PROGRESSIVE CORP/OH/
Form 10-Q
August 06, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 1O-Q

(Mark One)

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2013

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)

Ohio	**34-0963169**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6300 Wilson Mills Road, Mayfield Village, Ohio	**44143**
(Address of principal executive offices)	**(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 x 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 x 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 x	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 x

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: 600,362,159 outstanding at June 30, 2013

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.
The Progressive Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income

(unaudited)

Periods Ended June 30, (millions except per share amounts)	Three Months 2013	Three Months 2012	% Change	Six Months 2013	Six Months 2012	% Change
Revenues						
Net premiums earned	$ 4,277.0	$ 3,996.1	7	$ 8,456.3	$ 7,857.6	8
Investment income	102.2	112.5	(9)	202.7	227.2	(11)
Net realized gains (losses) on securities:						
Other-than-temporary impairment (OTTI) losses:						
Total OTTI losses	(1.5)	(5.1)	(71)	(1.7)	(5.6)	(70)
Non-credit losses, net of credit losses recognized on previously recorded non-credit OTTI losses	(.1)	(.3)	(67)	(.1)	(.7)	(86)
Net impairment losses recognized in earnings	(1.6)	(5.4)	(70)	(1.8)	(6.3)	(71)
Net realized gains (losses) on securities	134.5	.7	19114	215.3	79.1	172
Total net realized gains (losses) on securities	132.9	(4.7)	NM	213.5	72.8	193
Fees and other revenues	70.9	69.9	1	139.3	135.1	3
Service revenues	10.6	10.2	4	19.0	18.4	3
Gains (losses) on extinguishment of debt	0	(1.0)	NM	0	(1.7)	NM
Total revenues	4,593.6	4,183.0	10	9,030.8	8,309.4	9
Expenses						
Losses and loss adjustment expenses	3,117.0	3,043.7	2	6,102.5	5,806.1	5
Policy acquisition costs	364.0	364.5	0	722.9	724.1	0
Other underwriting expenses	581.1	562.7	3	1,166.7	1,138.7	2
Investment expenses	4.4	3.8	16	9.3	8.0	16
Service expenses	10.4	9.9	5	19.0	18.1	5
Interest expense	30.4	30.7	(1)	61.0	62.6	(3)
Total expenses	4,107.3	4,015.3	2	8,081.4	7,757.6	4
Net Income						
Income before income taxes	486.3	167.7	190	949.4	551.8	72
Provision for income taxes	161.7	49.1	229	316.2	175.6	80
Net income	324.6	118.6	174	633.2	376.2	68
Other Comprehensive Income (Loss), Net of Tax						
Net unrealized gains (losses) on securities:						
Net non-credit related OTTI losses, adjusted for valuation changes	.1	.1	0	.3	3.1	(90)
Other net unrealized gains (losses) on securities	(154.4)	(51.0)	203	(55.4)	148.4	NM

Total net unrealized gains (losses) on securities	(154.3)	(50.9)	203	(55.1)	151.5	NM
Net unrealized gains on forecasted transactions	(.4)	(.6)	(33)	(.7)	(1.2)	(42)
Foreign currency translation adjustment	(.8)	(.6)	33	(1.0)	(.1)	900
Other comprehensive income (loss)	(155.5)	(52.1)	198	(56.8)	150.2	NM
Comprehensive income	$ 169.1	$ 66.5	154	$ 576.4	$ 526.4	9
Computation of Net Income Per Share						
Average shares outstanding - Basic	599.5	604.8	(1)	600.1	605.5	(1)
Net effect of dilutive stock-based compensation	4.1	4.1	0	3.9	4.0	(3)
Total equivalent shares - Diluted	603.6	608.9	(1)	604.0	609.5	(1)
Basic: Net income per share	$ .54	$ .20	176	$ 1.06	$ .62	70
Diluted: Net income per share	$ .54	$ .19	176	$ 1.05	$ .62	70
Dividends declared per share[1]	$ 0	$ 0		$ 0	$ 0	

NM = Not Meaningful

[1] Progressive maintains an annual dividend program. See *Note 8 - Dividends* for further discussion.

See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries

Consolidated Balance Sheets

(unaudited)

(millions)	June 30, 2013	June 30, 2012	December 31, 2012
Assets			
Investments - Available-for-sale, at fair value:			
Fixed maturities (amortized cost: $12,824.1, $11,723.6, and $11,373.9)	$ 12,949.4	$ 12,075.9	$ 11,774.1
Equity securities:			
Nonredeemable preferred stocks (cost: $416.8, $425.4, and $404.0)	754.4	799.3	812.4
Common equities (cost: $1,438.2, $1,494.9, and $1,370.3)	2,224.5	2,055.1	1,899.0
Short-term investments (amortized cost: $1,558.1, $1,679.2, and $1,990.0)	1,558.1	1,679.2	1,990.0
Total investments	17,486.4	16,609.5	16,475.5
Cash	96.9	165.5	179.1
Accrued investment income	90.4	96.4	90.0
Premiums receivable, net of allowance for doubtful accounts of $125.6, $118.8, and $138.6	3,401.9	3,222.1	3,183.7
Reinsurance recoverables, including $35.1, $30.4, and $38.9 on paid losses and loss adjustment expenses	962.2	844.7	901.0
Prepaid reinsurance premiums	79.6	71.1	66.3
Deferred acquisition costs	468.1	452.4	434.5
Net deferred income taxes	67.9	127.0	109.4
Property and equipment, net of accumulated depreciation of $666.0, $606.6, and $625.0	950.6	914.3	933.7
Other assets	237.8	216.0	321.5
Total assets	$ 23,841.8	$ 22,719.0	$ 22,694.7
Liabilities and Shareholders Equity			
Unearned premiums	$ 5,323.5	$ 5,014.6	$ 4,930.7
Loss and loss adjustment expense reserves	8,086.2	7,573.2	7,838.4
Accounts payable, accrued expenses, and other liabilities	1,844.3	1,781.8	1,855.5
Debt[1]	2,063.9	2,062.8	2,063.1
Total liabilities	17,317.9	16,432.4	16,687.7
Common Shares, $1.00 par value (authorized 900.0; issued 797.6, 797.7, and 797.7, including treasury shares of 197.2, 188.5, and 193.1)	600.4	609.2	604.6
Paid-in capital	1,109.3	1,040.4	1,077.0
Retained earnings	4,000.0	3,794.3	3,454.4
Accumulated other comprehensive income, net of tax:			
Net non-credit related OTTI losses, adjusted for valuation changes	0	(2.3)	(.3)
Other net unrealized gains (losses) on securities	807.6	836.6	863.0
Total net unrealized gains (losses) on securities	807.6	834.3	862.7
Net unrealized gains on forecasted transactions	5.4	6.7	6.1
Foreign currency translation adjustment	1.2	1.7	2.2
Total accumulated other comprehensive income	814.2	842.7	871.0
Total shareholders equity	6,523.9	6,286.6	6,007.0
Total liabilities and shareholders equity	$ 23,841.8	$ 22,719.0	$ 22,694.7

[1] 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)

Six months ended June 30, (millions)	2013	2012
Cash Flows From Operating Activities		
Net income	$ 633.2	$ 376.2
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	49.0	45.5
Amortization of fixed-income securities	76.8	98.3
Amortization of equity-based compensation	35.1	31.5
Net realized (gains) losses on securities	(213.5)	(72.8)
Net (gains) losses on disposition of property and equipment	2.0	3.5
(Gains) losses on extinguishment of debt	0	1.7
Changes in:		
Premiums receivable	(218.4)	(292.3)
Reinsurance recoverables	(61.2)	(26.7)
Prepaid reinsurance premiums	(13.3)	(1.3)
Deferred acquisition costs	(33.6)	(18.8)
Income taxes	43.0	(21.1)
Unearned premiums	393.5	435.2
Loss and loss adjustment expense reserves	248.0	327.4
Accounts payable, accrued expenses, and other liabilities	168.6	230.6
Other, net	28.0	18.2
Net cash provided by operating activities	1,137.2	1,135.1
Cash Flows From Investing Activities		
Purchases:		
Fixed maturities	(4,262.6)	(2,628.7)
Equity securities	(208.2)	(79.4)
Sales:		
Fixed maturities	1,872.2	1,689.4
Equity securities	242.1	101.6
Maturities, paydowns, calls, and other:		
Fixed maturities	862.1	616.6
Equity securities	0	3.9
Net (purchases) sales of short-term investments other	430.6	(128.0)
Net unsettled security transactions	207.9	62.4
Purchases of property and equipment	(69.5)	(53.5)
Sales of property and equipment	1.6	1.5
Net cash used in investing activities	(923.8)	(414.2)
Cash Flows From Financing Activities		
Proceeds from exercise of stock options	0	.5
Tax benefit from exercise/vesting of equity-based compensation	7.4	4.1
Payment of debt	0	(350.0)
Reacquisition of debt	0	(31.9)
Dividends paid to shareholders[1]	(175.6)	(251.0)
Acquisition of treasury shares	(126.7)	(83.0)
Net cash used in financing activities	(294.9)	(711.3)

Effect of exchange rate changes on cash	(.7)	.2
Increase (decrease) in cash	(82.2)	9.8
Cash, January 1	179.1	155.7
Cash, June 30	$ 96.9	$ 165.5

[1] Progressive maintains an annual dividend program. See *Note 8 - 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, a mutual insurance company affiliate, and a limited partnership investment affiliate. All of the subsidiaries and affiliates 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 June 30, 2013, 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, 2012.

