Consolidated Statements of Income

(millions–except per share amounts)

For the years ended December 31,	2002	2001	2000
Revenues			
Premiums earned	$ 8,883.5	$ 7,161.8	$ 6,348.4
Investment income	455.2	413.6	385.2
Net realized gains (losses) on securities	(78.6)	(111.9)	16.9
Service revenues	34.3	24.7	20.5
Total revenues	9,294.4	7,488.2	6,771.0
Expenses			
Losses and loss adjustment expenses	6,299.1	5,264.1	5,279.4
Policy acquisition costs	1,031.6	864.9	788.0
Other underwriting expenses	874.2	686.9	559.3
Investment expenses	11.5	12.7	9.1
Service expenses	22.0	19.8	21.4
Interest expense	74.6	52.2	77.8
Nonrecurring item[1]	—	—	4.2
Total expenses	8,313.0	6,900.6	6,739.2
Net Income			
Income before income taxes	981.4	587.6	31.8
Provision (benefit) for income taxes	314.1	176.2	(14.3)
Net income	$ 667.3	$ 411.4	$ 46.1
Computation of Earnings Per Share			
Basic:			
Average shares outstanding	219.0	221.0	219.6
Per share	$ 3.05	$ 1.86	$ .21
Diluted:			
Average shares outstanding	219.0	221.0	219.6
Net effect of dilutive stock options	4.2	4.2	3.4
Total equivalent shares	223.2	225.2	223.0
Per share	$ 2.99	$ 1.83	$ .21

[1]Represents the realization of the foreign currency translation loss associated with the substantial liquidation of the Company's foreign subsidiary.

All share and per share amounts were adjusted for the April 22, 2002, 3-for-1 stock split.

See notes to consolidated financial statements.

Consolidated Balance Sheets

December 31,	2002	2001
		(millions)
Assets		
Investments:		
Available-for-sale:		
Fixed maturities, at market (amortized cost: $7,409.4 and $5,873.0)	$ 7,712.5	$ 5,949.0
Equity securities, at market:		
Preferred stocks (cost: $631.9 and $675.4)	656.7	713.9
Common equities (cost: $1,425.3 and $1,263.7)	1,347.3	1,336.0
Short-term investments, at amortized cost (market: $567.8 and $227.4)	567.8	227.4
Total investments	10,284.3	8,226.3
Cash	16.9	11.2
Accrued investment income	77.9	75.2
Premiums receivable, net of allowance for doubtful accounts of $54.6 and $46.2	1,742.8	1,497.1
Reinsurance recoverables, including $34.8 and $33.2 on paid losses	215.7	201.5
Prepaid reinsurance premiums	96.7	77.6
Deferred acquisition costs	363.5	316.6
Income taxes	219.2	178.1
Property and equipment, net of accumulated depreciation of $392.4 and $384.8	503.1	498.0
Other assets	44.3	40.8
Total assets	$ 13,564.4	$ 11,122.4
Liabilities and Shareholders' Equity		
Unearned premiums	$ 3,304.3	$ 2,716.7
Loss and loss adjustment expense reserves	3,813.0	3,238.0
Accounts payable, accrued expenses and other liabilities	1,190.1	821.3
Debt	1,489.0	1,095.7
Total liabilities	9,796.4	7,871.7
Shareholders' equity:		
Common Shares, $1.00 par value (authorized 300.0, issued 230.1 and 83.1, including treasury shares of 12.1 and 9.7)	218.0	73.4
Paid-in capital	584.7	554.0
Accumulated other comprehensive income (loss):		
Net unrealized appreciation on investment securities	162.4	121.5
Hedges on forecasted transactions	11.7	9.2
Foreign currency translation adjustment	(4.8)	(4.8)
Retained earnings	2,796.0	2,497.4
Total shareholders' equity	3,768.0	3,250.7
Total liabilities and shareholders' equity	$ 13,564.4	$ 11,122.4

See notes to consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

(millions–except per share amounts)

For the years ended December 31,	2002		2001		2000	
Retained Earnings						
Balance, Beginning of year	$ 2,497.4		$ 2,220.4		$ 2,210.5	
Net income	667.3	$ 667.3	411.4	$ 411.4	46.1	$ 46.1
Cash dividends on Common Shares ($.096, $.093 and $.090 per share, split effected)	(21.1)		(20.6)		(19.8)	
Treasury shares purchased	(200.7)		(112.5)		(15.5)	
Capitalization of stock split	(147.0)		—		—	
Other, net	.1		(1.3)		(.9)	
Balance, End of year	$ 2,796.0		$ 2,497.4		$ 2,220.4	
Accumulated Other Comprehensive Income (Loss), Net of Tax						
Balance, Beginning of year	$ 125.9		$ 64.7		$ (12.4)	
Change in unrealized appreciation		40.9		52.0		72.9
Hedges on forecasted transactions		2.5		9.2		—
Foreign currency translation adjustment		—		—		4.2
Other comprehensive income	43.4	43.4	61.2	61.2	77.1	77.1
Balance, End of year	$ 169.3		$ 125.9		$ 64.7	
Comprehensive Income		$ 710.7		$ 472.6		$ 123.2
Common Shares, $1.00 Par Value						
Balance, Beginning of year	$ 73.4		$ 73.5		$ 73.1	
Stock options exercised	1.2		.8		.7	
Treasury shares purchased[1]	(3.6)		(.9)		(.3)	
Capitalization of stock split	147.0		—		—	
Balance, End of year	$ 218.0		$ 73.4		$ 73.5	
Paid-In Capital						
Balance, Beginning of year	$ 554.0		$ 511.2		$ 481.6	
Stock options exercised	21.4		25.2		17.9	
Tax benefits on stock options exercised	19.3		24.4		11.3	
Treasury shares purchased	(10.0)		(6.8)		(2.0)	
Other	—		—		2.4	
Balance, End of year	$ 584.7		$ 554.0		$ 511.2	
Total Shareholders' Equity	$ 3,768.0		$ 3,250.7		$ 2,869.8	

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

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

[1]The Company did not split treasury shares. In 2002, the Company repurchased 136,182 Common Shares prior to the stock split and 3,471,916 Common Shares subsequent to the stock split.

