over the next few years, we will provide more of our ever expanding customer population the service center option with the addition of several new facilities, each co-located with full function community claims offices.

### Brand and Marketing

Accepting our role as a participant, it would still have been hard to imagine just a few years ago the ubiquity and awareness auto insurance advertising has achieved. Media and advertising options are ever expanding and often dilutive of the cost effective consumer communication we all seek. Reaching people when and how they want to be reached, and doing so from the wide range of involvement options, is making the allocation of dollars spent a science now highly comparable to our indemnity science of segmentation. This, along with our quantitative research on consumer insights and advertising effectiveness, are welcome extensions of our core skills and we have comfortably leveraged our capabilities into what we believe are high performing results.

Our central campaign, usually set in our insurance superstore, starring "Flo" had a great 2012. We continued challenging the creative boundaries, taking her out-of-store occasionally, searching to find that elusive balance between the benefits of a highly recognizable campaign while keeping content fresh and engaging. Among our many measures, the one suggesting Flo's already strong appeal increased during the year is perhaps the most rewarding to the efforts of so many. She continues to be highly imitated by costumed look-a-likes and this year walked-off with a boatload of recognition awards, including Advertising Age's addition of her to their "Top Ten Female Ad Icons of All Time" – who knew, Flo and Rosie the Riveter together.

Our plans for 2013 are every bit as ambitious and we'll keep pushing the boundaries to ensure our creative efforts maximize every dollar spent and even more importantly communicate a clear consumer mindset about who we are as a company and what you should expect as a customer.



### Investments and Capital Management

Most readers can remember times when a 6.8% total return, for us, nearly \$700 million post tax, on a heavily weighted fixed-income portfolio, would not be particularly notable; in 2012 it deserves that recognition. Very significant appreciation from our holdings of preferred stocks, many of which were the focus of significant mark-to-market reductions in "crisis" years, helped fuel our overall strong fixed-income returns, along with attractive results from our common stocks; a healthy reminder of the value of an investment, capital, and reporting philosophy that focuses on total return over a reasonable time frame and never places us in a position of forced disposition at market lows before the quality we saw in our asset selection can distinguish itself from more global market forces.

Our recurring interest income is frustratingly low at a pretax book yield now just under 3%, but we remain confident that our preference for shorter duration during times of extremely low interest rates is our best positioning to achieve our investment objectives.

During the year, we realized more than \$300 million in gains leaving a little over \$1.3 billion unrealized at year end – a 2012 increase of \$277 million. We publish monthly both net and comprehensive income measures of earnings per share and trailing 12-month return on equity, internally preferring the comprehensive measures as the best all-in assessment, and were pleased with the 23% year-over-year increase in comprehensive EPS to \$1.78 and the comprehensive ROE of 17.4%.

We spend significant time and effort modeling our capital requirements and sizing what we call “layers of capital” to satisfy regulatory requirements and any contingencies we can envision for our business. Capital in excess of these layers is available for share repurchases, acquisitions, and shareholder dividends. For 2012, we had some of each. Reflecting our clear philosophy regarding capital above our needs over a reasonable planning horizon, we returned about \$600 million as a \$1 per share dividend paid in November and further declared a variable dividend in December contingent on final gainshare and underwriting profit numbers for the year that amounted to \$172 million, or just over \$0.28 per share. Our capital actions fell more to dividends in 2012, with share repurchases totaling around \$174 million for 8.6 million shares. Acquisition was a very minor use of capital and represents the purchase of the equity position in ASI referenced earlier.

We enter 2013 with a strong and well-structured capital position, rate levels that we believe are well suited to achieve our underwriting objectives, exceptionally solid insurance operations, and an investment portfolio positioned to support our objectives. An improved investment environment with interest rates that more comfortably match our longer-term income expectations would be perfect, but, by design, in any given period, we are not dependent on it.

“We enter 2013 with a strong and well-structured capital position, rate levels that we believe are well suited to achieve our underwriting objectives, exceptionally solid insurance operations, and an investment portfolio positioned to support our objectives.”

## Our People and Culture

Each year writing this valediction becomes a time of some reflection, and recognition of the complexities of a human system designed to consistently produce extraordinary customer experiences and economic results. Catastrophe response, where I started this letter, is simply one visible part of the iceberg with so much more embedded in the pride and passion of all Progressive people committed to what they are doing and the customers we serve.

It's with this in mind that our first priority must always be to continuously refine our work environment to one where we're all motivated to do our best work, where we can grow constantly, and that others will want to join. Our people, culture, and aspiration to be "Consumers' #1 Choice for Auto Insurance" are what make us – Progressive.

To the people of Progressive, our agents and brokers, customers, and shareholders:

Thanks for all you do to make Progressive, progressive.



Glenn M. Renwick  
President and Chief Executive Officer





> more than  
210 hats and bags  
700 doilies  
60 sequin bags  
120 working hours  
40 pounds



**achieve**

Consistent achievement of superior results requires that our people understand Progressive’s objectives and their specific roles, and that their personal objectives dovetail with Progressive’s. Our objectives are ambitious, yet realistic. Progressive monitors its financial policies continuously and strives to meet these targets annually. Experience always clarifies objectives and illuminates better policies. We constantly evolve as we monitor the execution of our policies and progress toward achieving our objectives.

### Objectives

- > **Profitability** Progressive’s most important goal is for our insurance subsidiaries to produce an aggregate calendar year underwriting profit of at least 4%. Our business is a composite of many product offerings defined in part by product type, distribution channel, geography, customer tenure, and underwriting grouping. Each of these products has targeted operating parameters based on level of maturity, underlying cost structures, customer mix, and policy life expectancy. Our aggregate goal is the balanced blend of these individual performance targets in any calendar year.
- > **Growth** Our goal is to grow as fast as possible, constrained only by our profitability objective and our ability to provide high-quality customer service. Progressive is a growth-oriented company and management incentives are tied to profitable growth.

We report Personal Lines and Commercial Auto results separately. We further break down our Personal Lines’ results by channel (Agency and Direct) to give shareholders a clearer picture of the business dynamics of each distribution method and their respective rates of growth. Aggregate expense ratios and aggregate growth rates disguise the true nature and performance of each business.