Consistent with the presentation in our Annual Report on Form 10-K for the year ended December 31, 2012, we revised the presentation of our Statements of Comprehensive Income for the second quarter and first six months of 2012, to correctly classify $69.9 million and $135.1 million, respectively, of fees and other revenues as a component of total revenues. Previously, these items were presented net within our other underwriting expenses. These revisions had no effect on the results of operations (net or comprehensive income), financial condition (shareholders equity), or cash flows and are not considered to be material.

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

($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses)[1]	Fair Value	% of Total Fair Value
June 30, 2013						
Fixed maturities:						
U.S. government obligations	$ 3,362.8	$ 63.0	$ (15.0)	$ 0	$ 3,410.8	19.5%
State and local government obligations	2,010.6	27.7	(18.4)	0	2,019.9	11.6
Foreign government obligations[2]	16.4	0	0	0	16.4	.1
Corporate debt securities	3,048.8	57.0	(33.0)	(.8)	3,072.0	17.6
Residential mortgage-backed securities	870.9	30.5	(14.7)	0	886.7	5.1
Commercial mortgage-backed securities	2,213.9	48.9	(41.0)	0	2,221.8	12.7
Other asset-backed securities	941.7	7.6	(2.2)	.6	947.7	5.4
Redeemable preferred stocks	359.0	27.8	(12.7)	0	374.1	2.1
Total fixed maturities	12,824.1	262.5	(137.0)	(.2)	12,949.4	74.1
Equity securities:						
Nonredeemable preferred stocks	416.8	332.1	(1.5)	7.0	754.4	4.3
Common equities	1,438.2	794.5	(8.2)	0	2,224.5	12.7
Short-term investments:						
Other short-term investments	1,558.1	0	0	0	1,558.1	8.9
Total portfolio[3,4]	$ 16,237.2	$ 1,389.1	$ (146.7)	$ 6.8	$ 17,486.4	100.0%

($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses)[1]	Fair Value	% of Total Fair Value
June 30, 2012						
Fixed maturities:						
U.S. government obligations	$ 2,833.0	$ 105.6	$ 0	$ 0	$ 2,938.6	17.7%
State and local government obligations	1,926.9	51.2	(.5)	0	1,977.6	11.9
Foreign government obligations	0	0	0	0	0	0
Corporate debt securities	2,893.6	114.4	(5.6)	4.8	3,007.2	18.1
Residential mortgage-backed securities	429.2	14.7	(22.3)	0	421.6	2.5
Commercial mortgage-backed securities	2,020.2	74.7	(1.4)	0	2,093.5	12.6
Other asset-backed securities	1,250.8	13.7	(.2)	(.3)	1,264.0	7.6
Redeemable preferred stocks	369.9	21.0	(17.5)	0	373.4	2.3
Total fixed maturities	11,723.6	395.3	(47.5)	4.5	12,075.9	72.7
Equity securities:						
Nonredeemable preferred stocks	425.4	376.5	(1.0)	(1.6)	799.3	4.8
Common equities	1,494.9	591.1	(30.9)	0	2,055.1	12.4
Short-term investments:						
Other short-term investments	1,679.2	0	0	0	1,679.2	10.1
Total portfolio[3,4]	$ 15,323.1	$ 1,362.9	$ (79.4)	$ 2.9	$ 16,609.5	100.0%

($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses)[1]	Fair Value	% of Total Fair Value
December 31, 2012						
Fixed maturities:						
U.S. government obligations	$ 2,806.4	$ 90.1	$ 0	$ 0	$ 2,896.5	17.6%
State and local government obligations	1,914.4	50.6	(.6)	0	1,964.4	11.9
Foreign government obligations	0	0	0	0	0	0
Corporate debt securities	2,982.9	124.7	(1.0)	6.4	3,113.0	18.9
Residential mortgage-backed securities	413.4	24.0	(9.2)	0	428.2	2.6
Commercial mortgage-backed securities	1,963.9	84.9	(.1)	0	2,048.7	12.4
Other asset-backed securities	936.0	12.9	(.1)	(.2)	948.6	5.8
Redeemable preferred stocks	356.9	30.5	(12.7)	0	374.7	2.3
Total fixed maturities	11,373.9	417.7	(23.7)	6.2	11,774.1	71.5
Equity securities:						
Nonredeemable preferred stocks	404.0	404.6	0	3.8	812.4	4.9
Common equities	1,370.3	539.0	(10.3)	0	1,899.0	11.5
Short-term investments:						
Other short-term investments	1,990.0	0	0	0	1,990.0	12.1
Total portfolio[3,4]	$ 15,138.2	$ 1,361.3	$ (34.0)	$ 10.0	$ 16,475.5	100.0%

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

2 Reflects an Australian government obligation at June 30, 2013.

3 At June 30, 2013 and 2012, we had $117.0 million and $15.5 million, respectively, of net unsettled security transactions, including collateral on open derivative positions, recognized in other liabilities, compared to $90.9 million in other assets at December 31, 2012.

4 The total fair value of the portfolio at June 30, 2013 and 2012, and December 31, 2012 included $1.2 billion, $1.4 billion, and $1.4 billion, respectively, of securities held in a consolidated, non-insurance subsidiary of the holding company.

Our other short-term investments include commercial paper, reverse repurchase transactions, and other investments that are expected to mature within one year. We had $416.0 million, $400.6 million, and $581.0 million of open reverse repurchase commitments at June 30, 2013 and 2012, and December 31, 2012, respectively. At these dates, we did not hold any repurchase transactions where we lent collateral. To the extent our repurchase transactions were with the same counterparty and subject to an enforceable master netting arrangement, we could elect to offset these transactions. Historically, we have chosen to report these transactions on a gross basis on our balance sheets.

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

(millions)	June 30, 2013	June 30, 2012	December 31, 2012
Fixed maturities:			
Corporate debt securities	$ 188.6	$ 166.8	$ 176.1
Other asset-backed securities	16.0	15.9	16.4
Total fixed maturities	204.6	182.7	192.5
Equity securities:			
Nonredeemable preferred stocks	56.0	18.9	52.8
Total hybrid securities	$ 260.6	$ 201.6	$ 245.3

Certain corporate debt securities are accounted for as hybrid securities since they were acquired at a substantial premium and contain a change-in-control put option (derivative) that permits the investor, at its sole option if and when a change in control is triggered, to put the security back to the issuer at a 1% premium to par. Due to this change-in-control put option and the substantial market premium paid to acquire these securities, there is the potential that the election to put, upon the change in control, could result in an acceleration of the remaining premium paid on these securities, which would result in a loss of $14.8 million as of June 30, 2013, if all of the bonds experienced a simultaneous change in control and we elected to exercise all of our put options. The put feature limits the potential loss in value that could be experienced in the event a corporate action occurs that results in a change in control that materially diminishes the credit quality of the issuer. We are under no obligation to exercise the put option we hold if a change in control occurs.

The other asset-backed security in the table above represents one hybrid security that was acquired at a deep discount to par due to a failing auction, and contains a put option 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.

Fixed Maturities The composition of fixed maturities by maturity at June 30, 2013, was:

(millions)	Cost	Fair Value
Less than one year	$ 2,169.6	$ 2,205.4
One to five years	8,177.6	8,319.1
Five to ten years	2,330.6	2,274.9
Ten years or greater	93.9	97.6
Total[1]	$ 12,771.7	$ 12,897.0

1 Excludes $52.4 million related to our open interest rate swap positions.

Asset-backed securities are classified across the maturity distribution table based upon their projected distribution of cash flows. All other securities that do not have a single maturity date are reported at their expected maturity date. Contractual maturities may differ from expected maturities because the issuers of the securities may have the right to call or prepay obligations.

Gross Unrealized Losses As of June 30, 2013, we had $138.5 million of gross unrealized losses in our fixed-income securities (i.e., fixed-maturity securities, nonredeemable preferred stocks, and short-term investments) and $8.2 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. A review of our fixed-income securities indicated that the issuers were current with respect to their interest obligations and that there was no evidence of any deterioration of the current cash flow projections that would indicate we would not receive the remaining principal at maturity. In addition, 88% of our common stock portfolio was indexed to the Russell 1000; as such, this portfolio may contain securities in a loss position for an extended period of time, subject to possible write-downs, as described below. We may retain these securities as long as the portfolio and index correlation remain similar. To the extent there is issuer specific deterioration, we may write-down the securities of that issuer. The remaining 12% of our common stocks are part of a managed equity strategy selected and administered by external investment advisors. If our strategy were 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 Fair Value	Gross Unrealized Losses	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses
June 30, 2013						
Fixed maturities:						
U.S. government obligations	$ 1,035.9	$ (15.0)	$ 1,035.9	$ (15.0)	$ 0	$ 0
State and local government obligations	829.2	(18.4)	803.1	(18.2)	26.1	(.2)
Corporate debt securities	1,254.2	(33.0)	1,254.2	(33.0)	0	0
Residential mortgage-backed securities	627.4	(14.7)	550.0	(10.8)	77.4	(3.9)
Commercial mortgage-backed securities	1,001.0	(41.0)	1,001.0	(41.0)	0	0
Other asset-backed securities	260.8	(2.2)	260.8	(2.2)	0	0
Redeemable preferred stocks	151.3	(12.7)	31.4	(.2)	119.9	(12.5)
Total fixed maturities	5,159.8	(137.0)	4,936.4	(120.4)	223.4	(16.6)
Equity securities:						
Nonredeemable preferred stocks	89.8	(1.5)	89.8	(1.5)	0	0
Common equities	74.8	(8.2)	66.7	(5.9)	8.1	(2.3)
Total equity securities	164.6	(9.7)	156.5	(7.4)	8.1	(2.3)
Total portfolio	$ 5,324.4	$ (146.7)	$ 5,092.9	$ (127.8)	$ 231.5	$ (18.9)

