

## Incentive Compensation Plans

(unaudited — not covered by report of independent accountants)

The Company believes that equity compensation awards are a key form of long-term compensation. In 1989, the Company began awarding non-qualified stock options (NQSO) to key employees and directors of the Company as an equity component of the total incentive compensation plan. Beginning January 1, 2003, the Company will discontinue granting NQSOs in favor of providing equity compensation in the form of restricted stock. After considering various alternatives, the Company believes that restricted stock more closely aligns management's interest with that of shareholders.

The Company recognizes investor concerns over the effect of equity awards and the lack of clarity on shareholder value. Some advocates prefer the transparency of cash compensation, but this comes with the cost of reducing senior management and shareholder alignment. The Company believes a solution is to monetize the cost of equity compensation through its' commitment to neutralize dilution from stock options exercises and restricted stock grants through stock repurchases.

As of January 1, 2003, there were 12.3 million options outstanding with 6.7 million options currently eligible for exercise. The final expiration date for these outstanding options is December 31, 2011. The Company anticipates that approximately 10.9 million of the currently

outstanding options will have been exercised by the expiration date. As previously stated, it is the Company's policy to eliminate dilution from the exercise of employee options through periodic share repurchases. On January 1, 2001, the date the repurchase policy was established, Common Shares outstanding were 220.6 million, on a split-adjusted basis, and options outstanding were 14.0 million. These amounts became the benchmarks for share management purposes. Due to capital opportunities, the Company's view of future operations or market conditions, share repurchases may exceed the expected number of options to be exercised in that annual period. Any share repurchases in excess of the current year exercises will be carried forward and applied against future option exercises until the total dilutive obligation has been satisfied. Any shortfall of repurchases below the cumulative total option exercises will be acquired in the following year. When a carryforward balance exists, the Company will repurchase a minimum of 50% of the anticipated current year exercises.

The following NQSO grants were outstanding as of January 1, 2003. It should be noted that these amounts include .4 million of Directors' NQSOs and 1.8 million of options that became exercisable on January 1, 2003.

(millions, except prices)

Expiration Date December 31,	Average Strike Price	Options Granted	Exercisable	Outstanding <sup>1</sup>	Forecasted Exercises <sup>2</sup>
2003	\$ 10.35	3.5	.9	.9	.9
2004	12.76	2.7	1.0	1.0	1.0
2005	15.84	2.6	1.3	1.3	1.3
2006	23.28	2.2	1.1	1.1	1.1
2007	41.54	1.4	1.0	1.0	1.0
2008	46.38	1.5	.1	1.1	1.0
2009	19.72	3.3	1.0	2.8	2.3
2010	30.89	2.1	.3	1.9	1.4
2011	52.17	1.2	—	1.2	.9
Total		20.5	6.7	12.3	10.9

<sup>1</sup>Represents the total number of outstanding options, including vested and unvested issues, and in-the-money or out-of-the-money options.

<sup>2</sup>The difference between options currently outstanding and total projected exercises represents the Company's historical experience of option cancellations. Actual exercises can and will vary based on a number of factors including variation in the market price of Progressive stock. Forecasted results are based on historical experience and reflect the market and business conditions that existed at the time of issuance and exercise of the respective options.

Following is the Company's anticipated rate of option exercises over the remaining life of the option plan.

(millions, except prices)

<b>Projected Year of Exercise</b>	<b>Forecasted Exercises</b>	<b>Average Strike Price</b>
2003	2.2	\$ 17.75
2004	1.9	22.49
2005	1.8	24.19
2006	1.4	29.73
2007	1.2	35.24
2008	.9	33.70
2009	.9	26.98
2010	.4	36.64
2011	.2	52.17
Remaining obligation	<u>10.9</u>	<u>\$ 26.54</u>

The Company expects to repurchase shares to offset its remaining obligation during the expected future life of the options outstanding.

During 2002 and 2001, the following option exercises and share repurchases occurred:

(millions)	<b>Cumulative</b>	<b>2002</b>	<b>2001</b>
Options outstanding: Beginning of year	14.0	13.1	14.0
Granted	3.3	1.2	2.1
Exercised	(4.0)	(1.5)	(2.5)
Cancelled	(1.0)	(.5)	(.5)
Options outstanding: End of year	<u>12.3</u>	<u>12.3</u>	<u>13.1</u>
Repurchases for current year exercises	4.0	1.5	2.5
Excess repurchases	2.4	2.3	.1
Total repurchases	<u>6.4</u>	<u>3.8</u>	<u>2.6</u>
as a % of total obligation <sup>1</sup>	<u>43%</u>		
Cumulative carryforward (shortfall)	<u>2.4</u>		
as a % of remaining obligation	<u>22%</u>		

<sup>1</sup>Total obligation represents the remaining share repurchase obligation (10.9 million shares) plus the shares exercised from January 1, 2001 through December 31, 2002 (4.0 million shares).