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(millions)

For the years ended December 31,	2002	2001	2000
Cash Flows From Operating Activities			
Net income	$ 667.3	$ 411.4	$ 46.1
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	83.9	81.0	77.6
Net realized (gains) losses on securities	78.6	111.9	(16.9)
Realized foreign currency translation loss	—	—	4.2
Changes in:			
Unearned premiums	587.6	80.2	(144.9)
Loss and loss adjustment expense reserves	575.0	251.6	570.2
Accounts payable, accrued expenses and other liabilities	256.6	103.4	40.1
Prepaid reinsurance premiums	(19.1)	18.1	(7.4)
Reinsurance recoverables	(14.2)	36.2	17.0
Premiums receivable	(245.7)	69.9	193.8
Deferred acquisition costs	(46.9)	(6.7)	33.5
Income taxes	(65.1)	30.2	(6.9)
Tax benefits from exercise of stock options	19.3	24.4	11.3
Other, net	34.7	23.0	4.7
Net cash provided by operating activities	1,912.0	1,234.6	822.4
Cash Flows From Investing Activities			
Purchases:			
Available-for-sale: fixed maturities	(7,924.9)	(4,935.2)	(5,259.2)
equity securities	(680.7)	(1,696.0)	(1,227.2)
Sales:			
Available-for-sale: fixed maturities	5,823.3	3,335.5	4,728.3
equity securities	412.0	1,436.3	837.5
Maturities, paydowns, calls and other:			
Available-for-sale: fixed maturities	594.0	451.9	406.7
equity securities	—	135.9	27.0
Net (purchases) sales of short-term investments	(340.4)	(40.6)	42.2
Net unsettled security transactions	115.3	(95.3)	64.3
Purchases of property and equipment	(89.9)	(74.9)	(130.3)
Net cash used in investing activities	(2,091.3)	(1,482.4)	(510.7)
Cash Flows From Financing Activities			
Proceeds from exercise of stock options	22.6	26.0	18.6
Proceeds from debt	398.6	365.4	—
Payments of debt	(.8)	(.5)	(300.4)
Dividends paid to shareholders	(21.1)	(20.6)	(19.8)
Acquisition of treasury shares	(214.3)	(120.2)	(17.8)
Other, net	—	—	2.4
Net cash provided by (used in) financing activities	185.0	250.1	(317.0)
Increase (decrease) in cash	5.7	2.3	(5.3)
Cash, Beginning of year	11.2	8.9	14.2
Cash, End of year	$ 16.9	$ 11.2	$ 8.9

See notes to consolidated financial statements.

1 Reporting and Accounting Policies

Nature of Operations The Progressive Corporation, an insurance holding company formed in 1965, owns 69 subsidiaries and has 1 mutual insurance company affiliate and 1 reciprocal insurance company affiliate (the Company). The insurance subsidiaries and affiliates provide personal automobile insurance and other specialty property-casualty insurance and related services throughout the United States. The Company's Personal Lines segment writes insurance for private passenger automobiles and recreation vehicles through both the independent agent channel and the direct channel. The Company's Commercial Auto segment writes insurance for automobiles and trucks owned by small businesses primarily through the independent agent channel.

Basis of Consolidation and Reporting The accompanying consolidated financial statements include the accounts of The Progressive Corporation, its subsidiaries and affiliates. All of the subsidiaries and the affiliates are wholly owned or controlled. All intercompany accounts and transactions are eliminated in consolidation.

Estimates The Company is required to make estimates and assumptions when preparing its financial statements and accompanying notes in conformity with accounting principles generally accepted in the United States of America (GAAP). Actual results could differ from those estimates.

Investments Available-for-sale: fixed maturity securities are debt securities, which may have fixed or variable principal payment schedules, may be held for indefinite periods of time, and may be used as a part of the Company's asset/liability strategy or sold in response to changes in interest rates, anticipated prepayments, risk/reward characteristics, liquidity needs or similar economic factors. These securities are carried at market value with the corresponding unrealized appreciation or depreciation, net of deferred income taxes, reported in accumulated other comprehensive income. Market values are obtained from a recognized pricing service or other quoted sources. The asset-backed portfolio is accounted for under the retrospective method; prepayment assumptions are based on market expectations. For interest only and non-investment-grade asset-backed securities, the prospective method is used in accordance with the guidance prescribed by Emerging Issues Task Force Issue 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets."

Available-for-sale: equity securities include common equities and nonredeemable preferred stocks and are reported at quoted market values. Changes in the market values of these securities, net of deferred income taxes, are reflected as unrealized appreciation or depreciation in accumulated other comprehensive income. Changes in value of foreign equities due to foreign currency exchange rates are limited by foreign currency hedges; unhedged amounts are not material and changes in value are recognized in income in the current period. There were no foreign currency hedges outstanding at December 31, 2002.

Trading securities are securities bought principally for the purpose of sale in the near term and, when not material to the Company's financial position, cash flows or results of operations, are reported at market value within the available-for-sale portfolio. During 2002, the Company had no trading securities. In prior years, the net activity in trading securities was not material to the Company's financial position or cash flows; the effect on results of operations is separately disclosed in Note 2 – Investments. To the extent the Company has trading securities, changes in market value would be recognized in income in the current period.

Derivative instruments may include futures, options, forward positions, foreign currency forwards and interest rate swap agreements and may be used in the portfolio for risk management, fair value hedging or trading purposes. During 2002, the Company had no fair value hedges or derivative instruments held or issued for risk management or trading purposes. In prior years, the net activity in these instruments was not material to the Company's financial position, cash flows or results of operations; gains or losses during the year were reported in the available-for-sale portfolio. Gains and losses on foreign currency hedges offset the foreign exchange gains and losses on the foreign equity portfolio. The Company did not have any foreign currency equity during 2002.

To the extent the Company held derivative instruments, the derivatives would be recognized as either assets or liabilities and measured at fair value with changes in fair value recognized in income in the period of change. Changes in the fair value of the hedged items would be recognized in income while the hedge was in effect.

Derivatives designated as hedges would also be evaluated on established criteria to determine the effectiveness of their correlation to, and ability to reduce risk of, specific securities or transactions; effectiveness would be reassessed regularly. If the effectiveness of a fair value hedge becomes non-compliant, the adjustment in the change in value of the hedged item would no longer be recognized in income during the current period.

Derivatives may also be used to hedge forecasted transactions. Changes in fair value of these hedges are reported as a component of accumulated other comprehensive income and subsequently amortized into earnings over the life of the hedged transaction. Gains and losses on hedges on forecasted transactions are amortized over the life of the hedged item (see Note 4 – Debt). Hedges on forecasted transactions that no longer qualify for hedge accounting due to lack of correlation are considered derivatives used for risk management purposes.

Short-term investments include eurodollar deposits, commercial paper and other securities maturing within one year and are reported at amortized cost, which approximates market.

Investment securities are exposed to various risks such as interest rate, market and credit risk. Market values of securities fluctuate based on the magnitude of changing market conditions; significant changes in market conditions could materially affect portfolio value in the near term. The Company continually monitors its portfolio for pricing changes, which might indicate potential impairments and, on a quarterly basis, performs a detailed review of securities with

unrealized losses based on predetermined criteria. In such cases, changes in market value are evaluated to determine the extent to which such changes are attributable to (i) fundamental factors specific to the issuer, such as financial conditions, business prospects or other factors or (ii) market-related factors, such as interest rates or equity market declines. When a security in the Company's investment portfolio has an unrealized loss in market value that is deemed to be other than temporary, the Company reduces the book value of such security to its current market value, recognizing the decline as a realized loss in the income statement. Any future increases in the market value of securities written down are reflected as changes in unrealized gains as part of accumulated other comprehensive income within shareholders' equity.