(millions)	Total Fair Value	Gross Unrealized Losses	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses
June 30, 2012						
Fixed maturities:						
U.S. government obligations	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
State and local government obligations	118.3	(.5)	95.3	(.3)	23.0	(.2)
Corporate debt securities	170.0	(5.6)	111.4	(.4)	58.6	(5.2)
Residential mortgage-backed securities	271.3	(22.3)	32.3	(1.1)	239.0	(21.2)
Commercial mortgage-backed securities	73.5	(1.4)	39.9	(.1)	33.6	(1.3)
Other asset-backed securities	35.0	(.2)	20.0	0	15.0	(.2)
Redeemable preferred stocks	169.4	(17.5)	43.5	(1.5)	125.9	(16.0)
Total fixed maturities	837.5	(47.5)	342.4	(3.4)	495.1	(44.1)
Equity securities:						
Nonredeemable preferred stocks	22.3	(1.0)	0	0	22.3	(1.0)
Common equities	229.0	(30.9)	173.4	(17.8)	55.6	(13.1)
Total equity securities	251.3	(31.9)	173.4	(17.8)	77.9	(14.1)
Total portfolio	$ 1,088.8	$ (79.4)	$ 515.8	$ (21.2)	$ 573.0	$ (58.2)

(millions)	Total Fair Value	Gross Unrealized Losses	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses
December 31, 2012						
Fixed maturities:						
U.S. government obligations	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
State and local government obligations	162.8	(.6)	123.1	(.5)	39.7	(.1)
Corporate debt securities	128.2	(1.0)	128.2	(1.0)	0	0
Residential mortgage-backed securities	149.2	(9.2)	40.2	(.6)	109.0	(8.6)
Commercial mortgage-backed securities	7.1	(.1)	2.1	0	5.0	(.1)
Other asset-backed securities	25.0	(.1)	20.8	0	4.2	(.1)
Redeemable preferred stocks	155.7	(12.7)	24.9	0	130.8	(12.7)
Total fixed maturities	628.0	(23.7)	339.3	(2.1)	288.7	(21.6)
Equity securities:						
Nonredeemable preferred stocks	0	0	0	0	0	0
Common equities	118.2	(10.3)	100.7	(8.2)	17.5	(2.1)
Total equity securities	118.2	(10.3)	100.7	(8.2)	17.5	(2.1)
Total portfolio	$ 746.2	$ (34.0)	$ 440.0	$ (10.3)	$ 306.2	$ (23.7)

Other-Than-Temporary Impairment (OTTI) The following table shows the total non-credit portion of the OTTI recorded in accumulated other comprehensive income, reflecting the original non-credit loss at the time the credit impairment was determined:

(millions)	June 30, 2013	June 30, 2012	December 31, 2012
Fixed maturities:			
Residential mortgage-backed securities	$ (44.1)	$ (44.2)	$ (44.2)
Commercial mortgage-backed securities	(.9)	(.9)	(.9)
Total fixed maturities	$ (45.0)	$ (45.1)	$ (45.1)

The following tables provide rollforwards of the amounts related to credit losses recognized in earnings for the periods ended June 30, 2013 and 2012, for which portions of the OTTI losses were also recognized in accumulated other comprehensive income at the time the credit impairments were determined and recognized:

	Three Months Ended June 30, 2013		
	Mortgage-Backed		
(millions)	**Residential**	**Commercial**	**Total**
Beginning balance at April 1, 2013	$ 27.7	$ .5	$ 28.2
Credit losses for which an OTTI was previously recognized	0	0	0
Credit losses for which an OTTI was not previously recognized	0	0	0
Reductions for securities sold/matured	0	0	0
Change in recoveries of future cash flows expected to be collected[1]	(.6)	0	(.6)
Reductions for previously recognized credit impairments written-down to fair value[2]	(.2)	0	(.2)
Ending balance at June 30, 2013	$ 26.9	$ .5	$ 27.4

	Six Months Ended June 30, 2013		
	Mortgage-Backed		
(millions)	**Residential**	**Commercial**	**Total**
Beginning balance at January 1, 2013	$ 27.1	$ .6	$ 27.7
Credit losses for which an OTTI was previously recognized	0	0	0
Credit losses for which an OTTI was not previously recognized	0	0	0
Reductions for securities sold/matured	0	0	0
Change in recoveries of future cash flows expected to be collected[1]	0	(.1)	(.1)
Reductions for previously recognized credit impairments written-down to fair value[2]	(.2)	0	(.2)
Ending balance at June 30, 2013	$ 26.9	$ .5	$ 27.4

(millions)	Three Months Ended June 30, 2012 Mortgage-Backed Residential	Commercial	Total
Beginning balance at April 1, 2012	$ 28.3	$ .8	$ 29.1
Credit losses for which an OTTI was previously recognized	.2	0	.2
Credit losses for which an OTTI was not previously recognized	0	0	0
Reductions for securities sold/matured	0	0	0
Change in recoveries of future cash flows expected to be collected[1]	(.4)	(.1)	(.5)
Reductions for previously recognized credit impairments written-down to fair value[2]	0	0	0
Ending balance at June 30, 2012	$ 28.1	$ .7	$ 28.8

(millions)	Six Months Ended June 30, 2012 Mortgage-Backed Residential	Commercial	Total
Beginning balance at January 1, 2012	$ 34.5	$ 1.3	$ 35.8
Credit losses for which an OTTI was previously recognized	.1	0	.1
Credit losses for which an OTTI was not previously recognized	.2	0	.2
Reductions for securities sold/matured	0	(.2)	(.2)
Change in recoveries of future cash flows expected to be collected[1]	(2.7)	(.1)	(2.8)
Reductions for previously recognized credit impairments written-down to fair value[2]	(4.0)	(.3)	(4.3)
Ending balance at June 30, 2012	$ 28.1	$ .7	$ 28.8

1 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 decreases in expected cash flows on previously recorded reductions.

2 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).

Although 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), we are required to measure and report the amount of credit losses on the securities that were determined to be other-than-temporarily impaired. In that process, 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 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); historical credit ratings; and updated cash flow expectations 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.

Realized Gains/Losses

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

	Three Months		Six Months	
(millions)	**2013**	**2012**	**2013**	**2012**
Gross realized gains on security sales				
Fixed maturities:				
U.S. government obligations	$ 2.2	$ 2.5	$ 3.7	$ 9.6
State and local government obligations	0	0	6.8	12.1
Corporate and other debt securities	12.6	3.9	36.7	26.1
Residential mortgage-backed securities	1.7	0	2.1	0
Commercial mortgage-backed securities	4.3	3.5	8.3	4.5
Redeemable preferred stocks	0	.4	0	.4
Total fixed maturities	20.8	10.3	57.6	52.7
Equity securities:				
Nonredeemable preferred stocks	62.7	6.3	101.2	36.9
Common equities	12.3	8.6	15.0	9.8
Subtotal gross realized gains on security sales	95.8	25.2	173.8	99.4
Gross realized losses on security sales				
Fixed maturities:				
U.S. government obligations	(1.1)	(.4)	(1.4)	(.9)
Corporate and other debt securities	(.6)	0	(1.0)	0
Commercial mortgage-backed securities	(.7)	0	(.7)	0
Redeemable preferred stocks	0	0	(.1)	0
Total fixed maturities	(2.4)	(.4)	(3.2)	(.9)
Common equities	(.3)	0	(.3)	0
Subtotal gross realized losses on security sales	(2.7)	(.4)	(3.5)	(.9)
Net realized gains (losses) on security sales				
Fixed maturities:				
U.S. government obligations	1.1	2.1	2.3	8.7
State and local government obligations	0	0	6.8	12.1
Corporate and other debt securities	12.0	3.9	35.7	26.1
Residential mortgage-backed securities	1.7	0	2.1	0
Commercial mortgage-backed securities	3.6	3.5	7.6	4.5
Redeemable preferred stocks	0	.4	(.1)	.4
Total fixed maturities	18.4	9.9	54.4	51.8
Equity securities:				
Nonredeemable preferred stocks	62.7	6.3	101.2	36.9
Common equities	12.0	8.6	14.7	9.8
Subtotal net realized gains (losses) on security sales	93.1	24.8	170.3	98.5
Other-than-temporary impairment losses				
Fixed maturities:				
Residential mortgage-backed securities	(.3)	(.5)	(.4)	(1.0)
Commercial mortgage-backed securities	0	0	0	(.1)
Total fixed maturities	(.3)	(.5)	(.4)	(1.1)

Equity securities:				
Common equities	(1.3)	(4.9)	(1.4)	(5.2)
Subtotal other-than-temporary impairment losses	(1.6)	(5.4)	(1.8)	(6.3)
Other gains (losses)				
Hybrid securities	(3.5)	(.2)	(1.2)	6.9
Derivative instruments	44.9	(24.1)	46.2	(26.5)
Litigation settlements	0	.2	0	.2
Subtotal other gains (losses)	41.4	(24.1)	45.0	(19.4)
Total net realized gains (losses) on securities	$ 132.9	$ (4.7)	$ 213.5	$ 72.8

Gross realized gains and losses were predominately the result of sales transactions in our fixed-income portfolio, related to movements in credit spreads and interest rates. In addition, gains and losses reflect holding period valuation changes on hybrids and derivatives and write-downs for securities determined to be other-than-temporarily impaired in our fixed-maturity and equity portfolios.

Trading Securities At June 30, 2013 and 2012, and December 31, 2012, we did not hold any trading securities and did not have any net realized gains (losses) on trading securities for the three and six months ended June 30, 2013 and 2012.

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 and cash flows.