## Financial Policies

Progressive balances operating risk with risk of investing and financing activities in order to have sufficient capital to support all the insurance we can profitably underwrite and service. Risks arise in all operational and functional areas, and therefore must be assessed holistically, accounting for the offsetting and compounding effects of the separate sources of risk within Progressive.

We use risk management tools to quantify the amount of capital needed, in addition to surplus, to absorb consequences of events such as unfavorable loss reserve development, litigation, weather-related catastrophes, and investment-market corrections. Our financial policies define our allocation of risk and we measure our performance against them. If, in our view, future opportunities meet our financial objectives and policies, we will invest capital in expanding business operations. Underleveraged capital will be returned to investors. We expect to earn a return on equity greater than its cost. Presented is an overview of Progressive's Operating, Investing, and Financing policies.

## Objectives and Policies Scorecard

Financial Results		Target	> 2012	2011	2010	5 Years <sup>1</sup>	10 Years <sup>1</sup>
Underwriting margin	-Progressive <sup>2</sup>	4%	4.4%	7.0%	7.6%	6.5%	9.1%
	-Industry <sup>3</sup>	na		(1.6)%	(.4)%	(.1)%	1.6%
Net premiums written growth	-Progressive	(a)	8%	5%	3%	4%	6%
	-Industry <sup>3</sup>	na		2%	2%	0%	2%
Policies in force growth	-Personal auto	(a)	4%	5%	8%	5%	6%
	-Special lines	(a)	4%	5%	5%	5%	9%
	-Commercial Auto	(a)	2%	0%	0%	(1)%	6%
Companywide premiums-to-surplus ratio		(b)	2.9	2.9	2.9	na	na
Investment allocation	-Group I	(c)	21%	21%	22%	na	na
	-Group II	(c)	79%	79%	78%	na	na
Debt-to-total capital ratio		<30%	25.6%	29.6%	24.5%	na	na
Return on average shareholders' equity							
	-Net income	(d)	14.5%	16.5%	17.1%	14.1%	19.8%
	-Comprehensive income	(d)	17.4%	15.0%	22.3%	16.1%	21.3%

(a) Grow as fast as possible, constrained only by our profitability objective and our ability to provide high-quality customer service.

(b) Determined separately for each insurance subsidiary.

(c) Allocate portfolio between two groups:

Group I - Target 0% to 25% (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 - Target 75% to 100% (short-term securities and all other fixed-maturity securities)

(d) Progressive does not have a predetermined target for return on average shareholders' equity.

na = not applicable

<sup>1</sup>Represents results over the respective time period; growth represents average annual compounded rate of increase (decrease).

<sup>2</sup>Expressed as a percentage of net premiums earned. Underwriting profit is calculated by subtracting losses and loss adjustment expenses, policy acquisition costs, and other underwriting expenses from the total of net premiums earned and fees and other revenues.

<sup>3</sup>Represents private passenger auto insurance market data as reported by A.M. Best Company, Inc. The industry underwriting margin excludes the effect of policyholder dividends. Final comparable industry data for 2012 will not be available until our third quarter report. The 5- and 10-year growth rates are presented on a one-year lag basis for the industry.

> **Operating**

**Monitor pricing and reserving discipline**

- Manage profitability targets and operational performance at our lowest level of product definition
- Sustain premiums-to-surplus ratios at efficient levels, and at or below applicable state regulations, for each insurance subsidiary
- Ensure loss reserves are adequate and develop with minimal variance

> **Investing**

**Maintain a liquid, diversified, high-quality investment portfolio**

- Manage on a total return basis
- Manage interest rate, credit, prepayment, extension, and concentration risk
- Allocate portfolio between two groups:
  - Group I** – Target 0% to 25% (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** – Target 75% to 100% (short-term securities and all other fixed-maturity securities)

> **Financing**

**Maintain sufficient capital to support insurance operations**

- Maintain debt below 30% of total capital at book value
- Neutralize dilution from equity-based compensation in the year of issuance through share repurchases
- Return underleveraged capital through share repurchases, special dividends, and a variable dividend program based on annual underwriting results



**Achievements**

We are convinced that the best way to maximize shareholder value is to achieve these financial objectives and policies consistently. A shareholder who purchased 100 shares of Progressive for \$1,800 in our first public stock offering on April 15, 1971, owned 92,264 shares on December 31, 2012, with a market value of \$1,946,770, for an 18.9% compounded annual return, compared to the 6.6% return achieved by investors in the Standard & Poor's 500 during the same period. In addition, the shareholder received dividends of \$129,834 in 2012, bringing their total dividends received to \$508,990 since the shares were purchased.

In the ten years since December 31, 2002, Progressive shareholders have realized compounded annual returns, including dividend reinvestment, of 8.1%, compared to 7.1% for the S&P 500. In the

five years since December 31, 2007, Progressive shareholders' returns were 5.1%, compared to 1.7% for the S&P 500. In 2012, the returns were 15.4% on Progressive shares and 15.9% for the S&P 500.

Over the years, when we have had adequate capital and believed it to be appropriate, we have repurchased our shares. In addition, as our Financial Policies state, we will repurchase shares to neutralize the dilution from equity-based compensation programs and return any underleveraged capital to investors. During 2012, we repurchased 8,597,918 common shares. The total cost to repurchase these shares was \$174 million, with an average cost of \$20.26 per share. Since 1971, we have spent \$7.9 billion repurchasing our shares, at an average cost of \$6.79 per share.



### Operations Summary

> **Personal Lines** Managing to our 96 calendar year combined ratio target was more than the normal challenge for the Personal Lines group during 2012. Within our auto programs, severity of claims payments rose faster than anticipated and prior year reserve development was modestly adverse, compared to favorable development in the past few years. Our special lines programs, led by motorcycle, saw the frequency of claims jump markedly due to an early and relatively dry summer. Additionally, we experienced our second worst catastrophe ever with Superstorm Sandy incurring approximately \$100 million of losses companywide. Due in large part to mid-year actions to raise prices approximately 6%, our combined ratio of 95.6 surpassed our calendar year 96 target by 0.4 points; accident year results matched the calendar year results.

Unfortunately, but as expected, the mid-year price increases took a toll on new business production as well as customer retention. Policy growth for the year was 4%, yielding approximately 12.7 million policies in force at year end. While somewhat adverse to customer volume, our price increases helped us write over \$1 billion more in premiums in 2012 than in 2011, an increase of 8%. Auto written premium per policy was up 3% for the year. New auto business applications, however, were down 1% and up nearly 1% in our special lines programs. Retention of customers, as reflected by policy life expectancy, was down less than 1% in our auto programs and essentially flat in special lines.