Realized gains and losses on securities are computed based on the first-in first-out method and include write-downs on available-for-sale securities considered to have other than temporary declines in market value.

Property and Equipment Property and equipment are recorded at cost. Depreciation is provided over the estimated useful lives of the assets using accelerated methods for computers and the straight-line method for all other fixed assets. The useful lives range from 3 to 4 years for computers, 10 to 40 years for buildings and improvements, and 5 to 6 years for all other property and equipment. Property and equipment includes software capitalized for internal use. At December 31, 2002 and 2001, land and buildings comprised 71% and 73%, respectively, of total property and equipment.

Total interest capitalized was $.5 million, $1.2 million and $3.3 million in 2002, 2001 and 2000, respectively, relating to both the Company's construction projects and capitalized computer software costs.

Insurance Premiums and Receivables Insurance premiums written are earned primarily on a pro rata basis over the period of risk using a mid-month convention. The Company provides insurance and related services to individuals, small commercial accounts and lenders throughout the United States, and offers a variety of payment plans. Generally, premiums are collected in advance of providing risk coverage, minimizing the Company's exposure to credit risk. The Company performs a policy level evaluation to determine the extent the premiums receivable balance exceeds its unearned premiums balance. The Company then ages this exposure to establish an allowance for doubtful accounts.

Income Taxes The income tax provision is calculated under the balance sheet approach. Deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax bases of assets and liabilities at the enacted tax rates. The principal assets and liabilities giving rise to such differences are net unrealized gains/losses on securities, loss reserves, unearned premiums reserves, deferred acquisition costs and non-deductible accruals. The Company reviews its deferred tax assets and liabilities for recoverability. At December 31, 2002, the Company is able to demonstrate that the benefit of its deferred tax assets is fully realizable.

Loss and Loss Adjustment Expense Reserves Loss reserves represent the estimated liability on claims reported to the Company, plus reserves for losses incurred but not yet reported (IBNR). These estimates are reported net of amounts recoverable from salvage and subrogation. Loss adjustment expense reserves represent the estimated expenses required to settle these claims and losses. The methods of making estimates and establishing these reserves are reviewed regularly, and resulting adjustments are reflected in income currently. Such loss and loss adjustment expense reserves could be susceptible to significant change in the near term.

Reinsurance The Company's reinsurance transactions include premiums written under state-mandated involuntary plans for commercial vehicles (Commercial Auto Insurance Procedures–CAIP), for which the Company retains no indemnity risk (see Note 6 – Reinsurance for further discussion). The remaining reinsurance arises from the Company seeking to reduce its loss exposure in its auto and non-auto programs. Prepaid reinsurance premiums are recognized on a pro rata basis over the period of risk using a mid-month convention. Because the Company's primary line of business, auto insurance, is written at relatively low limits of liability, the Company does not believe that it needs to mitigate its risk through voluntary reinsurance.

Earnings Per Share Basic earnings per share are computed using the weighted average number of Common Shares outstanding. Diluted earnings per share include common stock equivalents assumed outstanding during the period. The Company's common stock equivalents include only stock options.

Deferred Acquisition Costs Deferred acquisition costs include commissions, premium taxes and other variable underwriting and direct sales costs incurred in connection with writing business. These costs are deferred and amortized over the policy period in which the related premiums are earned. The Company considers anticipated investment income in determining the recoverability of these costs. Management believes that these costs will be fully recoverable in the near term. The Company does not defer advertising costs.

Guaranty Fund Assessments Guaranty fund assessments are accrued after a formal determination of insolvency has occurred and the Company has written the premiums on which the assessments will be based.

Service Revenues and Expenses Service revenues consist primarily of fees generated from processing business for involuntary plans and are earned on a pro rata basis over the term of the related policies. Acquisition expenses are deferred and amortized over the period in which the related revenues are earned.

Supplemental Cash Flow Information Cash includes only bank demand deposits. The Company paid income taxes of $392.0 million, $127.3 million and $13.8 million in 2002, 2001 and 2000, respectively. Total interest paid was $64.4 million during 2002, $51.3 million during 2001 and $81.6 million during 2000.

The Company effected a 3-for-1 stock split in the form of a dividend to shareholders on April 22, 2002. The Company issued its Common Shares by transferring $147.0 million from retained earnings to the Common Share account. All share and per share amounts and stock prices were adjusted to give effect to the split. Treasury shares were not split.

Stock Options The Company follows the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," to account for its stock option activity in the financial

statements. The Company granted all options currently outstanding at an exercise price equal to the market price at the date of grant and, therefore, under APB 25, no compensation expense is recorded. The Company follows the disclosure provisions of Statement of Financial Accounting Standards (SFAS) 123, "Accounting for Stock-Based Compensation."

The following table is presented in accordance with SFAS 148, "Accounting for Stock-Based Compensation – Transition and Disclosure." The Company uses the Black-Scholes pricing model to calculate the fair value of the options awarded as of the date of grant.

(millions, except per share amounts)	2002	2001	2000
Net income, as reported	$ 667.3	$ 411.4	$ 46.1
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(16.9)	(15.4)	(12.1)
Net income, pro forma	$ 650.4	$ 396.0	$ 34.0
Earnings per share			
Basic – as reported	$ 3.05	$ 1.86	$ .21
Basic – pro forma	2.97	1.79	.15
Diluted – as reported	$ 2.99	$ 1.83	$ .21
Diluted – pro forma	2.92	1.76	.15

2 Investments

The composition of the investment portfolio at December 31 was:

(millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value	% of Total Portfolio
2002					
Available-for-sale:					
U.S. government obligations	$ 1,619.6	$ 27.3	$ —	$ 1,646.9	16.0%
State and local government obligations	1,900.3	76.2	(.5)	1,976.0	19.2
Foreign government obligations	25.6	.8	—	26.4	.3
Corporate and U.S. agency debt securities	1,443.1	75.6	(5.9)	1,512.8	14.7
Asset-backed securities	2,420.8	140.1	(10.5)	2,550.4	24.8
	7,409.4	320.0	(16.9)	7,712.5	75.0
Preferred stocks	631.9	35.1	(10.3)	656.7	6.4
Common equities	1,425.3	55.3	(133.3)	1,347.3	13.1
Short-term investments	567.8	—	—	567.8	5.5
	$ 10,034.4	$ 410.4	$ (160.5)	$ 10,284.3	100.0%
2001					
Available-for-sale:					
U.S. government obligations	$ 667.9	$ 3.1	$ (3.3)	$ 667.7	8.1%
State and local government obligations	1,066.0	24.6	(6.0)	1,084.6	13.2
Foreign government obligations	38.2	.9	—	39.1	.5
Corporate and U.S. agency debt securities	1,823.7	41.7	(13.2)	1,852.2	22.5
Asset-backed securities	2,277.2	62.2	(34.0)	2,305.4	28.0
	5,873.0	132.5	(56.5)	5,949.0	72.3
Preferred stocks	675.4	39.4	(.9)	713.9	8.7
Common equities	1,263.7	110.8	(38.5)	1,336.0	16.2
Short-term investments	227.4	—	—	227.4	2.8
	$ 8,039.5	$ 282.7	$ (95.9)	$ 8,226.3	100.0%

For changes in the net unrealized gains (losses) during the period, see Note 10 – Other Comprehensive Income.