The following table shows the status of our derivative instruments at June 30, 2013 and 2012, and December 31, 2012, and for the three and six months ended June 30, 2013 and 2012; amounts are on a pretax basis:

(millions)						**Balance Sheet[2]**			**Comprehensive Income Statement**			
						Assets (Liabilities) Fair Value			**Net Realized Gains (Losses) on Securities**			
	Notional Value[1]								**Three months ended**		**Six months ended**	
	June 30,		**Dec. 31,**			**June 30,**		**Dec. 31,**	**June 30,**		**June 30,**	
Derivatives designated as:	**2013**	**2012**	**2012**	**Purpose**	**Classification**	**2013**	**2012**	**2012**	**2013**	**2012**	**2013**	**2012**
Hedging instruments												
Closed:												
Ineffective cash flow hedge	$ 0	$ 30	$ 31	Manage interest rate risk	NA	$ 0	$ 0	$ 0	$ 0	$ .3	$ 0	$ .6
Non-hedging instruments												
Assets:												
Interest rate swaps	750	0	0	Manage portfolio duration	Investments fixed maturities	52.4	0	0	50.2	0	50.2	0
Corporate credit default swaps	0	25	0	Manage credit risk	Investments fixed maturities	0	.7	0	0	.1	0	(.3)
Liabilities:												
Interest rate swaps	0	1,263	1,263	Manage portfolio duration	Other liabilities	0	(91.5)	(95.5)	0	(24.5)	0	(26.8)
Closed:												
Interest rate swaps	1,263	0	0	Manage portfolio duration	NA	0	0	0	(5.3)	0	(4.0)	0
Corporate credit default swaps	0	0	25	Manage credit risk	NA	0	0	0	0	0	0	0
Total	NA	NA	NA			$ 52.4	$ (90.8)	$ (95.5)	$ 44.9	$ (24.1)	$ 46.2	$ (26.5)

NA= Not Applicable

[1] The amounts represent the value held at quarter and year end for open positions and the maximum amount held during the period for closed positions.

[2] To the extent we hold both derivative assets and liabilities with the same counterparty that are subject to an enforceable master netting arrangement, we expect that we will report them on a gross basis on our balance sheets, consistent with our historical presentation.

CASH FLOW HEDGES

We did not repurchase any debt securities in the first six months of 2013. During the second quarter, first six months, and full year of 2012, we repurchased, in the open market, $17.8 million, $30.4 million, and $30.9 million, respectively, in aggregate principal amount of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 (the 6.70% Debentures). In addition, for the portion of the 6.70% Debentures we repurchased, we reclassified $0.3 million, $0.6 million, and $0.6 million during these same periods, on a pretax basis, of the unrealized gain on forecasted transactions from accumulated other comprehensive income on the balance sheet to net realized gains on securities on the comprehensive income statement.

INTEREST RATE SWAPS

During the periods ended June 30, 2013 and 2012, and December 31, 2012, we invested in interest rate swap positions, primarily to manage the fixed-income portfolio duration. During the second quarter 2013, we opened three ten-year interest rate swap positions; in each case, we are paying a fixed rate and receiving a variable rate, effectively shortening the duration of our fixed-income portfolio. We closed three interest rate swap positions during the second quarter 2013. The closed positions were a 9-year interest rate swap position (opened in 2009) and two 5-year interest rate swap positions (opened in 2011); in each case, we were paying a fixed rate and receiving a variable rate. As of June 30, 2013, the balance of the cash collateral that we had received from the applicable counterparties on the open positions was $54.4 million. As of June 30, 2012 and December 31, 2012, the balance of the cash collateral that we had delivered to the applicable counterparty on the then open positions was $101.3 million and $105.0 million, respectively.

CORPORATE CREDIT DEFAULT SWAPS

Financial Services Sector We held no credit default swaps in this sector during 2013 or at December 31, 2012. During the three and six months ended June 30, 2012, 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 held this protection to reduce some of our exposure to additional valuation declines on a preferred stock position of the same issuer. As of June 30, 2012, the balance of the cash collateral that we had received from the counterparty on the then open position was $0.7 million.

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, active exchange-traded equity securities, and certain short-term 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).

Determining the fair value of the investment portfolio is the responsibility of management. As part of the responsibility, we evaluate whether a market is distressed or inactive in determining the fair value for 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.

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

	Fair Value				
(millions)	**Level 1**	**Level 2**	**Level 3**	**Total**	**Cost**
June 30, 2013					
Fixed maturities:					
U.S. government obligations	$ 3,410.8	$ 0	$ 0	$ 3,410.8	$ 3,362.8
State and local government obligations	0	2,019.9	0	2,019.9	2,010.6
Foreign government obligations	16.4	0	0	16.4	16.4
Corporate debt securities	0	3,072.0	0	3,072.0	3,048.8
Subtotal	3,427.2	5,091.9	0	8,519.1	8,438.6
Asset-backed securities:					
Residential mortgage-backed	0	729.6	157.1	886.7	870.9
Commercial mortgage-backed	0	2,194.2	27.6	2,221.8	2,213.9
Other asset-backed	0	947.7	0	947.7	941.7
Subtotal asset-backed securities	0	3,871.5	184.7	4,056.2	4,026.5
Redeemable preferred stocks:					
Financials	0	132.6	0	132.6	113.7
Utilities	0	66.4	0	66.4	64.9
Industrials	0	175.1	0	175.1	180.4
Subtotal redeemable preferred stocks	0	374.1	0	374.1	359.0
Total fixed maturities	3,427.2	9,337.5	184.7	12,949.4	12,824.1
Equity securities:					
Nonredeemable preferred stocks:					
Financials	256.6	446.2	34.8	737.6	402.6
Utilities	0	16.8	0	16.8	14.2
Subtotal nonredeemable preferred stocks	256.6	463.0	34.8	754.4	416.8
Common equities:					
Common stocks	2,185.8	0	0	2,185.8	1,435.1
Other risk investments	0	0	38.7	38.7	3.1
Subtotal common equities	2,185.8	0	38.7	2,224.5	1,438.2
Total fixed maturities and equity securities	5,869.6	9,800.5	258.2	15,928.3	14,679.1
Short-term investments:					
Other short-term investments	1,117.8	440.3	0	1,558.1	1,558.1
Total portfolio	$ 6,987.4	$ 10,240.8	$ 258.2	$ 17,486.4	$ 16,237.2
Debt	$ 0	$ 2,300.8	$ 0	$ 2,300.8	$ 2,063.9

(millions)	Fair Value Level 1	Level 2	Level 3	Total	Cost
June 30, 2012					
Fixed maturities:					
U.S. government obligations	$ 2,938.6	$ 0	$ 0	$ 2,938.6	$ 2,833.0
State and local government obligations	0	1,977.6	0	1,977.6	1,926.9
Foreign government obligations	0	0	0	0	0
Corporate debt securities	0	3,007.2	0	3,007.2	2,893.6
Subtotal	2,938.6	4,984.8	0	7,923.4	7,653.5
Asset-backed securities:					
Residential mortgage-backed	0	367.1	54.5	421.6	429.2
Commercial mortgage-backed	0	2,070.3	23.2	2,093.5	2,020.2
Other asset-backed	0	1,262.9	1.1	1,264.0	1,250.8
Subtotal asset-backed securities	0	3,700.3	78.8	3,779.1	3,700.2
Redeemable preferred stocks:					
Financials	0	130.3	0	130.3	120.7
Utilities	0	64.9	0	64.9	65.9
Industrials	0	178.2	0	178.2	183.3
Subtotal redeemable preferred stocks	0	373.4	0	373.4	369.9
Total fixed maturities	2,938.6	9,058.5	78.8	12,075.9	11,723.6
Equity securities:					
Nonredeemable preferred stocks:					
Financials	259.8	498.4	0	758.2	394.0
Utilities	0	41.1	0	41.1	31.4
Subtotal nonredeemable preferred stocks	259.8	539.5	0	799.3	425.4
Common equities:					
Common stocks	2,042.9	0	0	2,042.9	1,491.5
Other risk investments	0	0	12.2	12.2	3.4
Subtotal common equities	2,042.9	0	12.2	2,055.1	1,494.9
Total fixed maturities and equity securities	5,241.3	9,598.0	91.0	14,930.3	13,643.9
Short-term investments:					
Other short-term investments	1,330.3	348.9	0	1,679.2	1,679.2
Total portfolio	$ 6,571.6	$ 9,946.9	$ 91.0	$ 16,609.5	$ 15,323.1
Debt	$ 0	$ 2,342.2	$ 0	$ 2,342.2	$ 2,062.8

(millions)	Fair Value Level 1	Level 2	Level 3	Total	Cost
December 31, 2012					
Fixed maturities:					
U.S. government obligations	$ 2,896.5	$ 0	$ 0	$ 2,896.5	$ 2,806.4
State and local government obligations	0	1,964.4	0	1,964.4	1,914.4
Foreign government obligations	0	0	0	0	0
Corporate debt securities	0	3,113.0	0	3,113.0	2,982.9
Subtotal	2,896.5	5,077.4	0	7,973.9	7,703.7
Asset-backed securities:					
Residential mortgage-backed	0	382.7	45.5	428.2	413.4
Commercial mortgage-backed	0	2,023.4	25.3	2,048.7	1,963.9
Other asset-backed	0	948.6	0	948.6	936.0
Subtotal asset-backed securities	0	3,354.7	70.8	3,425.5	3,313.3
Redeemable preferred stocks:					
Financials	0	129.7	0	129.7	110.7
Utilities	0	66.7	0	66.7	64.9
Industrials	0	178.3	0	178.3	181.3
Subtotal redeemable preferred stocks	0	374.7	0	374.7	356.9
Total fixed maturities	2,896.5	8,806.8	70.8	11,774.1	11,373.9
Equity securities:					
Nonredeemable preferred stocks:					
Financials	259.6	494.5	31.9	786.0	383.3
Utilities	0	26.4	0	26.4	20.7
Subtotal nonredeemable preferred stocks	259.6	520.9	31.9	812.4	404.0
Common equities:					
Common stocks	1,887.0	0	0	1,887.0	1,367.2
Other risk investments	0	0	12.0	12.0	3.1
Subtotal common equities	1,887.0	0	12.0	1,899.0	1,370.3
Total fixed maturities and equity securities	5,043.1	9,327.7	114.7	14,485.5	13,148.2
Short-term investments:					
Other short-term investments	1,679.9	310.1	0	1,990.0	1,990.0
Total portfolio	$ 6,723.0	$ 9,637.8	$ 114.7	$ 16,475.5	$ 15,138.2
Debt	$ 0	$ 2,394.4	$ 0	$ 2,394.4	$ 2,063.1

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 second quarter or first six months of 2013. At June 30, 2012 and December 31, 2012, we had one redeemable preferred security with a value of $25.0 million that was transferred from Level 1 to Level 2 as it was no longer traded on an exchange. We recognize transfers between levels at the end of the reporting period.