We continued to improve our cost structure in 2012. Our underwriting expense ratios improved in-part due to the higher average prices, but also due to efforts to decrease the work per policy in force, a longer sustaining structural gain. We also continued to reduce low value added costs. As an example, more than half of our auto customers now receive policy correspondence from us via electronic means, avoiding significant paper, processing, and mail costs. Progress on our core policy servicing system redesign advanced during the year, and we now have about 15% of our auto customer policies migrated to the new system.

Heading into 2012, we set out to attain leadership in the highly dynamic mobile sales and service space in our industry and we feel we achieved that goal. We elevated the capability for households with multiple drivers and vehicles to quote and buy via mobile devices in around 90% of the country, and consumer response exceeded our expectations. In 36 states and the District of Columbia, we added an innovation in the quote flow that allows consumers to snap a picture of a driver license and insurance ID card and avoid manually entering most of the required data fields. We also added the highly successful competitor comparison rate experience to our mobile offering in most of the country. We will continue to invest heavily in mobile sales and servicing capabilities as agent and consumer preferences shift rapidly in this direction.

During the year, annualized premiums written within our Snapshot® usage-based rating programs surpassed \$1 billion. Our lead within the industry in usage-based insurance rating is significant in terms of experience, scale, and consumer awareness. We extended our patent coverage here as well, with three additional U.S. patents granted since the beginning of the year to bring our total to six. While our introduction of the ability to “test drive” Snapshot before buying a Progressive policy met with less demand than expected, the customers that do try and buy are proving to be very much the customers we seek in this unique approach. We expect to revise our marketing approach for this offering as the consumer proposition and economics are compelling. Our usage-based offerings continue to help us grow in the near term and establish frameworks for dramatically different approaches to matching risk to price in our industry going forward.

We continue to see huge growth potential amongst consumers that bundle their home and auto insurance and made meaningful progress during the year with our Progressive Home Advantage® program. The number of households that maintain more than one product through Progressive grew by 13% in 2012. We now work with a number of different property providers and offer the Home Advantage option through our agents in 22 states, plus

D.C., and in 48 states, plus D.C., online, via phone sales at the Home Advantage underwriter, or via phone sales within Progressive call centers. In short, we want to meet customer bundling needs where, when, and how they would like to interact with us.

Remaining at the forefront of our industry in terms of innovative approaches to pricing, distribution, and the consumer experience is at the core of our foundation. Beyond usage-based rating enhancements, we continued to roll out improvements in our auto programs including occupation rating, household rating structures, and refinements in segmentation of non-indemnity costs. In our special lines programs, we added further segmentation around operating experience of special lines vehicles. Optional coverages tailored to the unique needs of special lines customers were also added, such as Propulsion Plus® in our boat programs, which covers mechanical damage to lower units and outdrives. We continued to enhance our desktop auto online quoting system with a Coverage Checker solution that allows consumers to know that they're not just getting a great price, but also makes sure they're still getting the coverage they need. Our agent quoting and marketing offerings continue to lead the industry and we implemented recent enhancements that make it easier for our agents to optimize conversion of prospective consumers, cross-sell current customers, and re-solicit unsold prospects.

In 2013, we will work to advance our Snapshot and mobile offerings and ensure more customers can enjoy multiple products through Progressive. Our auto and special lines programs will retain what we believe are the broadest acceptability guidelines in the industry and, at the same time, strive to be appropriately selective with shoppers and customers to ensure that we are adequately priced for all. These approaches will, we believe, both fuel new customer growth and increase the likelihood of our current customers remaining with us.

> **Commercial Auto** Progressive's Commercial Auto business outperformed the industry in 2012 and made substantive progress penetrating business market targets and selectively broadening our market scope. The positive industry growth trends, which emerged in the latter part of 2011, carried over into 2012 and we were beneficiaries of those trends. Top line growth was strong, with net premiums written increasing 13% over 2011. This compares favorably to commercial auto industry growth, which we estimate will be in the 4% to 5% range when final results are tabulated. Our combined ratio for 2012 was 94.8, representing a deterioration of 3.9 points from 90.9 for the prior year. We believe this combined ratio result will, however, be materially better than final industry results, perhaps by 8 points or more. The relative performance advantage was nice to see and reaffirmed the merit of being disciplined in the pursuit of a defined and consistent underwriting profit target over time and across a range of market conditions. Nonetheless, we fell a bit short of our own expectations and entered 2013 with renewed ambition to do even better.

Commercial Auto premium growth resulted from a 2% increase in policies in force and a double digit increase in written premium per policy. The increase in written premium per policy reflects the cumulative effect of 88 state level rate revisions executed throughout the year, along with a planned shift in the mix of business toward higher average premium states and business types. The market was generally accepting of the necessary price increases and our policy retention held steady throughout the year, somewhat indicative of overall industrywide strengthening of commercial auto pricing. The industrywide price strengthening was a welcome development and not surprising given the industry's current underwriting results. We did, however, experience declines in new prospect sales conversion consistent with our rate actions in a market that remains competitive with ample capacity. We continue to develop new and creative ways to grow our Commercial Auto business, in balance with our profit targets.

Much attention was focused on our for-hire transportation business market target to ensure this important customer group meets our profit expectations. We have invested heavily in developing this market, securing the position of America's number one insurer of non-fleet trucks. In 2012, the for-hire transportation market saw increases in accident frequency, collision severity, and stronger policy growth in some higher severity states, which collectively challenged our profit targets. We addressed this through targeted rate increases, tighter underwriting filters, and more robust premium auditing on both new and renewal policies. Over the course of the year, we gained greater confidence in both our pricing and business model for this owner/operator-oriented market and identified additional opportunities to solidify the integrity of our underwriting.

Two other core business market targets, contractors and business auto, performed well in 2012, with policies in force growth of 2% and 1%, respectively, and gains in net premiums written of 7% and 6%. Profitability for both was in line with our targets and we are well positioned to benefit from growth opportunities if competitors



take actions consistent with underlying industry results. While economic growth remained tepid, signs of a housing recovery began to emerge late in the year and we saw a corresponding increase in our flow of contractor prospects. Our towing business market target benefited from a stronger pricing environment yielding 11% net premiums written growth, while achieving its underwriting profit target.