At December 31, 2002, bonds in the principal amount of $80.2 million were on deposit with various regulatory agencies to meet statutory requirements. The Company did not have any securities of one issuer with an aggregate cost or market value exceeding ten percent of total shareholders' equity at December 31, 2002 or 2001.

The components of net investment income for the years ended December 31 were:

(millions)	2002	2001	2000
Available-for-sale: fixed maturities	$ 379.4	$ 335.0	$ 296.8
preferred stocks	45.1	53.8	37.5
common equities	22.8	14.2	26.1
Short-term investments	7.9	10.6	24.8
Investment income	455.2	413.6	385.2
Investment expenses	11.5	12.7	9.1
Net investment income	$ 443.7	$ 400.9	$ 376.1

The components of net realized gains (losses) for the years ended December 31 were:

(millions)	2002	2001	2000
Gross realized gains:			
Available-for-sale: fixed maturities	$ 159.4	$ 63.0	$ 41.3
preferred stocks	12.0	4.2	1.2
common equities	35.3	119.7	158.2
Short-term investments	—	.1	.7
	206.7	187.0	201.4
Gross realized losses:			
Available-for-sale: fixed maturities	(85.6)	(51.9)	(43.8)
preferred stocks	(.1)	(31.0)	(2.9)
common equities	(199.6)	(216.0)	(137.8)
	(285.3)	(298.9)	(184.5)
Net realized gains (losses) on securities:			
Available-for-sale: fixed maturities	73.8	11.1	(2.5)
preferred stocks	11.9	(26.8)	(1.7)
common equities	(164.3)	(96.3)	20.4
Short-term investments	—	.1	.7
	$ (78.6)	$ (111.9)	$ 16.9

For 2002, 2001 and 2000, net realized gains (losses) on securities include $136.5 million, $36.0 million and $43.1 million, respectively, of write downs in securities determined to have an other than temporary decline in market value for securities held at December 31.

Trading securities are accounted for separately in accordance with SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities." At December 31, 2002 and 2001, the Company did not hold any trading securities. Net realized losses on trading securities for the years ended December 31, 2002, 2001 and 2000 were $0, $6.5 million and $19.0 million, respectively. Trading securities are not material to the Company's financial condition, cash flows or results of operations and are reported within the available-for-sale portfolio, rather than separately disclosed.

The composition of fixed maturities by maturity at December 31, 2002 was:

(millions)	Cost	Market Value
Less than one year	$ 574.9	$ 589.7
One to five years	4,197.2	4,357.2
Five to ten years	2,471.0	2,597.3
Ten years or greater	166.3	168.3
	$ 7,409.4	$ 7,712.5

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

The Company records derivative instruments at fair value on the balance sheet, with changes in value reflected in income during the current period. This accounting treatment did not change when SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," became effective January 1, 2001; therefore, no transition adjustment was required.

Derivative instruments are generally used to manage the Company's risks and enhance the yields of the available-for-sale portfolio. This is accomplished by modifying the basis, duration, interest rate or foreign currency characteristics of the portfolio, hedged securities or hedged cash flows. During 2002, the Company entered into a cash flow hedge in anticipation of its $400 million debt issuance, of which $150 million was originally expected to be a 10-year issuance and $250 million a 30-year issuance. The decision to issue all 30-year debt made the 10-year hedge a discontinued hedge and the loss recognized on closing the hedge of $1.5 million was realized in income in accordance with SFAS 133. During 2001, the Company entered into a cash flow hedge in anticipation of its $350 million debt issuance. The debt issuance hedges are described further in Note 4 – Debt.

At December 31, 2002 and 2001, the Company did not hold any open risk management derivative positions. During 2002, the Company recognized net losses on risk management derivatives of $0, compared to $2.7 million in 2001 and $2.3 million in 2000.

Derivative instruments may also be used for trading purposes. At December 31, 2002, the Company held no derivative instruments used for trading purposes. At December 31, 2001, the Company held a credit default protection instrument, with a net market value of less than $.1 million. Net gains (losses) on derivative positions were $(.1) million in 2002, $1.9 million in 2001 and $2.6 million in 2000 and are included in the available-for-sale portfolio.

For all derivative positions, net cash requirements are limited to changes in market values, which may vary based upon changes in interest rates, currency exchange rates and other factors. Exposure to credit risk is limited to the carrying value; collateral may be required to limit credit risk.

As of December 31, 2002, the Company had open investment funding commitments of $26.9 million. The Company had no uncollateralized lines or letters of credit as of December 31, 2002 or 2001.

3 Income Taxes

The components of the Company's income tax provision (benefit) were as follows:

(millions)	2002	2001	2000
Current tax provision	$ 404.9	$ 176.6	$ 25.0
Deferred tax benefit	(90.8)	(.4)	(39.3)
Total income tax provision (benefit)	$ 314.1	$ 176.2	$ (14.3)

The provision (benefit) for income taxes in the accompanying consolidated statements of income differed from the statutory rate as follows:

(millions)	2002		2001		2000	
Income before income taxes	$ 981.4		$ 587.6		$ 31.8	
Tax at statutory rate	$ 343.5	35%	$ 205.7	35%	$ 11.1	35%
Tax effect of:						
Exempt interest income	(15.6)	(2)	(14.7)	(3)	(17.6)	(55)
Dividends received deduction	(12.9)	(1)	(12.6)	(2)	(10.3)	(32)
Goodwill amortization	—	—	—	—	1.4	4
Foreign currency translation loss	—	—	—	—	1.4	4
Other items, net	(.9)	—	(2.2)	—	(.3)	(1)
	$ 314.1	32%	$ 176.2	30%	$ (14.3)	(45)%

At December 31, 2002 and 2001, net income taxes payable were $75.6 million and $49.4 million, respectively.