Our short-term security holdings classified as Level 1 are highly liquid, actively marketed, and have a very short duration, primarily seven days or less to redemption. These securities are held at their original cost, adjusted for any amortization of discount or premium, since that value very closely approximates what an active market participant would be willing to pay for such securities. The remainder of our short-term securities are classified as Level 2 and are not priced externally since these securities continually trade at par value. These securities are classified as Level 2 since they are primarily longer-dated auction securities issued by municipalities that contain a redemption put feature back to the auction pool with a redemption period of less than seven days. The auction pool is created by a liquidity provider and if the auction is not available at the end of the seven days, we have the right to put the security back to the issuer at par.

At both June 30, 2013 and December 31, 2012, vendor-quoted prices represented 57% of our Level 1 classifications (excluding short-term investments), compared to 56% at June 30, 2012. The securities quoted by vendors in Level 1 represent our holdings in U.S. Treasury Notes and an Australian government obligation, which are frequently traded and the quotes are considered similar to exchange-traded quotes. The balance of our Level 1 pricing comes from quotes obtained directly from trades made on an active exchange and our interest rate swap derivative positions that have a very similar market to the U.S. Treasury Note market.

At both June 30, 2013 and December 31, 2012, vendor-quoted prices comprised 98% of our Level 2 classifications (excluding short-term investments), while dealer-quoted prices represented 2%, compared to 97% and 3% at June 30, 2012. In our process for selecting a source (e.g., dealer, pricing service) to provide pricing for securities in our portfolio, we reviewed documentation from the sources that detailed the pricing techniques and methodologies used by these sources and determined if their policies adequately considered market activity, either based on specific transactions for the particular security type or based on modeling of securities with similar credit quality, duration, yield, and structure that were recently transacted. Once a source is chosen, we continue to monitor any changes or modifications to their processes by reviewing their documentation on internal controls for pricing and market reviews.

As part of our pricing procedures, we obtain quotes from more than one source to help us fully evaluate the market price of securities. However, our internal pricing policy is to use a consistent source for individual securities in order to maintain the integrity of our valuation process. Quotes obtained from the sources are not considered binding offers to transact. Under our policy, when a review of the valuation received from our selected source appears to be outside of what is considered market level activity (which is defined as trading at spreads or yields significantly different than those of comparable securities or outside the general sector level movement without a reasonable explanation), we may use an alternate source s price. To the extent we determine that it may be prudent to substitute one source s price for another, we will contact the initial source to obtain an understanding of the factors that may be contributing to the significant price variance, which often leads the source to adjust their pricing input data for future pricing.

To allow us to determine if our initial source is providing a price that is outside of a reasonable range, we review our portfolio pricing on a weekly basis. We frequently challenge prices from our sources when a price provided does not match our expectations based on our evaluation of market trends/activity. Initially, we perform a global review of our portfolio by sector to identify securities whose prices appear outside of a reasonable range. We refine our review to analyze prices by specific criteria, such as whether the security is investment or non-investment-grade, prime or sub-prime, or a consumer product (e.g., auto, credit card). Through this review, we try to determine what contributed to the price variances among sources by analyzing spread movement, comparable security trades, if available, or industry or specific issuer fundamentals. We review quality control measures of our sources as they become available to determine if any significant changes have occurred from period to period that might indicate issues/concerns regarding their evaluation or market coverage. We also review data assumptions as supplied by our sources to determine if that data is relevant to current market conditions. In addition, we independently review each sector for transaction volumes, new issuances, and changes in spreads, as well as the overall movement of interest rates along the yield curve to determine if sufficient activity and liquidity exists to provide a credible source for our market valuations.

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 with those generated based on quotes we received externally and research material valuation differences. We compare our results to index returns for each major sector adjusting for duration and credit quality differences to better understand our portfolio s results. Additionally, we review on a monthly basis our external sales transactions and compare the actual final market sales price to a previous market valuation price. This review provides us further validation that our pricing sources are providing market level prices, since we are able to explain significant price changes (i.e., greater than 2%) as known events occur in the marketplace and affect a particular security s price at sale.

This analysis provides us additional comfort regarding the source s process, the quality of its review, and its willingness to improve its analysis based on feedback from clients. We believe this effort helps ensure that we are reporting the most representative fair values of our securities.

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, and lack of similar securities trading to obtain observable market level inputs), these valuations are more subjective in nature. Certain private equity investments and fixed-income investments included in the Level 3 category are valued using external pricing supplemented by internal review and analysis.

After all the valuations are received and our review is complete, if the inputs used by vendors are determined to not contain sufficient observable market information, we will reclassify the affected security valuations to Level 3. At June 30, 2013 and 2012, and December 31, 2012, 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 June 30, 2013, we had one private common equity security with a value of $38.0 million; the valuation reflects a negotiated sale that is expected to be completed by the end of 2013. At June 30, 2012 and December 31, 2012, the same private common equity security was internally priced with a value of $11.2 million. At June 30, 2013, we had one private preferred equity security, with a value of $34.8 million that was priced internally. The same security had a value of $31.9 million at December 31, 2012; we did not hold the security at June 30, 2012. At June 30, 2013 and 2012, and December 31, 2012, we did not have any securities in our fixed-maturity portfolio that were priced internally. Despite the lack of sufficient observable market information, we believe the valuations received in conjunction with our procedures for evaluating third-party prices support the fair values as reported in the financial statements.

We review the prices from our external sources for reasonableness using internally developed assumptions to derive prices for the securities, which are then compared to the prices we received. Based on our review, all prices received from external sources remained unadjusted.

The following tables provide a summary of changes in fair value associated with Level 3 assets for the three and six months ended June 30, 2013 and 2012:

(millions)	Fair value at Mar. 31, 2013	Calls/ Maturities/ Paydowns	Purchases	Sales	Net Realized (gain)/loss on sales	Change in Valuation	Net Transfers in (out)	Fair value at June 30, 2013
	Level 3 Fair Value Three months ended June 30, 2013							
Fixed maturities:								
Asset-backed securities:								
Residential mortgage-backed	$ 85.6	$ (6.3)	$ 79.9	$ 0	$ 0	$ (2.1)	$ 0	$ 157.1
Commercial mortgage-backed	27.3	(.4)	0	0	0	.7	0	27.6
Other asset-backed	0	0	0	0	0	0	0	0
Total fixed maturities	112.9	(6.7)	79.9	0	0	(1.4)	0	184.7
Equity securities:								
Nonredeemable preferred stocks:								
Financials[1]	33.8	0	0	0	0	1.0	0	34.8
Common equities:								
Other risk investments	12.0	(.1)	.3	0	(.5)	27.0	0	38.7
Total Level 3 securities	$ 158.7	$ (6.8)	$ 80.2	$ 0	$ (.5)	$ 26.6	$ 0	$ 258.2

[1] The $1.0 million represents net holding period gains on a hybrid security which is reflected in net realized gains (losses) on securities in the comprehensive income statement.

(millions)	Fair value at Dec. 31, 2012	Calls/ Maturities/ Paydowns	Purchases	Sales	Net Realized (gain)/loss on sales	Change in Valuation	Net Transfers in (out)	Fair value at June 30, 2013
	Level 3 Fair Value Six months ended June 30, 2013							
Fixed maturities:								
Asset-backed securities:								
Residential mortgage-backed	$ 45.5	$ (11.6)	$ 125.1	$ 0	$ 0	$ (1.9)	$ 0	$ 157.1
Commercial mortgage-backed	25.3	(.8)	0	0	0	3.1	0	27.6
Other asset-backed	0	0	0	0	0	0	0	0
Total fixed maturities	70.8	(12.4)	125.1	0	0	1.2	0	184.7
Equity securities:								
Nonredeemable preferred stocks:								
Financials[1]	31.9	0	0	0	0	2.9	0	34.8
Common equities:								
Other risk investments	12.0	(.1)	.3	0	(.5)	27.0	0	38.7
Total Level 3 securities	$ 114.7	$ (12.5)	$ 125.4	$ 0	$ (.5)	$ 31.1	$ 0	$ 258.2

[1] The $2.9 million represents net holding period gains on a hybrid security which is reflected in net realized gains (losses) on securities in the comprehensive income statement.