Investment in direct distribution of Commercial Auto continued in 2012. Growth in prospects was realized with increased calls to our sales center in the second half of 2012 and a very significant increase in visits to ProgressiveCommercial.com. Buoyed by prior years' success in growing the direct business through highly targeted small business and trucking advertising efforts, we expanded our direct marketing to include broad market advertising. The first Progressive television ad wholly dedicated to small business Commercial Auto was developed and began airing in the second quarter, supported by a coordinated print and radio campaign. Progressive already enjoys strong consumer awareness as a



commercial auto insurer. We want to build on that and create a stronger call to action for small business owners who are assessing their insurance options. The campaign will again be featured in advance of the 2013 peak insurance shopping season. To support our direct customers, several projects were initiated to enhance, as well as introduce, new online and mobile services. Mobile device optimization of ProgressiveCommercial.com and the online quoting application was deployed during the year allowing small business customers who are often on the go to easily interact with us.

We continue to deepen our understanding and focus our resources on key Commercial Auto customer markets that share common characteristics and are generally subject to a similar set of economic and market forces. We see many benefits to this approach that go beyond assessing near-term market opportunities and aligning marketing and sales resources accordingly. Business market targeting provides better understanding of loss costs, claims development patterns, and changes in exposure. We have aligned

many of our claims, actuarial, and product management processes around this concept in order to achieve advancements in pricing accuracy, segmentation, and loss cost management. The results have been encouraging and there is opportunity to do much more.

We have also begun to identify meaningful differences in customer requirements for product design, customer service, customer communication, and distribution. With that understanding, we have begun to more closely align our service organization and research and development group around the same business market targets. Fully operationalizing the concept will be a 2013 priority. A good example of the results we believe are possible is the dedicated route driver program we rolled out in 2012 with a customized solution for these small business owner/operators that purchase and deliver branded products over defined delivery routes. These vehicle-centric businesses are a great fit for Progressive, and we look forward to developing the business model further in 2013.

## Operating Results

### Personal Lines

	> 2012	2011	Change
Net premiums written (in billions)	\$ 14.6	\$ 13.6	8%
Net premiums earned (in billions)	\$ 14.4	\$ 13.4	7%
Loss and loss adjustment expense ratio	74.8	71.6	3.2 pts.
Underwriting expense ratio	20.8	21.6	(.8) pts.
Combined ratio	95.6	93.2	2.4 pts.
Policies in force (in thousands)	12,735.3	12,283.8	4%

### Commercial Auto

Net premiums written (in billions)	\$ 1.7	\$ 1.5	13%
Net premiums earned (in billions)	\$ 1.6	\$ 1.5	12%
Loss and loss adjustment expense ratio	72.6	68.9	3.7 pts.
Underwriting expense ratio	22.2	22.0	.2 pts.
Combined ratio	94.8	90.9	3.9 pts.
Policies in force (in thousands)	519.6	509.1	2%



**report**



**Basis of Presentation:** The accompanying consolidated financial statements include the accounts of The Progressive Corporation, its subsidiaries, and affiliates. These financial statements should be read in conjunction with the complete Consolidated Financial Statements, including the complete Notes to the Consolidated Financial Statements, as well as Management’s Discussion and Analysis of Financial Condition and Results of Operations and Supplemental Information, which are included in Progressive’s 2012 Annual Report to Shareholders, which is attached as an Appendix to Progressive’s 2013 Proxy Statement.

**Internal Control Over Financial Reporting**

Progressive’s management is responsible for establishing and maintaining adequate internal control over financial reporting. Based on Progressive’s evaluation under the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), management concluded that Progressive’s internal control over financial reporting was effective as of December 31, 2012. The complete “Management’s Report on Internal Control over Financial Reporting,” as required by Section 404 of The Sarbanes-Oxley Act of 2002 and applicable SEC regulations, along with the related report of PricewaterhouseCoopers LLP, is presented in the 2012 Annual Report to Shareholders, which is attached as an Appendix to Progressive’s 2013 Proxy Statement.

**CEO and CFO Certifications**

Glenn M. Renwick, President and Chief Executive Officer of The Progressive Corporation, and Brian C. Domeck, Vice President and Chief Financial Officer of The Progressive Corporation, have issued the certifications required by Sections 302 and 906 of The Sarbanes-Oxley Act of 2002 and applicable SEC regulations with respect to Progressive’s 2012 Annual Report on Form 10-K, including the financial statements provided in this Report and in the 2012 Annual Report to Shareholders, which is attached as an Appendix to Progressive’s 2013 Proxy Statement. Among other matters required to be included in those certifications, Mr. Renwick and Mr. Domeck have each certified that, to the best of his knowledge, the financial statements, and other financial information included in the Annual Report on Form 10-K, fairly present in all material respects the financial condition, results of operations, and cash flows of Progressive as of, and for, the periods presented. See Exhibits 31 and 32 to Progressive’s Annual Report on Form 10-K for the complete Section 302 and 906 Certifications, respectively.

## Consolidated Statements of Comprehensive Income

(millions – except per share amounts)

For the years ended December 31,

> 2012

2011

2010

### Revenues

Net premiums earned	\$ 16,018.0	\$ 14,902.8	\$ 14,314.8
Investment income	443.0	480.0	520.1
Net realized gains (losses) on securities:			
Other-than-temporary impairment (OTTI) losses:			
Total OTTI losses	(7.3)	(6.0)	(19.1)
Non-credit losses, net of credit losses recognized on previously recorded non-credit OTTI losses	(.7)	.5	5.2
Net impairment losses recognized in earnings	(8.0)	(5.5)	(13.9)
Net realized gains (losses) on securities	314.8	108.1	110.0
Total net realized gains (losses) on securities	306.8	102.6	96.1
Fees and other revenues	281.8	266.5	252.2
Service revenues	36.1	22.8	25.9
Gains (losses) on extinguishment of debt	(1.8)	(.1)	6.4
Total revenues	17,083.9	15,774.6	15,215.5

### Expenses

Losses and loss adjustment expenses	11,948.0	10,634.8	10,131.3
Policy acquisition costs	1,436.6	1,399.2	1,359.9
Other underwriting expenses	2,206.3	2,088.0	1,992.3
Investment expenses	15.4	13.5	11.9
Service expenses	36.1	19.4	21.4
Interest expense	123.8	132.7	133.5
Total expenses	15,766.2	14,287.6	13,650.3