Deferred income taxes reflect the effect for financial statement reporting purposes of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. At December 31, 2002 and 2001, the components of the net deferred tax assets were as follows:

(millions)	2002	2001
Deferred tax assets:		
Unearned premiums reserve	$ 230.7	$ 191.4
Non-deductible accruals	79.2	54.6
Loss reserves	149.6	135.5
Capital loss carryforward	—	14.1
Write-downs on securities	50.7	11.4
Other	5.6	1.6
Deferred tax liabilities:		
Deferred acquisition costs	(127.2)	(110.8)
Unrealized gains	(87.5)	(65.3)
Hedges on forecasted transactions	(6.3)	(5.0)
Net deferred tax assets	$ 294.8	$ 227.5

4 Debt

Debt at December 31 consisted of:

(millions)	2002		2001	
	Cost	Market Value	Cost	Market Value
6.25% Senior Notes due 2032 (issued: $400.0, November 2002)	$ 393.5	$ 432.2	$ —	$ —
6.375% Senior Notes due 2012 (issued: $350.0, December 2001)	347.2	370.4	347.0	348.4
6⅝% Senior Notes due 2029 (issued: $300.0, March 1999)	294.0	295.8	293.9	271.1
7.30% Notes due 2006 (issued: $100.0, May 1996)	99.8	110.9	99.8	106.1
6.60% Notes due 2004 (issued: $200.0, January 1994)	199.8	208.1	199.6	209.5
7% Notes due 2013 (issued: $150.0, October 1993)	148.7	165.5	148.6	150.6
Other debt	6.0	6.0	6.8	6.8
	$1,489.0	$1,588.9	$1,095.7	$1,092.5

Debt includes amounts the Company has borrowed and contributed to the capital of its insurance subsidiaries or borrowed for other long-term purposes. Market values are obtained from publicly quoted sources. Interest on all debt is payable semiannually. There are no restrictive financial covenants.

The 6.25% Senior Notes, the 6.375% Senior Notes and the 6⅝% Senior Notes (collectively, "Senior Notes") may be redeemed in whole or in part at any time, at the option of the Company, subject to a "make whole" provision. All other debt is noncallable.

Prior to issuance of the Senior Notes, the Company entered into forecasted debt issuance hedges to hedge against possible rises in interest rates. Upon issuance of the applicable debt securities, the hedges were closed. Pursuant to SFAS 133, the Company recognized, as part of accumulated other comprehensive income, a $5.1 million gain associated with the 6.25% Senior Notes and an $18.4 million gain associated with the 6.375% Senior Notes. In addition, in 2001, the Company reclassified the remaining $4.2 million loss associated with the 6⅝% Senior Notes from a deferred asset account, in accordance with SFAS 80, "Accounting for Futures Contracts," to accumulated other comprehensive income. The gain/loss on these hedges is recognized as an adjustment to interest expense over the life of the related debt issuances.

In May 1990, the Company entered into a revolving credit arrangement with National City Bank, which is reviewed by the bank annually. Under this agreement, the Company has the right to borrow up to $10.0 million. By selecting from available credit options, the Company may elect to pay interest at rates related to the London interbank offered rate, the bank's base rate or at a money market rate. A commitment fee is payable on any unused portion of the committed amount at the rate of .125% per annum. The Company had no borrowings under this arrangement at December 31, 2002 or 2001.

Aggregate principal payments on debt outstanding at December 31, 2002, are $0 for 2003, $206.0 million for 2004, $0 for 2005, $100.0 million for 2006, $0 for 2007 and $1.2 billion thereafter.

5 Loss and Loss Adjustment Expense Reserves

Activity in the loss and loss adjustment expense reserves, prepared in accordance with GAAP, is summarized as follows:

(millions)	2002	2001	2000
Balance at January 1	$ 3,238.0	$ 2,986.4	$ 2,416.2
Less reinsurance recoverables on unpaid losses	168.3	201.1	216.0
Net balance at January 1	3,069.7	2,785.3	2,200.2
Incurred related to:			
Current year	6,295.6	5,363.1	5,203.6
Prior years	3.5	(99.0)	75.8
Total incurred	6,299.1	5,264.1	5,279.4
Paid related to:			
Current year	4,135.0	3,570.4	3,447.7
Prior years	1,601.7	1,409.3	1,246.6
Total paid	5,736.7	4,979.7	4,694.3
Net balance at December 31	3,632.1	3,069.7	2,785.3
Plus reinsurance recoverables on unpaid losses	180.9	168.3	201.1
Balance at December 31	$ 3,813.0	$ 3,238.0	$ 2,986.4

The Company's objective is to establish case and IBNR reserves that are adequate to cover all loss costs, while sustaining minimal variation from the date that the reserves are initially established until losses are fully developed. The Company's reserves developed conservatively in 2001. Throughout 2000, the Company experienced an increase in severity trends which led to adverse development on prior accident years in 2000.

Because the Company is primarily an insurer of motor vehicles, it has limited exposure for environmental, asbestos and general liability claims. The Company has established reserves for these exposures, in amounts which it believes to be adequate based on information currently known. The Company does not believe that these claims will have a material affect on the Company's liquidity, financial condition, cash flows or results of operations.

The Company writes personal and commercial auto insurance in the coastal states, which could be exposed to natural catastrophes. Although the occurrence of a major catastrophe could have a significant affect on the Company's quarterly results, the Company believes such an event would not be so material as to disrupt the overall normal operations of the Company. The Company is unable to predict if any such events will occur in the near term.

6 Reinsurance

Reinsurance contracts do not relieve the Company from its obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize its exposure to significant losses from reinsurer insolvencies.

As of December 31, 2002 and 2001, approximately 55% and 50%, respectively, of the "prepaid reinsurance premiums" and "reinsurance recoverables" are comprised of CAIP, for which the Company retains no indemnity risk.

The effect of reinsurance on premiums written and earned for the years ended December 31 was as follows:

	2002		2001		2000	
(millions)	Written	Earned	Written	Earned	Written	Earned
Direct premiums	$9,665.7	$9,078.1	$7,379.2	$7,299.0	$6,402.1	$6,547.0
Ceded	(213.8)	(194.7)	(119.2)	(137.3)	(206.0)	(198.6)
Assumed	.1	.1	.1	.1	—	—
Net premiums	$9,452.0	$8,883.5	$7,260.1	$7,161.8	$6,196.1	$6,348.4

Losses and loss adjustment expenses are net of reinsurance ceded of $131.8 million in 2002, $102.4 million in 2001 and $161.0 million in 2000.

7 Statutory Financial Information

At December 31, 2002, $405.5 million of consolidated statutory policyholders' surplus represents net admitted assets of the Company's insurance subsidiaries and affiliates that are required to meet minimum statutory surplus requirements in such entities' states of domicile. The companies may be licensed in states other than their states of domicile, which may have higher minimum statutory surplus requirements. Generally, the net admitted assets of insurance companies that, subject to other applicable insurance laws and regulations, are available for transfer to the parent company cannot include the net admitted assets required to meet the minimum statutory surplus requirements of the states where the companies are licensed.

During 2002, the insurance subsidiaries paid aggregate cash dividends of $34.5 million to the parent company. Based on the dividend laws currently in effect, the insurance subsidiaries may pay aggregate dividends of $455.5 million in 2003 without prior approval from regulatory authorities.