(millions)	Fair Value at Mar. 31, 2012	Calls/ Maturities/ Paydowns	Purchases	Sales	Net Realized (gain)/loss on sales	Change in Valuation	Net Transfers in (out)	Fair value at June 30, 2012
	Level 3 Fair Value Three months ended June 30, 2012							
Fixed maturities:								
Asset-backed securities:								
Residential mortgage-backed	$ 58.7	$ (4.1)	$ 0	$ 0	$ 0	$ (.1)	$ 0	$ 54.5
Commercial mortgage-backed	22.8	(.1)	0	0	0	.5	0	23.2
Other asset-backed	1.8	(.7)	0	0	0	0	0	1.1
Total fixed maturities	83.3	(4.9)	0	0	0	.4	0	78.8
Equity securities:								
Nonredeemable preferred stocks:								
Financials	0	0	0	0	0	0	0	0
Common equities:								
Other risk investments	11.1	0	0	0	0	1.1	0	12.2
Total Level 3 securities	$ 94.4	$ (4.9)	$ 0	$ 0	$ 0	$ 1.5	$ 0	$ 91.0

(millions)	Fair Value at Dec. 31, 2011	Calls/ Maturities/ Paydowns	Purchases	Sales	Net Realized (gain)/loss on sales	Change in Valuation	Net Transfers in (out)	Fair value at June 30, 2012
	Level 3 Fair Value Six months ended June 30, 2012							
Fixed maturities:								
Asset-backed securities:								
Residential mortgage-backed	$ 62.3	$ (7.8)	$ 0	$ 0	$ 0	$ 0	$ 0	$ 54.5
Commercial mortgage-backed	21.3	(.1)	0	0	0	2.0	0	23.2
Other asset-backed	2.6	(1.5)	0	0	0	0	0	1.1
Total fixed maturities	86.2	(9.4)	0	0	0	2.0	0	78.8
Equity securities:								
Nonredeemable preferred stocks:								
Financials	0	0	0	0	0	0	0	0
Common equities:								
Other risk investments	11.5	0	0	0	0	.7	0	12.2
Total Level 3 securities	$ 97.7	$ (9.4)	$ 0	$ 0	$ 0	$ 2.7	$ 0	$ 91.0

The following tables provide a summary of the quantitative information about Level 3 fair value measurements for our applicable securities at June 30, 2013 and 2012, and December 31, 2012:

($ in millions)	Fair Value at June 30, 2013	Quantitative Information about Level 3 Fair Value Measurements Valuation Technique	Unobservable Input	Unobservable Input Assumption
Fixed maturities:				
Asset-backed securities:				
Residential mortgage-backed	$ 13.9	External vendor	Prepayment rate[1]	1,0
Commercial mortgage-backed	27.6	External vendor	Prepayment rate[2]	0
Total fixed maturities	41.5			
Equity securities:				
Nonredeemable preferred stocks:				
Financials	34.8	Multiple of tangible net book value	Price to book ratio multiple	1.9
Common equities:				
Other risk investments	0			
Subtotal Level 3 securities	$ 76.3			
Pricing exemption securities[3]	181.9			
Total Level 3 securities	$ 258.2			

[1] Assumes that one security has 1% and another security has 0% of the principal amount of the underlying loans that will be paid off prematurely in each year.

[2] Assumes that two securities have 0% of the principal amount of the underlying loans that will be paid off prematurely in each year.

[3] The fair values for $143.9 million of these securities were obtained from non-binding external sources where unobservable inputs are not reasonably available to us. The remaining $38.0 million reflects a negotiated sale on a private common equity security that is expected to be completed by the end of 2013.

($ in millions)	Fair Value at June 30, 2012	Quantitative Information about Level 3 Fair Value Measurements Valuation Technique	Unobservable Input	Unobservable Input Assumption
Fixed maturities:				
Asset-backed securities:				
Residential mortgage-backed	$ .2	External vendor	Prepayment rate[1]	16
Commercial mortgage-backed	0			
Total fixed maturities	.2			
Equity securities:				
Nonredeemable preferred stocks:				
Financials	0			
Common equities:				
Other risk investments	11.2	Discounted consolidated equity	Discount for lack of marketability	20%
Subtotal Level 3 securities	$ 11.4			
Pricing exemption securities[2]	79.6			

Total Level 3 securities	$ 91.0

1 Assumes that one security has 16% of the principal amount of the underlying loans that will be paid off prematurely in each year.

2 The fair values for these securities were obtained from non-binding external sources where unobservable inputs are not reasonably available to us.

($ in millions)	Fair Value at Dec. 31, 2012	Quantitative Information about Level 3 Fair Value Measurements Valuation Technique	Unobservable Input	Unobservable Input Assumption
Fixed maturities:				
Asset-backed securities:				
Residential mortgage-backed	$ .2	External vendor	Prepayment rate[1]	16
Commercial mortgage-backed	25.3	External vendor	Prepayment rate[2]	0
Total fixed maturities	25.5			
Equity securities:				
Nonredeemable preferred stocks:				
Financials	31.9	Multiple of tangible net book value	Price to book ratio multiple	1.9
Common equities:				
Other risk investments	11.2	Discounted consolidated equity	Discount for lack of marketability	20%
Subtotal Level 3 securities	68.6			
Pricing exemption securities[3]	46.1			
Total Level 3 securities	$ 114.7			

1 Assumes that one security has 16% of the principal amount of the underlying loans that will be paid off prematurely in each year.
2 Assumes that three securities have 0% of the principal amount of the underlying loans that will be paid off prematurely in each year.
3 The fair values for these securities were obtained from non-binding external sources where unobservable inputs are not reasonably available to us.

Due to the relative size of the securities fair values compared to the total portfolio s fair value, any changes in pricing methodology would not have a significant change in valuation that would materially impact net and comprehensive income. During 2013 or 2012, there were no material assets or liabilities measured at fair value on a nonrecurring basis.

Note 4 *Debt* Debt consisted of:

(millions)	June 30, 2013 Carrying Value	June 30, 2013 Fair Value	June 30, 2012 Carrying Value	June 30, 2012 Fair Value	December 31, 2012 Carrying Value	December 31, 2012 Fair Value
7% Notes due 2013	$ 150.0	$ 152.3	$ 149.8	$ 160.7	$ 149.9	$ 157.1
3.75% Senior Notes due 2021	497.4	517.6	497.2	540.1	497.3	549.1
6 5/8% Senior Notes due 2029	295.2	362.1	295.1	378.3	295.2	385.0
6.25% Senior Notes due 2032	394.6	479.1	394.4	502.2	394.5	513.5
6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067	726.7	789.7	726.3	760.9	726.2	789.7
Total	$ 2,063.9	$ 2,300.8	$ 2,062.8	$ 2,342.2	$ 2,063.1	$ 2,394.4

We did not repurchase any debt securities in the first six months of 2013. During the second quarter, first six months, and full year of 2012, we repurchased, in the open market, $17.8 million, $30.4 million, and $30.9 million, respectively, in aggregate principal amount of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 (the 6.70% Debentures). Since the amount paid exceeded the carrying value of the debt we repurchased, we recognized losses on these extinguishments of $1.0 million, $1.7 million, and $1.8 million in the respective periods. In addition, for the portion of the 6.70% Debentures we repurchased, we reclassified $0.3 million, $0.6 million, and $0.6 million during these same periods, on a pretax basis, of the unrealized gain on forecasted transactions from accumulated other comprehensive income on the balance sheet to net realized gains on securities on the comprehensive income statement.

Our next scheduled debt maturity is $150 million of our 7% Notes due October 2013.

Note 5 ***Income Taxes*** At June 30, 2013 and 2012, and December 31, 2012, 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 that it is more likely than not that the 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 six months ended June 30, 2013, there have been no material changes in our uncertain tax positions.

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

	Six Months Ended June 30,	
(millions)	**2013**	**2012**
Income taxes, net of refunds	$ 265.0	$ 192.0
Interest	61.6	73.5

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

Following are the operating results for the respective periods:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		**2012**		**2013**		**2012**	
(millions)	**Revenues**	**Pretax Profit (Loss)**	**Revenues**	**Pretax Profit (Loss)**	**Revenues**	**Pretax Profit (Loss)**	**Revenues**	**Pretax Profit (Loss)**
Personal Lines								
Agency	$ 2,151.5	$ 131.5	$ 2,024.0	$ 46.4	$ 4,258.7	$ 306.4	$ 3,984.6	$ 185.6
Direct	1,685.4	126.0	1,564.2	26.0	3,327.0	253.2	3,077.4	87.3
Total Personal Lines[1]	3,836.9	257.5	3,588.2	72.4	7,585.7	559.6	7,062.0	272.9
Commercial Auto	440.1	32.1	407.6	24.1	870.5	47.4	794.9	53.5
Other indemnity	0	(3.8)	.3	(1.4)	.1	(3.5)	.7	(2.6)
Total underwriting operations	4,277.0	285.8	3,996.1	95.1	8,456.3	603.5	7,857.6	323.8
Fees and other revenues[2]	70.9	NA	69.9	NA	139.3	NA	135.1	NA
Service businesses	10.6	.2	10.2	.3	19.0	0	18.4	.3
Investments[3]	235.1	230.7	107.8	104.0	416.2	406.9	300.0	292.0
Gains (losses) on extinguishment of debt	0	0	(1.0)	(1.0)	0	0	(1.7)	(1.7)
Interest expense	NA	(30.4)	NA	(30.7)	NA	(61.0)	NA	(62.6)
Consolidated total	$ 4,593.6	$ 486.3	$ 4,183.0	$ 167.7	$ 9,030.8	$ 949.4	$ 8,309.4	$ 551.8

1 Personal auto insurance accounted for 91% of the total Personal Lines segment net premiums earned in all periods; 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 Pretax profit (loss) for fees and other revenues are allocated to operating segments.