### Net Income

Income before income taxes	1,317.7	1,487.0	1,565.2
Provision for income taxes	415.4	471.5	496.9
Net income	902.3	1,015.5	1,068.3

### Other Comprehensive Income (Loss), Net of Tax

Net unrealized gains (losses) on securities:			
Net non-credit related OTTI losses, adjusted for valuation changes	5.1	(3.6)	13.9
Other net unrealized gains (losses) on securities	174.8	(80.9)	323.2
Total net unrealized gains (losses) on securities	179.9	(84.5)	337.1
Net unrealized gains on forecasted transactions	(1.8)	(6.8)	(6.9)
Foreign currency translation adjustment	.4	.1	.3
Other comprehensive income (loss)	178.5	(91.2)	330.5
Comprehensive income	\$ 1,080.8	\$ 924.3	\$ 1,398.8

### Computation of Net Income Per Share

Average shares outstanding–Basic	603.3	632.3	657.9
Net effect of dilutive stock-based compensation	4.5	4.6	5.4
Total equivalent shares–Diluted	607.8	636.9	663.3
Basic: Net income per share	\$ 1.50	\$ 1.61	\$ 1.62
Diluted: Net income per share	\$ 1.48	\$ 1.59	\$ 1.61

Notes to the Consolidated Financial Statements are included in Progressive's 2012 Annual Report to Shareholders, which is attached as an Appendix to Progressive's 2013 Proxy Statement.

(millions)

December 31,	> 2012	2011
<b>Assets</b>		
Investments—Available-for-sale, at fair value:		
Fixed maturities (amortized cost: \$11,373.9 and \$11,455.7)	\$ 11,774.1	\$ 11,759.3
Equity securities:		
Nonredeemable preferred stocks (cost: \$404.0 and \$473.7)	812.4	806.3
Common equities (cost: \$1,370.3 and \$1,431.0)	1,899.0	1,845.6
Short-term investments (amortized cost: \$1,990.0 and \$1,551.8)	1,990.0	1,551.8
Total investments	16,475.5	15,963.0
Cash	179.1	155.7
Accrued investment income	90.0	105.7
Premiums receivable, net of allowance for doubtful accounts of \$138.6 and \$124.2	3,183.7	2,929.8
Reinsurance recoverables, including \$38.9 and \$32.3 on paid losses and loss adjustment expenses	901.0	818.0
Prepaid reinsurance premiums	66.3	69.8
Deferred acquisition costs	434.5	433.6
Net deferred income taxes	109.4	196.0
Property and equipment, net of accumulated depreciation of \$625.0 and \$573.8	933.7	911.3
Other assets	321.5	261.9
Total assets	<u>\$ 22,694.7</u>	<u>\$ 21,844.8</u>
<b>Liabilities and Shareholders' Equity</b>		
Unearned premiums	\$ 4,930.7	\$ 4,579.4
Loss and loss adjustment expense reserves	7,838.4	7,245.8
Accounts payable, accrued expenses, and other liabilities <sup>1</sup>	1,855.5	1,770.8
Debt <sup>2</sup>	2,063.1	2,442.1
Total liabilities	16,687.7	16,038.1
Common Shares, \$1.00 par value (authorized 900.0; issued 797.7, including treasury shares of 193.1 and 184.7)	604.6	613.0
Paid-in capital	1,077.0	1,006.2
Retained earnings	3,454.4	3,495.0
Accumulated other comprehensive income, net of tax:		
Net non-credit related OTTI losses, adjusted for valuation changes	(.3)	(5.4)
Other net unrealized gains (losses) on securities	863.0	688.2
Total net unrealized gains (losses) on securities	862.7	682.8
Net unrealized gains on forecasted transactions	6.1	7.9
Foreign currency translation adjustment	2.2	1.8
Total accumulated other comprehensive income	871.0	692.5
Total shareholders' equity	6,007.0	5,806.7
Total liabilities and shareholders' equity	<u>\$ 22,694.7</u>	<u>\$ 21,844.8</u>

<sup>1</sup>See Note 12—Litigation and Note 13—Commitments and Contingencies for further discussion.

<sup>2</sup>Consists of both short- and long-term debt. See Note 4—Debt for further discussion.

Notes to the Consolidated Financial Statements are included in Progressive's 2012 Annual Report to Shareholders, which is attached as an Appendix to Progressive's 2013 Proxy Statement.

## Consolidated Statements of Changes in Shareholders' Equity

(millions – except per share amounts)

For the years ended December 31,

> 2012

2011

2010

### Common Shares, \$1.00 par value

Balance, Beginning of year	\$ 613.0	\$ 662.4	\$ 672.6
Stock options exercised	.1	2.0	3.4
Treasury shares purchased	(8.6)	(51.3)	(13.3)
Net restricted equity awards issued (forfeited)	.1	(.1)	(.3)
Balance, End of year	\$ 604.6	\$ 613.0	\$ 662.4

### Paid-In Capital

Balance, Beginning of year	\$ 1,006.2	\$ 1,007.1	\$ 939.7
Stock options exercised	.4	20.4	23.8
Tax benefit from exercise/vesting of equity-based compensation	5.8	6.4	14.0
Treasury shares purchased	(14.5)	(80.7)	(19.3)
Net restricted equity awards (issued) forfeited	(.1)	.1	.3
Amortization of equity-based compensation	62.4	50.3	44.8
Reinvested dividends on restricted stock units	11.2	2.6	3.8
Other	5.6	0	0
Balance, End of year	\$ 1,077.0	\$ 1,006.2	\$ 1,007.1

### Retained Earnings

Balance, Beginning of year	\$ 3,495.0	\$ 3,595.7	\$ 3,683.1
Net income	902.3	1,015.5	1,068.3
Treasury shares purchased	(151.1)	(865.8)	(226.0)
Cash dividends declared on common shares (\$1.2845, \$4.072, and \$1.3987 per share)	(772.5)	(248.1)	(924.8)
Reinvested dividends on restricted stock units	(11.2)	(2.6)	(3.8)
Other, net	(8.1)	.3	(1.1)
Balance, End of year	\$ 3,454.4	\$ 3,495.0	\$ 3,595.7

### Accumulated Other Comprehensive Income, Net of Tax

Balance, Beginning of year	\$ 692.5	\$ 783.7	\$ 453.2
Other comprehensive income (loss)	178.5	(91.2)	330.5
Balance, End of year	\$ 871.0	\$ 692.5	\$ 783.7
Total Shareholders' Equity	\$ 6,007.0	\$ 5,806.7	\$ 6,048.9

There are 20.0 million Serial Preferred Shares authorized; no such shares are issued or outstanding.

