Management's Discussion and Analysis of Financial Condition and Results of Operations

The consolidated financial statements and the related notes, together with the supplemental information, should be read in conjunction with the following discussion of the consolidated financial condition and results of operations.

Financial Condition The Progressive Corporation is a holding company and does not have any revenue producing operations of its own. It receives cash through borrowings, equity sales, subsidiary dividends and other transactions, and may use the proceeds to contribute to the capital of its insurance subsidiaries in order to support premium growth, to repurchase its Common Shares, to retire its outstanding indebtedness, to pay dividends and for other business purposes.

During 2002, the Company repurchased 3,608,098 of its Common Shares, with 136,182 Common Shares repurchased prior to its 3-for-1 stock split, effective April 22, 2002, and 3,471,916 repurchased after the split. The total cost to repurchase these shares was $214.3 million with an average cost, on a split-adjusted basis, of $55.23 per share (the Company did not split its treasury shares). The 2002 repurchases included 19,294 Common Shares (average cost of $47.10 per share) repurchased to satisfy obligations under the Company's benefit plans. During the three-year period ended December 31, 2002, the Company repurchased 4,841,386 of its Common Shares at a total cost of $352.4 million; these repurchases included 124,216 Common Shares repurchased to satisfy obligations under the Company's benefit plans. See the *Incentive Compensation Plans* disclosure for further discussion on the Company's policy regarding share repurchases.

During the three-year period ended December 31, 2002, The Progressive Corporation received $329.2 million of dividends from its subsidiaries, net of capital contributions made to these subsidiaries. The regulatory restrictions on subsidiary dividends are described in Note 7 – Statutory Information, to the financial statements.

The Company has substantial capital resources and is unaware of any trends, events or circumstances not disclosed herein that are reasonably likely to affect its capital resources in a material way. The Company has $250 million available for issuance of debt securities under a shelf registration statement filed with the Securities and Exchange Commission (SEC) in October 2002 (see discussion below).

In October 2002, the Company filed a shelf registration statement with the SEC for the issuance of up to $650 million of debt securities, which included $150 million of unissued debt securities from a shelf registration filed in November 2001. The registration statement was declared effective in October 2002, and, in November 2002, the Company issued $400.0 million of 6.25% Senior Notes due 2032 under the shelf. The net proceeds of $398.6 million, which included $5.1 million received under a hedge on forecasted transactions that the Company entered into in anticipation of the debt issuance, are intended to be used for general corporate purposes. A portion of the net proceeds may be used to retire the Company's outstanding 6.60% Notes due 2004 with a principal amount of $200 million.

In November 2001, the Company filed a shelf registration statement with the SEC for the issuance of up to $500 million of debt securities. The registration statement was declared effective in November 2001, and, in December 2001, the Company issued $350.0 million of 6.375% Senior Notes due 2012 under the shelf. The net proceeds of $365.4 million, which included $18.4 million received under a hedge on forecasted transactions that the Company entered into in anticipation of the debt issuance, were intended to be used for general corporate purposes. The $150 million remaining under the shelf was rolled into the shelf registration statement filed with the SEC in October 2002.

During the last three years, the Company issued $750.0 million and repaid $301.7 million of debt securities. See Note 4 – Debt, for further discussion on the Company's current outstanding debt. The Company's debt to total capital (debt plus equity) ratio is 28%.

Based on the information reported above, management believes that the Company has substantial capital resources and sufficient borrowing capacity to support current and anticipated growth.

The Company's insurance operations create liquidity by collecting and investing premiums from new and renewal business in advance of paying claims. For the three years ended December 31, 2002, operations generated positive cash flows of $3.97 billion and cash flows are expected to be positive in both the short-term and reasonably foreseeable future. The Company's investment portfolio is highly liquid and consists substantially of readily marketable, investment-grade securities.

Total capital expenditures for the three years ended December 31, 2002, aggregated $295.1 million. During this period, the Company constructed a five building, 732,300 square foot, corporate office complex in Mayfield Village, Ohio. Construction was completed in the first quarter of 2001 at a total cost of $129.0 million. The Company is currently planning to construct a 322,000 square foot call center complex in Colorado Springs, Colorado at an estimated total project cost of $62 million. The project is scheduled to be completed in 2004. In addition, the Company plans to expand its vehicle claims repair service by 20 additional sites in 2003. The Company expects to incur an estimated $3.6 million in lease costs related to these sites in 2003. These projects are funded through operating cash flows.