3 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. Underwriting profitability 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. The underwriting margin is the pretax underwriting profit (loss) expressed as a percentage of net premiums earned (i.e., revenues from underwriting operations). Combined ratio is the complement of the underwriting margin. Following are the underwriting margins/combined ratios for our underwriting operations:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		2012		2013		2012	
	Under-writing Margin	Combined Ratio	Under-writing Margin	Combined Ratio	Under-writing Margin	Combined Ratio	Under-writing Margin	Combined Ratio
Personal Lines								
Agency	6.1%	93.9	2.3%	97.7	7.2%	92.8	4.7%	95.3
Direct	7.5	92.5	1.7	98.3	7.6	92.4	2.8	97.2
Total Personal Lines	6.7	93.3	2.0	98.0	7.4	92.6	3.9	96.1
Commercial Auto	7.3	92.7	5.9	94.1	5.4	94.6	6.7	93.3
Other indemnity[1]	NM	NM	NM	NM	NM	NM	NM	NM
Total underwriting operations	6.7	93.3	2.4	97.6	7.1	92.9	4.1	95.9

[1] 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 ***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 2013, the Board has determined the target percentage to be 33-1/3% of annual after-tax underwriting income, which is unchanged from the 2012 target percentage.

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 by the Compensation Committee of the Board. This Gainshare factor is also used in the annual cash bonus program currently in place for our employees (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 June 30, 2013, the Gainshare factor was 1.19. 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 dividend program will result in a variable payment to shareholders each year, subject to certain limitations. If the Gainshare factor is zero or if our comprehensive income is less than after-tax underwriting income, no dividend would be payable under our annual variable dividend policy. However, the ultimate decision on whether or not a dividend will be paid is in the discretion of the Board of Directors. If a dividend for 2013 will be paid, the Board would likely declare the 2013 annual dividend in December 2013, with a record date in January 2014 and payment shortly thereafter. For the six months ended June 30, 2013, our comprehensive income was $576.4 million, which is higher than the $392.3 million of after-tax underwriting income for the same period.

Progressive paid dividends per common share of $.2845 and $.4072 in February 2013 and 2012, respectively, under our annual variable dividend policy. These dividends were paid pursuant to declarations made by the Board of Directors in December 2012 and 2011. In addition to the annual variable dividend, the Board of Directors declared a $1.00 per common share special dividend in October 2012, which was paid in November 2012.

Note 9 ***Other Comprehensive Income (Loss)*** The components of other comprehensive income (loss), including reclassification adjustments by income statement line item, were as follows:

(millions)	Pretax total accumulated other comprehensive income	Total tax (provision) benefit	After tax total accumulated other comprehensive income	**Components of Changes in Accumulated Other Comprehensive Income (after tax)** Total net unrealized gains (losses) on securities	Net unrealized gains on forecasted transactions[1]	Foreign currency translation adjustment
Balance at March 31, 2013	**$ 1,491.8**	**$ (522.1)**	**$ 969.7**	**$ 961.9**	**$ 5.8**	**$ 2.0**
Other comprehensive income (loss) before reclassifications:						
Investment securities	(147.1)	51.5	(95.6)	(95.6)	0	0
Net non-credit related OTTI losses, adjusted for valuation changes	.1	0	.1	.1	0	0
Forecasted transactions	0	0	0	0	0	0
Foreign currency translation adjustment	(1.2)	.4	(.8)	0	0	(.8)
Total other comprehensive income (loss) before reclassifications	(148.2)	51.9	(96.3)	(95.5)	0	(.8)
Less: Reclassification adjustment for amounts realized in net income by income statement line item:						
Net impairment losses recognized in earnings	(1.5)	.5	(1.0)	(1.0)	0	0
Net realized gains (losses) on securities	92.0	(32.2)	59.8	59.8	0	0
Interest expense[2]	.5	(.1)	.4	0	.4	0
Total reclassification adjustment for amounts realized in net income	91.0	(31.8)	59.2	58.8	.4	0
Total other comprehensive income (loss)	(239.2)	83.7	(155.5)	(154.3)	(.4)	(.8)
Balance at June 30, 2013	**$ 1,252.6**	**$ (438.4)**	**$ 814.2**	**$ 807.6**	**$ 5.4**	**$ 1.2**

(millions)	Pretax total accumulated other comprehensive income	Total tax (provision) benefit	After tax total accumulated other comprehensive income	Components of Changes in Accumulated Other Comprehensive Income (after tax) Total net unrealized gains (losses) on securities	Net unrealized gains on forecasted transactions[1]	Foreign currency translation adjustment
Balance at December 31, 2012	**$ 1,340.0**	**$ (469.0)**	**$ 871.0**	**$ 862.7**	**$ 6.1**	**$ 2.2**
Other comprehensive income (loss) before reclassifications:						
Investment securities	80.7	(28.2)	52.5	52.5	0	0
Net non-credit related OTTI losses, adjusted for valuation changes	.4	(.1)	.3	.3	0	0
Forecasted transactions	0	0	0	0	0	0
Foreign currency translation adjustment	(1.5)	.5	(1.0)	0	0	(1.0)
Total other comprehensive income (loss) before reclassifications	79.6	(27.8)	51.8	52.8	0	(1.0)
Less: Reclassification adjustment for amounts realized in net income by income statement line item:						
Net impairment losses recognized in earnings	(1.6)	.6	(1.0)	(1.0)	0	0
Net realized gains (losses) on securities	167.6	(58.7)	108.9	108.9	0	0
Interest expense[2]	1.0	(.3)	.7	0	.7	0
Total reclassification adjustment for amounts realized in net income	167.0	(58.4)	108.6	107.9	.7	0
Total other comprehensive income (loss)	(87.4)	30.6	(56.8)	(55.1)	(.7)	(1.0)
Balance at June 30, 2013	**$ 1,252.6**	**$ (438.4)**	**$ 814.2**	**$ 807.6**	**$ 5.4**	**$ 1.2**

[1] Entered into for the purpose of managing interest rate risk associated with our debt issuances.

[2] We expect to reclassify $2.2 million (pretax) into income during the next 12 months.

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, written by our insurance subsidiaries, in the ordinary course of business. We consider all legal actions relating to such claims in establishing our loss and loss adjustment expense reserves.

In addition, The Progressive Corporation and/or its insurance subsidiaries are named as defendants in a number of class action or individual lawsuits arising out of the operations of the insurance subsidiaries. These cases include those alleging damages as a result of our subsidiaries 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 subsidiaries 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. We establish accruals for lawsuits when it is probable that a loss has been incurred and we can reasonably estimate its potential exposure, which may include a range of loss. As to lawsuits in which the loss is not considered both probable and estimable, or is considered probable but not estimable, we have not established a liability at this time in accordance with current accounting guidance. In the event that any one or more of these cases results in a substantial judgment against, or settlement by, Progressive, the resulting liability could have a material effect on our consolidated financial condition, cash flows, and/or results of operations.

For a further discussion on our pending litigation, see *Note 12 Litigation* in our Annual Report to Shareholders, which is included as Exhibit 13 to our Annual Report on Form 10-K, for the year ended December 31, 2012.

Note 11 ***Reclassifications*** For the period ended June 30, 2012, we reclassified net deferred income taxes to be reported as a separate line item and income taxes recoverable to be reported as a component of other assets to conform with the current-year presentation. There was no effect on total assets.

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

I. OVERVIEW

During the second quarter 2013, The Progressive Corporation s insurance subsidiaries generated net premiums written and policies in force growth of 6% and 1%, respectively, on a year-over-year basis. Overall, our net income was up 174% to $324.6 million, or $.54 per share, for the second quarter 2013, reflecting both strong underwriting profitability and increased net realized gains from our investment portfolio, as compared to last year. Underwriting profitability for the quarter of 6.7%, or $285.8 million, was 4.3 points better than last year, and we recognized $132.9 million of net realized gains from our investment portfolio versus $4.7 million of losses last year. Our investment income of $102.2 million was down 9%, or $10.3 million, on a year-over-year basis, primarily reflecting lower yields. At June 30, 2013, our total capital position (debt plus equity) was $8.6 billion, reflecting a $0.1 billion increase during the quarter.

A. Operations

During the second quarter 2013, we realized a year-over-year increase in net premiums written of 6% on a companywide basis. Our Agency and Direct Personal Lines businesses grew 6% and 8%, respectively, and our Commercial Auto business grew 3%. To analyze growth, we review written premium per policy (i.e., rates), new business applications (i.e., issued policies), and customer retention. For the second quarter 2013, rate increases taken during 2012 have been a significant contributor to the written premium growth. Due in large part to these rate increases, new business applications decreased from last year in all of our products except Direct auto, while customer retention was down in personal auto but relatively flat in Commercial Auto and for our special lines products.

Adjusting rates is an ongoing process. In light of rising claims costs, we raised rates principally in the second and third quarters of 2012 across all of our products, but mainly in personal auto. As a result, we started experiencing increases in personal auto written premium per policy that continued into the second quarter 2013. For the second quarter 2013, on a year-over-year basis, written premium per policy increased 7% and 4% in our Agency and Direct auto businesses, respectively. Commercial Auto premiums per policy increased about 6% for the second quarter 2013, and our special lines products written premium per policy was up 4%.

As a result of the rate increases taken, new business applications declined in the second quarter for all products except Direct auto. On a year-over-year basis, Personal Lines new applications decreased 4%, reflecting declines in our Agency auto business and special lines products of 7% and 6%, respectively, partially offset by a 3% increase in our Direct auto business new applications. The new business growth in Direct auto reflects both an increase in demand along with some small rate decreases taken in some of our larger Direct auto states in response to our ongoing market reviews. Our Commercial Auto new applications decreased 7%, continuing to reflect the rate increases taken in 2012 and the first half of 2013. We will continue to evaluate future rate needs and react quickly as we recognize changing trends.