There are 5.0 million Voting Preference Shares authorized; no such shares have been issued.

Notes to the Consolidated Financial Statements are included in Progressive's 2012 Annual Report to Shareholders, which is attached as an Appendix to Progressive's 2013 Proxy Statement.

## Consolidated Statements of Cash Flows

(millions)

For the years ended December 31,

	> 2012	2011	2010
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 902.3	\$ 1,015.5	\$ 1,068.3
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	94.4	88.5	83.1
Amortization of fixed-income securities	186.7	233.0	229.2
Amortization of equity-based compensation	63.4	50.5	45.9
Net realized (gains) losses on securities	(306.8)	(102.6)	(96.1)
Net (gains) losses on disposition of property and equipment	7.1	8.7	2.3
(Gains) losses on extinguishment of debt	1.8	.1	(6.4)
Changes in:			
Premiums receivable	(253.8)	(191.4)	(283.6)
Reinsurance recoverables	(83.0)	(76.5)	(176.7)
Prepaid reinsurance premiums	3.5	18.3	(18.8)
Deferred acquisition costs	(.9)	(16.4)	(15.0)
Income taxes	19.8	28.4	48.1
Unearned premiums	351.1	225.6	180.8
Loss and loss adjustment expense reserves	592.6	174.8	418.0
Accounts payable, accrued expenses, and other liabilities	123.6	35.5	210.2
Other, net	(10.4)	5.9	(10.0)
Net cash provided by operating activities	1,691.4	1,497.9	1,679.3
<b>Cash Flows from Investing Activities</b>			
Purchases:			
Fixed maturities	(5,199.2)	(6,032.4)	(4,491.7)
Equity securities	(463.1)	(582.0)	(511.4)
Sales:			
Fixed maturities	3,705.6	4,442.6	3,055.8
Equity securities	793.0	423.5	241.9
Maturities, paydowns, calls, and other:			
Fixed maturities	1,488.9	1,540.9	1,341.1
Equity securities	16.0	0	0
Net purchases of short-term investments – other	(438.2)	(461.0)	(11.5)
Net unsettled security transactions	(44.0)	(.6)	(54.0)
Purchases of property and equipment	(127.7)	(78.9)	(64.7)
Sales of property and equipment	3.8	3.0	8.0
Net cash used in investing activities	(264.9)	(744.9)	(486.5)
<b>Cash Flows from Financing Activities</b>			
Proceeds from exercise of stock options	.5	22.4	27.2
Tax benefit from exercise/vesting of equity-based compensation	5.8	6.4	14.0
Net proceeds from debt issuance	0	491.9	0
Payment of debt	(350.0)	0	0
Reacquisition of debt	(32.5)	(15.0)	(214.3)
Dividends paid to shareholders	(853.7)	(263.6)	(763.7)
Acquisition of treasury shares	(174.2)	(997.8)	(258.6)
Net cash used in financing activities	(1,404.1)	(755.7)	(1,195.4)
Effect of exchange rate changes on cash	1.0	(.5)	.8
Increase (decrease) in cash	23.4	(3.2)	(1.8)
Cash, Beginning of year	155.7	158.9	160.7
Cash, End of year	\$ 179.1	\$ 155.7	\$ 158.9

Notes to the Consolidated Financial Statements are included in Progressive's 2012 Annual Report to Shareholders, which is attached as an Appendix to Progressive's 2013 Proxy Statement.

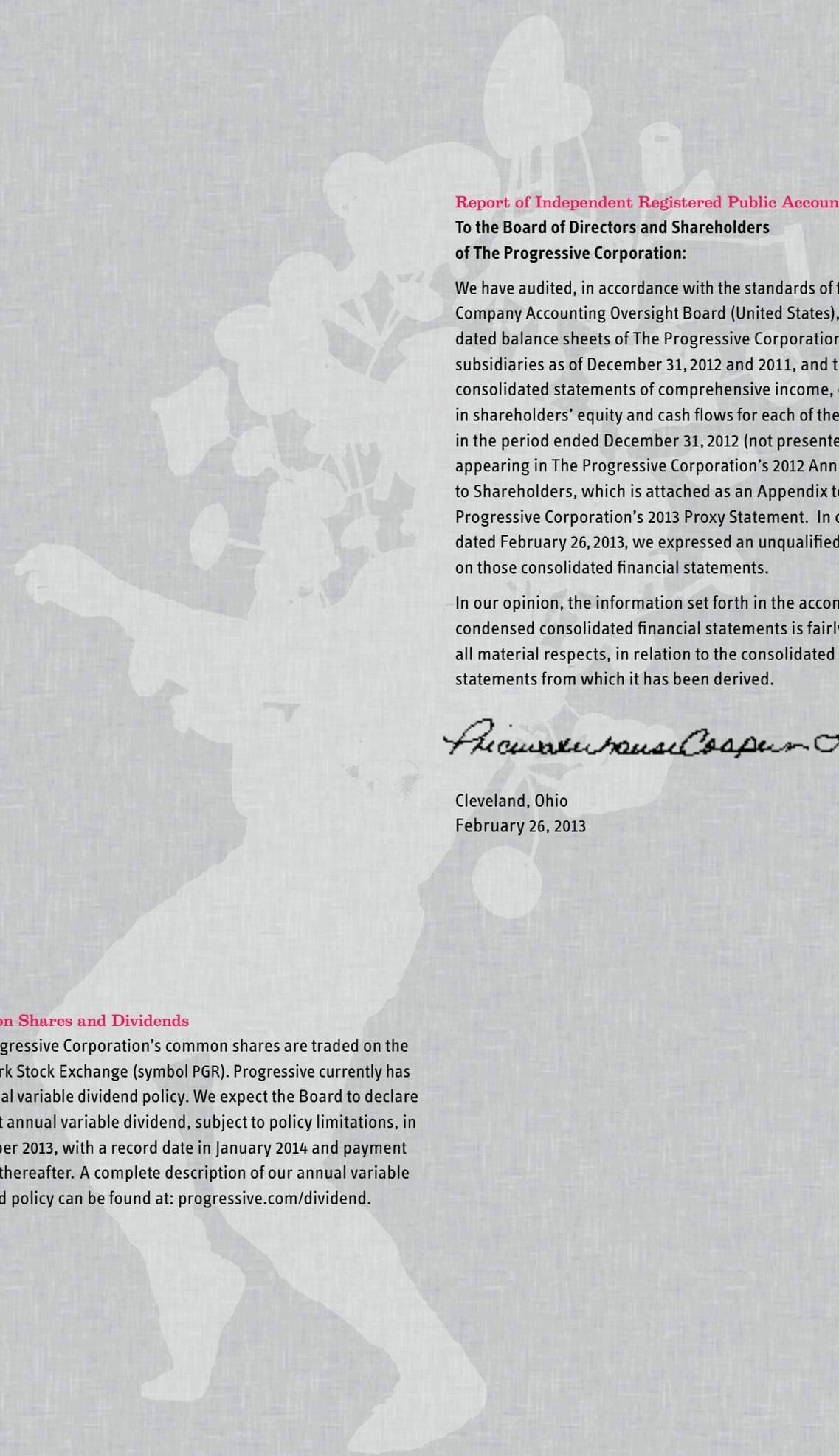
**Safe Harbor Statement Under the Private Securities**