Statutory policyholders' surplus was $3,370.2 million and $2,647.7 million at December 31, 2002 and 2001, respectively. Statutory net income was $557.4 million, $469.5 million and $33.8 million for the years ended December 31, 2002, 2001 and 2000, respectively.

The Company files statutory-basis financial statements with state insurance departments in all states in which the Company is licensed. On January 1, 2001, significant changes to the statutory basis of accounting became effective. The cumulative effect of these changes was recorded as a direct adjustment to statutory surplus. The effect of adoption increased statutory surplus by $340.5 million.

8 Employee Benefit Plans

Retirement Plans The Company has a two-tiered Retirement Security Program. The first tier is a defined contribution pension plan covering all employees who meet requirements as to age and length of service. Contributions vary from 1% to 5% of annual eligible compensation up to the Social Security wage base, based on years of eligible service. Company contributions were $13.0 million in 2002, $10.7 million in 2001and $9.3 million in 2000.

The second tier is a long-term savings plan under which the Company matches amounts contributed to the plan by an employee up to a maximum of 3% of the employee's eligible compensation. Effective April 1, 2002, Company matching contributions may be invested by a participant in any of the investment funds available under the plan. Previously, such contributions were required to be invested in the Company stock fund until fully vested. Company matching contributions were $16.9 million in 2002, $14.4 million in 2001 and $12.9 million in 2000.

During 2000, the Company terminated its defined benefit pension plan and recognized $3.2 million in settlement expenses. In addition, the Company recognized pension expense of $2.8 million in 2000.

Postemployment Benefits The Company provides various postemployment benefits to former or inactive employees who meet eligibility requirements, their beneficiaries and covered dependents. Postemployment benefits include salary continuation and disability-related benefits, including workers' compensation, and, if elected, continuation of health-care benefits. The Company's liability was $10.0 million at December 31, 2002, compared to $8.3 million in 2001.

Postretirement Benefits The Company provides postretirement health and life insurance benefits to all employees who met requirements as to age and length of service at December 31, 1988. This group of employees represents less than 1% of the Company's current workforce. The Company's funding policy is to contribute annually the maximum amount that can be deducted for Federal income tax purposes. Contributions are intended to provide not only for benefits attributed to services to date, but also for those expected to be earned in the future.

Deferred Compensation The Company maintains The Progressive Corporation Executive Deferred Compensation Plan (Deferral Plan), which permits eligible executives to defer receipt of some or all of their annual bonuses or other incentive awards. These deferred amounts are deemed invested in one or more investment funds, including Common Shares of the Company, offered under the Deferral Plan. All distributions from the Deferral Plan will be made in cash, except that distributions representing amounts deemed invested in Common Shares will be made in Common Shares. The Company reserved 900,000 Common Shares for issuance under the Deferral Plan. The Company established an irrevocable grantor trust to provide a source of funds to assist the Company in meeting its liabilities under the Deferral Plan. At December 31, 2002 and 2001, the trust held assets of $23.6 million and $19.2 million, respectively, of which $5.2 million and $5.0 million were held in Common Shares, to cover its liabilities.

Incentive Compensation Plans The Company's 1995 Incentive Plan, which provides for the granting of stock options and other stock-based awards to key employees of the Company, has 15 million shares authorized. The 1989 Incentive Plan has expired. The non-qualified stock options granted are for periods up to ten years, become exercisable at various dates not earlier than six months after the date of grant, and remain exercisable for specified periods thereafter. All options granted have an exercise price equal to the market value of the Common Shares on the date of grant. All option exercises are settled in Common Shares.

A summary of all employee stock option activity during the years ended December 31 follows:

Options Outstanding	2002 Number of Shares	2002 Weighted Average Exercise Price	2001 Number of Shares	2001 Weighted Average Exercise Price	2000 Number of Shares	2000 Weighted Average Exercise Price
Beginning of year	12,682,380	$ 23.81	13,576,176	$ 20.53	13,375,389	$ 19.40
Add (deduct):						
Granted	1,194,192	52.17	2,012,082	30.89	3,257,367	19.67
Exercised	(1,464,862)	15.11	(2,437,755)	10.47	(2,036,772)	8.53
Cancelled	(464,439)	30.81	(468,123)	28.58	(1,019,808)	26.93
End of year	11,947,271	$ 27.44	12,682,380	$ 23.81	13,576,176	$ 20.53
Exercisable, end of year	4,542,722	$ 17.19	4,206,609	$ 13.19	4,633,842	$ 10.30
Available, end of year	6,988,479		7,739,682		10,876,707	

The following employee options were outstanding or exercisable as of December 31, 2002:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 10 < 15	1,820,370	1.52 years	$ 11.57	1,820,370	$ 11.57
15 < 20	3,735,788	5.64 years	18.05	1,279,778	15.77
20 < 30	1,280,399	4.41 years	23.15	1,094,606	22.83
30 < 40	1,967,283	7.89 years	30.86	277,263	31.16
40 < 50	1,966,240	5.58 years	44.54	66,325	45.04
50 < 60	1,177,191	8.97 years	52.20	4,380	51.46
$ 10 < 60	11,947,271			4,542,722	

In addition to the employee incentive plans disclosed above, the Company registered 600,000 Common Shares relating to stock options granted to directors of the Company, which have the same vesting, exercise and contract terms as the employee stock option awards. During 2002, 2001 and 2000, the Company granted options for 23,571 shares, 38,853 shares and 71,847 shares, respectively, to the non-employee directors. As of December 31, 2002, 2001 and 2000, the directors stock options outstanding and exercisable were 343,044 shares, 385,473 shares and 414,468 shares, respectively.

Under SFAS 123, the Company uses the Black-Scholes pricing model to calculate the fair value of the options awarded as of the date of grant, including 134,271 options awarded to directors during the last three years, using the following assumptions:

	2002	2001	2000
Option Term	6 years	6 years	6 years
Annualized Volatility Rate	39.5%	37.7%	31.4%
Risk-free Rate of Return	4.66%	5.24%	6.40%
Dividend Yield	.25%	.30%	.50%
Black-Scholes Value	44.6%	44.5%	41.6%

The Company elected to account for terminations when they occur rather than include an attrition factor into its model.

In 2002 and 2001, the Company granted to certain senior managers options, which in addition to having a fixed vesting date, contain a provision for accelerated vesting based on achieving predetermined objectives. To calculate the fair value of these options awarded, the Company used the assumptions above, except for an eight-year option term, based on the exercise pattern of this group of employees. These assumptions produced a Black-Scholes value of 51.5% and 51.1% for 2002 and 2001, respectively.

The amounts charged to income for incentive compensation plans, attributable to executive cash bonus programs for key members of management and a gainsharing program for all other employees, were $169.4 million in 2002, $128.3 million in 2001 and $8.3 million in 2000.