During the second quarter, our renewal applications increased 3% in Personal Lines and 1% in Commercial Auto, primarily reflecting the growth in policies in force we generated during 2012. Both our Agency and Direct businesses contributed to the Personal Lines increase.

We continued with the many initiatives we have in place to help stimulate growth and provide consumers with distinctive insurance options. Our three primary initiatives all made meaningful progress, including:

Expansion of our mobile acquisition capabilities our technology is able to provide the capability for almost all combinations of cars and drivers quoted on a mobile device.

Cross-sell our products our relationships with our non-affiliated homeowner insurance carriers continue to grow and, during the quarter, we launched significant marketing communication plans to promote the bundling of home and auto insurance to our jointly appointed agents. In addition, we continued to enhance our systems to enable our agents and customer service representatives, as well as our customers, to quote and view all their Progressive products concurrently.

Snapshot®, our usage-based insurance product we launched a marketing campaign to communicate the benefits of Snapshot in a way we believe will help demonstrate the advantages to consumers. Specifically, the messaging focuses on how good drivers are paying more for insurance due to the poorer driving and insurance profile of other drivers. In addition, our agents continued to test drive Snapshot to allow them to experience the product for themselves and to be able to communicate to their customers the ease of using Snapshot and the benefits of capturing the additional driver specific information provided by the device.

On a companywide basis, year-over-year, policies in force grew 1%, with Personal Lines growing 1% and Commercial Auto flat. Our Direct auto business grew 2%, our Agency auto business declined 1%, and our special lines policies grew 1% over last year. We ended the second quarter with 13.0 million Personal Lines policyholders.

To further grow policies in force, it is critical that we retain our customers for longer periods, which is why increasing retention continues to be one of our most important priorities and why our efforts to increase the number of multi-product households continues to be a key initiative. 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 decreased 6% and 7% for our Agency and Direct auto businesses, respectively, compared to last year. These declines in retention were not unexpected following the rate increases we took in 2012. Our policy life expectancy for our Commercial Auto business and our special lines products was relatively flat compared to last year.

Our 6.7% companywide underwriting profit margin for the second quarter 2013 was 4.3 points better than our margin for the same period last year and exceeded our target of at least 4%. As previously discussed, the rate increases taken primarily in the second and third quarters of 2012 led to increased earned premium per policy in 2013, which was a significant contributor to the increased underwriting profitability. In addition, we experienced lower catastrophe losses in the second quarter 2013, compared to the second quarter 2012.

B. Investments and Capital Management

The fair value of our investment portfolio was $17.5 billion at June 30, 2013. 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. 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

We use the credit ratings from models provided by the National Association of Insurance Commissioners (NAIC) for classifying our residential and commercial mortgage-backed securities, excluding interest-only securities, while all other debt securities derive their credit ratings from nationally recognized statistical rating organizations (NRSRO) in determining whether securities should be classified as Group I or Group II. At June 30, 2013, 22% of our portfolio was allocated to Group I securities and 78% to Group II securities, compared to 21% and 79%, respectively, at December 31, 2012.

Our investment portfolio produced a fully taxable equivalent (FTE) total return of 0.1% for the second quarter 2013. Our common stock portfolio s positive total return of 2.9% more than offset our fixed-income portfolio s loss of (0.5)%. At June 30, 2013, 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.

Our recurring investment income generated a pretax book yield of 2.6% during the second quarter 2013. At June 30, 2013, our duration was 1.9 years, which limited our exposure to capital loss during the quarter as interest rates rose sharply from extremely low levels. We remain confident that our preference for shorter duration during times of low interest rates is our best positioning.

At June 30, 2013, we held $16.4 million in Australian government obligations and $7.1 million in Australian Treasury Bills to support our Australian operations; we held no other foreign sovereign debt. We held $616.7 million of U.S. dollar-denominated corporate bonds and nonredeemable preferred stocks issued by companies that are domiciled, or whose parent companies are domiciled, in European countries. Of these securities, $80.6 million are U.K.-domiciled financial institution nonredeemable preferred stocks and $536.1 million are corporate bonds from U.K. and other European companies primarily in the consumer, industrial, energy, and communications industries. We had no direct exposure to Southern European-domiciled companies at June 30, 2013. In total, our European-domiciled fixed-income securities represented approximately 4% of our portfolio at June 30, 2013.

At June 30, 2013, our total capital (debt plus equity) was $8.6 billion, compared to $8.1 billion at December 31, 2012, and our debt-to-total capital ratio decreased to 24.0% from 25.6% at year-end 2012. We continue to manage our investing and financing activities in order to maintain sufficient capital to support all of the insurance we can profitably write and service.

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. Operations generated positive cash flows of $1.1 billion for the first six months of both 2013 and 2012.

We held total capital (debt plus equity) of $8.6 billion, at book value, at June 30, 2013, compared to $8.3 billion and $8.1 billion at June 30, 2012 and December 31, 2012, respectively. Our debt-to-total capital ratio was 24.0%, 24.7%, and 25.6% at June 30, 2013 and 2012 and December 31, 2012, respectively. Our next scheduled debt maturity is $150 million of our 7% Notes in October 2013, which will be funded from operating cash flows.

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, scheduled principal and interest payments on our debt, any announced dividends, and other expected capital requirements. The covenants on our existing debt securities do not include any rating or credit triggers that would require an adjustment of the interest rate or an acceleration of principal payments in the event our securities are downgraded by a rating agency.

We seek to deploy capital in a prudent manner and use multiple data sources and modeling tools to estimate the frequency, severity, and correlation of identified exposures, including, but not limited to, catastrophic and other insured 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 by 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, and 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 at 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, which is included as Exhibit 13 to our Annual Report on Form 10-K, for the year ended December 31, 2012.

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.

During the first six months of 2013 and at all times during 2012, our total capital exceeded the sum of our regulatory capital layer plus our self-constructed extreme contingency load.

The amount of capital in our third layer was at a level that allowed our Board of Directors to take several actions to return underleveraged capital to our investors, including:

Repurchases of our outstanding debt securities. From time to time, we 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. Although we did not repurchase any debt securities in the first half of 2013, during the second quarter and first six months of 2012, we repurchased, in the open market, $17.8 million and $30.4 million, respectively, in principal amount of our 6.70% Debentures.

Repurchases of our common shares. In accordance with our financial policies, we continued our practice of repurchasing our common shares. As of June 30, 2013, we had 36.8 million shares remaining under our 2011 Board repurchase authorization. The following table shows our share repurchase activity during the respective periods:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
(millions, except per share amounts)	**2013**	**2012**	**2013**	**2012**
Total number of shares purchased	3.0	2.1	5.3	4.0
Total cost	$ 75.4	$ 45.3	$ 126.7	$ 83.0
Average price paid per share	$ 25.19	$ 21.21	$ 24.07	$ 20.74

Dividends. As part of our capital management activities, in February 2013 and 2012, we paid our annual variable dividend of $.2845 per share and $.4072 per share, respectively, which were each declared in December of the prior year.

Short-Term Borrowings

We did not engage in short-term borrowings to fund our operations or for other purposes during the six months ended June 30, 2013 and during 2012. 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*.

During the first quarter 2013, we entered into an unsecured, discretionary line of credit with PNC Bank, National Association (PNC) in the maximum principal amount of $100 million. All advances under this agreement are subject to PNC s discretion, would bear interest at a variable, daily rate, and must be repaid on the earlier of the 30th day after the advance or the expiration date of the facility, March 25, 2014. We have not borrowed funds under this agreement.

During the first six months of 2013 and 2012, we engaged in repurchase agreements for periods of 14 days and 25 days, respectively, under which we loaned U.S. Treasury securities to internally approved counterparties in exchange for cash equal to the fair value of the securities, as described in more detail below under *Results of Operations Investments; Repurchase and Reverse Repurchase Transactions.* These investment transactions were entered into to enhance the yield from our fixed-income portfolio and not as a source of liquidity or funding for our operations. We had no open repurchase commitments at June 30, 2013 or 2012, or December 31, 2012.

B. Commitments and Contingencies

Contractual Obligations

During the first six months of 2013, our contractual obligations have not changed materially from those discussed in our Annual Report on Form 10-K for the year ended December 31, 2012.

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 2012. 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, 2012.

Other

During the first half of 2013, we added four new service centers, including two centers added during the second quarter. As of June 30, 2013, we have in operation 58 service centers in 43 metropolitan areas across the country that provide our concierge level of claims service and are designed to provide end-to-end resolution for auto physical damage losses. Currently, we own 80% of our service centers and lease the remaining sites. In 21 of these centers, we have combined a claims office with a service center to improve our efficiency. In an effort to provide the service center experience to more of our expanding customer population, over the next four years we expect to complete construction of 10-20 new service centers, each co-located with a full service claims office. The cost of these facilities, excluding land, is estimated to average $4 to $6 million per center, depending on a number of variables, including the size and location of the center and will be funded through operating cash flows.

III. RESULTS OF OPERATIONS UNDERWRITING

A. Growth

	Three Months Ended June 30,			Six Months Ended June 30,		
($ in millions)	2013	2012	% Change	2013	2012	% Change
NET PREMIUMS WRITTEN						
Personal Lines						
Agency	$ 2,223.7	$ 2,097.4	6	$ 4,425.9	$ 4,173.9	6
Direct	1,681.1	1,561.2	8	3,467.4	3,217.7	8
Total Personal Lines	3,904.8	3,658.6	7	7,893.3	7,391.6	7
Commercial Auto	482.3	470.5	3			