**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; the outcome of disputes relating to intellectual property rights; the outcome of litigation or governmental investigations that may be pending or 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, and safeguard personal and sensitive information in our possession; 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.

Quarter	Stock Price			Rate of Return	Dividends Declared per Share
	High	Low	Close		
<b>&gt; 2012</b>					
1	\$ 23.37	\$ 19.01	\$ 23.18		\$ 0
2	23.41	20.22	20.83		0
3	21.28	19.17	20.74		0
4	23.19	20.68	21.10		1.2845
	\$ 23.41	\$ 19.01	\$ 21.10	15.4%	\$ 1.2845
<b>2011</b>					
1	\$ 21.24	\$ 19.12	\$ 21.13		\$ 0
2	22.08	19.79	21.38		0
3	21.66	16.88	17.76		0
4	19.74	16.97	19.51		.4072
	\$ 22.08	\$ 16.88	\$ 19.51	.2%	\$ .4072



**Report of Independent Registered Public Accounting Firm  
To the Board of Directors and Shareholders  
of The Progressive Corporation:**

We have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of The Progressive Corporation and its subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2012 (not presented herein) appearing in The Progressive Corporation's 2012 Annual Report to Shareholders, which is attached as an Appendix to The Progressive Corporation's 2013 Proxy Statement. In our report dated February 26, 2013, we expressed an unqualified opinion on those consolidated financial statements.

In our opinion, the information set forth in the accompanying condensed consolidated financial statements is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

*PricewaterhouseCoopers LLP*

Cleveland, Ohio  
February 26, 2013

**Common Shares and Dividends**

The Progressive Corporation's common shares are traded on the New York Stock Exchange (symbol PGR). Progressive currently has an annual variable dividend policy. We expect the Board to declare the next annual variable dividend, subject to policy limitations, in December 2013, with a record date in January 2014 and payment shortly thereafter. A complete description of our annual variable dividend policy can be found at: [progressive.com/dividend](http://progressive.com/dividend).

**Principal Office**

The Progressive Corporation  
6300 Wilson Mills Road, Mayfield Village, Ohio 44143  
440-461-5000  
progressive.com

**Annual Meeting** The Annual Meeting of Shareholders will be held at the offices of The Progressive Corporation, 6671 Beta Drive, Mayfield Village, Ohio 44143 on May 16, 2013, at 10 a.m. eastern time. There were 3,114 shareholders of record on December 31, 2012.

**Shareholder/Investor Relations** Progressive does not maintain a mailing list for distribution of shareholders' reports. To view Progressive's publicly filed documents, shareholders can access our website: [progressive.com/sec](http://progressive.com/sec). To view our earnings and other releases, access [progressive.com/investors](http://progressive.com/investors).

For financial-related information or to request copies of Progressive's publicly filed documents free of charge, write to: The Progressive Corporation, Investor Relations, 6300 Wilson Mills Road, Box W33, Mayfield Village, Ohio 44143, email: [investor\\_relations@progressive.com](mailto:investor_relations@progressive.com) or call: 440-395-2222.

For all other company information, call: 440-461-5000 or access our website at [progressive.com/contactus](http://progressive.com/contactus).

**Corporate Governance** Progressive's Corporate Governance Guidelines and Board Committee Charters are available at: [progressive.com/governance](http://progressive.com/governance).

**Charitable Contributions** Progressive contributes annually to The Progressive Insurance Foundation, which provides: (i) financial support to the Insurance Institute for Highway Safety to further its work in reducing the human trauma and economic costs of auto accidents; and (ii) matching funds to eligible 501(c)(3) charitable organizations to which Progressive employees contribute.

**Social Responsibility** Progressive uses an interactive online format to communicate our social responsibility efforts. This report can be found at: [progressive.com/socialresponsibility](http://progressive.com/socialresponsibility).

**Registered Trademark** Net Promoter® is a registered trademark of Satmetrix Systems, Inc.

**Online Annual Report and Proxy Statement** Our 2012 Annual Report to Shareholders can be found at: [progressive.com/annualreport](http://progressive.com/annualreport).

We have also posted copies of our 2013 Proxy Statement and 2012 Annual Report to Shareholders, in a "PDF" format, at: [progressiveproxy.com](http://progressiveproxy.com).

**Transfer Agent and Registrar**

**Registered Shareholders:** If you have questions or changes to your account and your Progressive shares are registered in your name, write to: American Stock Transfer & Trust Company, Attn: Operations Center, 6201 15th Avenue, Brooklyn, NY 11219; phone: 1-866-709-7695; email: [info@amstock.com](mailto:info@amstock.com); or visit their website at: [www.amstock.com](http://www.amstock.com).

**Beneficial Shareholders:** If your Progressive shares are held in a brokerage or other financial institution account, contact your broker or financial institution directly regarding questions or changes to your account.