9 Segment Information

The Company writes personal automobile and other specialty property-casualty insurance and provides related services throughout the United States. The Company's Personal Lines segment writes insurance for private passenger automobiles and recreation vehicles, and is generated either by an agent or written directly by the Company. The Personal Lines-Agent channel includes business written by the Company's network of more than 30,000 independent insurance agencies and strategic alliance business relationships (other insurance companies, financial institutions, employers and national brokerage agencies). The Personal Lines-Direct channel includes business written through 1-800-PROGRESSIVE, online at progressive.com and on behalf of affinity groups. The Personal Lines segment, which includes both the Agent and Direct channels, are managed at a local level and structured into six regions. Each business area has a business leader and a product team, with local product managers at the state or regional level.

The Company's Commercial Auto segment writes primary liability, physical damage and other auto-related insurance for automobiles and trucks owned by small businesses. During 2002, the Company began separately reporting the Commercial Auto business from its other businesses and restated all prior periods discussed in this report.

The Company's other businesses include writing lenders' collateral protection and directors' and officers' liability insurance and providing insurance-related services, mainly processing CAIP business.

All revenues are generated from external customers and the Company does not have a reliance on any major customer.

The Company evaluates segment profitability based on pretax underwriting and service profit (loss). Expense allocations are based on certain assumptions and estimates; stated segment operating results would change if different methods were applied. The Company does not allocate assets, investment income, interest expense or income taxes to operating segments. In addition, the Company does not separately identify depreciation and amortization expense by segment and such disclosure would be impracticable. Company-wide depreciation and amortization expense was $83.9 million in 2002, $81.0 million in 2001 and $77.6 million in 2000. The accounting policies of the operating segments are the same as those described in Note 1 – Reporting and Accounting Policies.

Following are the operating results for the years ended December 31:

(millions)	2002 Revenues	2002 Pretax Profit (Loss)	2001 Revenues	2001 Pretax Profit (Loss)	2000 Revenues	2000 Pretax Profit (Loss)
Personal Lines–Agent	$5,542.7	$ 388.0	$4,706.8	$ 251.2	$4,643.4	$ (176.0)
Personal Lines–Direct	2,365.1	203.8	1,787.0	40.9	1,220.6	(128.7)
Total Personal Lines[1]	7,907.8	591.8	6,493.8	292.1	5,864.0	(304.7)
Commercial Auto Business	880.0	80.0	552.3	45.7	384.9	12.8
Other businesses[2]	130.0	19.1	140.4	13.0	120.0	8.5
Investments[3]	376.6	365.1	301.7	289.0	402.1	393.0
Interest expense	—	(74.6)	—	(52.2)	—	(77.8)
	$9,294.4	$ 981.4	$7,488.2	$ 587.6	$6,771.0	$ 31.8

[1]Personal automobile insurance accounted for 93% of the total Personal Lines segment net premiums written in 2002, 2001 and 2000.

[2]For 2000, pretax profit includes the realization of a $4.2 million foreign currency translation loss associated with the substantial liquidation of the Company's foreign subsidiary.

[3]Revenues represent recurring investment income and net realized gains/losses on securities; pretax profit is net of investment expenses.

10 Other Comprehensive Income

The components of other comprehensive income (loss) for the years ended December 31 were as follows:

(millions)	2002 Pretax	2002 Tax (Provision) Benefit	2002 After Tax	2001 Pretax	2001 Tax (Provision) Benefit	2001 After Tax	2000 Pretax	2000 Tax (Provision) Benefit	2000 After Tax
Unrealized gains (losses) arising during period:									
Available-for-sale:									
fixed maturities	$ 240.9	$ (84.3)	$ 156.6	$ 17.0	$ (5.9)	$ 11.1	$ 191.3	$ (67.0)	$ 124.3
equity securities	(137.8)	48.2	(89.6)	40.9	(14.3)	26.6	(69.8)	24.4	(45.4)
Reclassification adjustment:[1]									
Available-for-sale:									
fixed maturities	(13.8)	4.7	(9.1)	16.7	(5.8)	10.9	(30.9)	10.7	(20.2)
equity securities	(26.2)	9.2	(17.0)	5.2	(1.8)	3.4	21.8	(7.6)	14.2
Net unrealized gains (losses)	63.1	(22.2)	40.9	79.8	(27.8)	52.0	112.4	(39.5)	72.9
Hedges on forecasted transactions[2]	3.8	(1.3)	2.5	14.2	(5.0)	9.2	—	—	—
Foreign currency translation adjustment[3]	—	—	—	—	—	—	4.2	—	4.2
Other comprehensive income	$ 66.9	$ (23.5)	$ 43.4	$ 94.0	$ (32.8)	$ 61.2	$ 116.6	$ (39.5)	$ 77.1

[1] Represents adjustments for gains (losses) realized in net income for securities held in the portfolio at December 31 of the preceding year.

[2] Entered into for the purpose of managing interest rate risk associated with debt issuances. See Note 4 – Debt. The Company expects to reclassify $1.5 million into income within the next 12 months.

[3] Foreign currency translation adjustments have no tax effect.

11 Litigation

The Company is named as defendant in various lawsuits generally relating to its insurance operations. All legal actions relating to claims made under insurance policies are considered by the Company in establishing its loss and loss adjustment expense reserves.

The Company is also named as defendant in a number of putative class action lawsuits. Other insurance companies face many of these same issues. The lawsuits discussed below are in various stages of development. The Company plans to contest these suits vigorously and pursue settlement negotiations in those cases for which it deems it appropriate to do so. The outcome of these cases, excluding those where a settlement agreement has been reached and approved by the court, is uncertain at this time. In accordance with GAAP, the Company is only permitted to establish loss reserves for lawsuits when it is probable that a loss has been incurred and the Company can reasonably estimate its potential exposure.

There are currently four putative class action lawsuits pending against the Company in various state courts seeking actual and punitive damages and alleging breach of contract and fraud because of the Company's specification of after-market (non-original equipment manufacturer) replacement parts in the repair of insured or claimant vehicles. Plaintiffs in these suits allege that after-market parts are inferior to replacement parts manufactured by the vehicle's original manufacturer and that the use of such parts fails to restore the damaged vehicle to its "pre-loss" condition, as required by their insurance policies. The Company does not consider a loss from these cases to be probable and estimable, and is unable to estimate a range of loss, if any, at this time.

The Company is defending seven putative class action lawsuits in various state courts seeking damages from the Company alleging breach of contract for failing to pay inherent diminished value of insureds' vehicles under the collision, comprehensive or uninsured motorist property damage provisions of their auto policies. Six of these cases are pending in Texas. Inherent diminished value is defined by plaintiffs as the difference between the market value of the insured automobile before an accident and the market value after proper repair. Plaintiffs allege that they are entitled to the payment of inherent diminished value under the terms of their insurance policies. In February 2002, the Company reached an agreement to settle its

Georgia diminution in value case for $19.8 million, plus administrative costs. The Company believes that Georgia law on diminution in value is an anomaly and has successfully defended several of these cases in other jurisdictions. Accordingly, the Company does not consider a loss from the remaining cases to be probable and estimable, and is unable to estimate a range of loss, if any, at this time.