**Counsel** Baker & Hostetler LLP, Cleveland, Ohio

**Contact Non-Management Directors** Interested parties have the ability to contact the non-management directors as a group by sending a written communication clearly addressed to the non-management directors to either of the following:

Peter B. Lewis, Chairman of the Board, The Progressive Corporation, 6300 Wilson Mills Road, Mayfield Village, Ohio 44143 or email: [peter\\_lewis@progressive.com](mailto:peter_lewis@progressive.com).

Charles E. Jarrett, Secretary, The Progressive Corporation, 6300 Wilson Mills Road, Mayfield Village, Ohio 44143 or email: [chuck\\_jarrett@progressive.com](mailto:chuck_jarrett@progressive.com).

The recipient will forward communications so received to the non-management directors.

**Accounting Complaint Procedure** Any employee or other interested party with a complaint or concern regarding accounting, internal accounting controls, or auditing matters relating to Progressive may report such complaint or concern directly to the Chairman of the Audit Committee, as follows: Patrick H. Nettles, Ph.D., Chairman of the Audit Committee, [patrick\\_nettnles@progressive.com](mailto:patrick_nettnles@progressive.com).

Any such complaint or concern also may be reported anonymously over the following toll-free Alert Line: 1-800-683-3604 or online at [www.progressivealertline.com](http://www.progressivealertline.com). Progressive will not retaliate against any individual by reason of his or her having made such a complaint or reported such a concern in good faith. View the complete procedures at [progressive.com/governance](http://progressive.com/governance).

**Whistleblower Protections** Progressive will not retaliate against any officer or employee of Progressive because of any lawful act done by the officer or employee to provide information or otherwise assist in investigations regarding conduct that the officer or employee reasonably believes to be a violation of federal securities laws or of any rule or regulation of the Securities and Exchange Commission or federal securities laws relating to fraud against shareholders. View the complete Whistleblower Protections at [progressive.com/governance](http://progressive.com/governance).

**Directors**

**Stuart B. Burgdoerfer**<sup>1, 6</sup>  
Executive Vice President and  
Chief Financial Officer,  
Limited Brands, Inc.  
(retailing)

**Charles A. Davis**<sup>4, 5, 6</sup>  
Chief Executive Officer,  
Stone Point Capital LLC  
(private equity investing)

**Roger N. Farah**<sup>3, 6</sup>  
President and Chief Operating Officer,  
Ralph Lauren Corporation  
(lifestyle products)

**Lawton W. Fitt**<sup>4, 5, 6</sup>  
Retired Partner,  
Goldman Sachs Group  
(financial services)

**Stephen R. Hardis**<sup>2, 4, 5, 6</sup>  
Retired Chairman of the Board  
and Chief Executive Officer,  
Eaton Corporation  
(manufacturing)

**Jeffrey D. Kelly**<sup>3, 6</sup>  
Executive Vice President and  
Chief Financial Officer,  
RenaissanceRe Holdings, Ltd.  
(reinsurance services)

**Peter B. Lewis**<sup>2, 4, 6</sup>  
Chairman of the Board,  
The Progressive Corporation  
(non-executive)

**Heidi G. Miller, Ph.D.**<sup>1, 6</sup>  
Retired President of International,  
JPMorgan Chase & Co.  
(financial services)

**Patrick H. Nettles, Ph.D.**<sup>1, 6</sup>  
Executive Chairman,  
Ciena Corporation  
(telecommunications)

**Glenn M. Renwick**<sup>2</sup>  
President and Chief Executive Officer,  
The Progressive Corporation

**Bradley T. Sheares, Ph.D.**<sup>3, 6</sup>  
Former Chief Executive Officer,  
Reliant Pharmaceuticals, Inc.  
(pharmaceuticals)

<sup>1</sup>Audit Committee Member

<sup>2</sup>Executive Committee Member

<sup>3</sup>Compensation Committee Member

<sup>4</sup>Investment and Capital Committee Member

<sup>5</sup>Nominating and Governance Committee Member

<sup>6</sup>Independent Director

**Corporate Officers**

**Glenn M. Renwick**  
President and  
Chief Executive Officer

**Brian C. Domeck**  
Vice President and  
Chief Financial Officer

**Charles E. Jarrett**  
Vice President, Secretary,  
and Chief Legal Officer

**Thomas A. King**  
Vice President and Treasurer

**Jeffrey W. Basch**  
Vice President and  
Chief Accounting Officer

**Mariann Wojtkun Marshall**  
Assistant Secretary

**Peter B. Lewis**  
Chairman of the Board  
(non-executive)

**24-Hour Insurance Quotes, Claims Reporting, and Customer Service**

	<b>Personal autos, motorcycles, and recreational vehicles</b>	<b>Commercial autos/trucks</b>
<b>To Receive a Quote</b>	1-800-PROGRESSIVE (1-800-776-4737) progressive.com	1-888-806-9598 progressivecommercial.com
<b>To Report a Claim</b>	1-800-274-4499 progressive.com <sup>1</sup>	1-800-274-4499
<b>For Customer Service:</b> If you bought your policy through an independent agent or broker	1-800-925-2886 (1-800-300-3693 in California) progressiveagent.com	1-800-444-4487 progressivecommercial.com
If you bought your policy directly through Progressive online or by phone	1-800-PROGRESSIVE (1-800-776-4737) progressive.com	1-800-895-2886 progressivecommercial.com
If you have a complaint or concern regarding any claim handling or other claims-related issue <sup>2</sup>	1-800-274-4641 email: claims@email.progressive.com	1-800-274-4641 email: claims@email.progressive.com

<sup>1</sup>Claims reporting via the website is currently only available for personal auto policies.

<sup>2</sup>Any policyholder, claimant, or other interested party who has any complaint or concern regarding any claim handling or other claims-related issue may report such complaint or concern using the contact information above. The complaint or concern will be promptly forwarded to the appropriate management personnel in our claims organization for review and response.

> **more than**  
100 vintage beaded and  
sequin garments  
140 working hours  
15 pounds



**Artwork:** Nick Cave ©2012  
**Photography:** James Prinz Photography, Chicago  
Courtesy of the artist and Jack Shainman Gallery, New York  
**Design:** Nesnadny + Schwartz, Cleveland + New York + Toronto  
**Printing:** AGS Custom Graphics  
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**PROGRESSIVE**