There are five putative class action lawsuits pending against the Company in Florida challenging the legal propriety of the Company's payment of preferred provider rates on personal injury protection (PIP) claims. The primary issue is whether the Company violated Florida law by paying (PIP) medical expense claims at preferred provider rates. The Company has established a loss reserve in connection with certain of these cases. For those cases where a reserve has been established, the Company believes that any ultimate disposition of these lawsuits for amounts in excess of the current reserve will not materially affect the Company's financial condition, cash flows or results of operations. As to the remaining cases, the Company does not consider a loss to be probable and estimable, and is unable to estimate a range of loss, if any, at this time.

There are currently four putative class actions pending against the Company, which challenge the Company's use of certain automated database vendors to assist in valuing total loss claims. Plaintiffs allege that these databases systematically undervalue total loss claims to the detriment of insureds. The plaintiffs are seeking actual and punitive damages. The Company has established a loss reserve in connection with certain of these cases. For those cases where a reserve has been established, the Company believes that any ultimate disposition of these lawsuits for amounts in excess of the current reserve will not materially affect the Company's financial condition, cash flows or results of operations. As to the remaining cases, the Company does not consider a loss to be probable and estimable, and is unable to estimate a range of loss, if any, at this time.

The Company is currently defending five lawsuits involving worker classification issues. These lawsuits challenge the Company's exempt employee classification under the federal Fair Labor Standards Act and/or various state laws. In November 2002, the Company reached an agreement to settle its lawsuit relating to the classification of the Company's California claims employees as exempt workers for purposes of state wage and hour laws for an amount not to exceed $10 million. This class action lawsuit was based on California-specific law. The Company continues to believe that its classification of claim representatives as exempt workers is appropriate under federal law. Accordingly, the Company does not consider a loss from the remaining cases to be probable and estimable, and is unable to estimate a range of loss, if any, at this time.

In July 2002, the Company settled a nationwide class action lawsuit challenging one of the Company's claim adjustment practices, known as the charging of "betterment," in the adjustment of first party physical damage (vehicle damage) claims. Specifically, it was alleged that the Company made improper adjustments for depreciation and physical condition. This settlement has received trial court approval and the claims process is complete.

The Company is currently defending five putative class actions challenging the subsidiaries' alternative commissions programs. Under these programs, the Company's independent insurance agencies were able to offer its insurance products at different commission levels. In July 2002, the Company reached a nationwide settlement of these cases. The settlement, when final, will result in the payment of approximately $60 million, including the costs of settlement and attorneys' fees. This class action settlement has received trial court approval and the claims process is complete. The settlement of these cases is currently being appealed by various objectors. On December 23, 2002, a case was filed in Mississippi on behalf of 19 individuals who opted-out of the nationwide settlement. This case also challenges the alternative commissions programs. The Company does not consider a loss from this case to be probable and estimable, and is unable to estimate a range of loss, if any, at this time.

The Company is currently defending six cases challenging certain aspects of the Company's use of credit information and notice requirements under the federal Fair Credit Reporting Act. Three of these cases are putative national class actions, one is a state-specific class action that was certified in December 2002, and two are individual cases. The Company does not consider loss from these cases to be probable and estimable, and is unable to estimate a range of loss, if any, at this time.

There are currently two putative class actions pending against the Company challenging the Company's use of automated database vendors to assist in evaluating certain first party bodily injury claims. The plaintiffs allege that Progressive uses biased third party vendors to analyze medical bills and determine whether the treatment and/or expenses are "reasonable" and "necessary." The Company does not consider a loss from these cases to be probable and estimable, and is unable to estimate a range of loss, if any, at this time.

12 Commitments and Contingencies

The Company has operating lease commitments and service agreements with terms greater than one year, some with options to renew at the end of the contract periods.

The minimum commitments under noncancelable agreements at December 31, 2002, are as follows:

(millions)

Year	Operating Leases	Service Contracts	Total
2003	$ 62.3	$ 74.5	$ 136.8
2004	46.6	56.4	103.0
2005	27.8	20.2	48.0
2006	18.9	—	18.9
2007	12.7	—	12.7
Thereafter	33.4	—	33.4

Total expense incurred by the Company was:

(millions)

Year	Operating Leases	Service Contracts	Total
2002	$ 71.0	$ 66.7	$ 137.7
2001	69.9	49.9	119.8
2000	61.5	38.5	100.0

During 2000, the Company accrued $20.0 million related to the termination of a strategic alliance relationship. As a result of this dissolution, a related reinsurance agreement terminated and the Company was entitled to the run-off of all of the premium written under this agreement. The amount accrued represents the Company's best estimate of the share of the net present value of the future profit on that business that the other party was entitled to receive upon this termination. There are no contingent obligations associated with this arrangement.

During 2002, the Company incurred $21.2 million of guaranty fund assessments, compared to $14.6 million in 2001 and $2.0 million in 2000. At December 31, 2002 and 2001, the Company had $17.9 million and $11.5 million, respectively, reserved for future assessments on current insolvencies. The Company believes that any assessment in excess of its current reserves will not materially affect the Company's financial condition, cash flows or results of operations.

As of December 31, 2002, the Company had open investment funding commitments of $26.9 million. The Company had no uncollateralized lines or letters of credit as of December 31, 2002 or 2001.

13 Fair Value of Financial Instruments

Information about specific valuation techniques and related fair value detail is provided in Note 1 – Reporting and Accounting Policies, Note 2 – Investments and Note 4 – Debt. The cost and market value of the financial instruments as of December 31 are summarized as follows:

	2002		2001	
(millions)	Cost	Market Value	Cost	Market Value
Investments:				
Available-for-sale: fixed maturities	$7,409.4	$7,712.5	$5,873.0	$5,949.0
preferred stocks	631.9	656.7	675.4	713.9
common equities	1,425.3	1,347.3	1,263.7	1,336.0
Short-term investments	567.8	567.8	227.4	227.4
Debt	(1,489.0)	(1,588.9)	(1,095.7)	(1,092.5)

14 Related Party Transactions

In January 2003, March 2002 and October 2001, the Company repurchased 400,000, 6,182 and 30,866, respectively, of its Common Shares, $1.00 par value, from Peter B. Lewis, the Company's Chairman of the Board, at $52.23, $53.92 and $47.82, respectively, on a split-adjusted basis. The prices per share equaled the then current market prices of the Company's stock as quoted on the New York Stock Exchange. These transactions are part of the Company's ongoing repurchase program to eliminate the effect of dilution created by equity compensation awards.