Other than the items disclosed in Note 2 – Investments and Note 12 – Commitments and Contingencies regarding open investment funding commitments and operating leases and service agreements, respectively, the Company does not have any off-balance-sheet arrangements.

A summary of the Company's contractual obligations as of December 31, 2002, follows:

(millions)	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	Payments due by period				
Debt (Note 4)	$ 1,506.0	$ —	$ 206.0	$ 100.0	$ 1,200.0
Operating Leases (Note 12)	201.7	62.3	74.4	31.6	33.4
Service Contracts (Note 12)	151.1	74.5	76.6	—	—
Total	$ 1,858.8	$ 136.8	$ 357.0	$ 131.6	$ 1,233.4

Investments The Company invests in fixed-maturity, equity and short-term securities and manages its portfolio to an 85% fixed income and 15% equity target allocation. The Company's investment strategy recognizes its need to maintain capital adequate to support its insurance operations. The Company evaluates the risk/reward tradeoffs of investment opportunities, measuring their effects on stability, diversity, overall quality and liquidity of the investment portfolio. Investments in the Company's portfolio have varying degrees of risk. The market value of the portfolio was as follows:

(millions)	December 31, 2002		December 31, 2001	
Investment-Grade Fixed Maturities:				
Short/Intermediate-Term	$ 7,932.0	77.1%	$5,827.3	70.8%
Long-Term[1]	168.3	1.6	202.3	2.5
Non-Investment-Grade Fixed Maturities[2]	180.0	1.8	146.8	1.8
Total Fixed Maturities	8,280.3	80.5	6,176.4	75.1
Preferred Stocks[3]	656.7	6.4	713.9	8.7
Term Trust Certificates	—	—	50.1	.6
Total Fixed Income	8,937.0	86.9	6,940.4	84.4
Common Stocks[4]	1,275.0	12.4	1,201.0	14.6
Other Risk Investments[5]	72.3	.7	84.9	1.0
Equity Risk Securities	1,347.3	13.1	1,285.9	15.6
Total Portfolio[6]	$10,284.3	100.0%	$8,226.3	100.0%

[1]Includes securities with maturities of 10 years or greater. 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. See Note 2 – Investments.

[2]Non-investment-grade fixed-maturity securities offer the Company higher returns and added diversification but may involve greater risks, often related to creditworthiness, solvency and relative liquidity of the secondary trading market.

[3]Comprised of over 95% of fixed-rate preferred stocks with mechanisms that are expected to provide an opportunity to liquidate at par.

[4]Common stocks are traded on nationally recognized securities exchanges.

[5]Includes private equity investments and limited partnership interests in private equity and mezzanine investment funds which have no off-balance-sheet exposure or contingent obligations. See Note 2 – Investments for open funding commitments.

[6]Includes $1.3 billion of securities in the portfolio of a consolidated, non-insurance subsidiary of the holding company; composition is similar to the consolidated portfolio.

The fixed-income portfolio includes fixed-maturity securities, preferred stocks, short-term investments and term trust certificates (discussed below). The primary market risk exposure to the fixed-income portfolio is interest rate risk, which is limited by managing the portfolio duration to a defined range of 1.8 to 5 years. The distribution of maturities and convexity are monitored on a regular basis. Interest rate risk includes the risk from movements in the underlying market rates and in credit spreads of the respective sectors of debt securities held. The fixed-income portfolio had a duration of 3.2 years at December 31, 2002, compared to 3.7 years at December 31, 2001. Included in fixed-income securities are net unsettled securities acquisitions of $112.2 million at December 31, 2002 and $3.1 million of net unsettled security dispositions at December 31, 2001. Excluding these unsettled securities transactions, the allocation of fixed-income securities at December 31, 2002, was 86.8% of the portfolio, slightly higher than the target allocation of 85%, but within the Company's normal range of variation; at December 31, 2001, the allocation was 84.4%.

Term trust certificates, the common shares of closed-end bond funds, have the risk/reward characteristics of the underlying bonds and, along with the equity risk securities, are classified as Common Equities on the balance sheet.

Included in the fixed-income portfolio, the Company held asset-backed securities at December 31, 2002, which were comprised of the following:

(millions)	Market Value	Duration (years)	Rating[1]	Unrealized Gains[2]
Collateralized Mortgage Obligations – Residential (CMO):				
Sequential Bonds	$ 327.6	1.05	AAA	$ 8.9
Planned Amortization Class Bonds	359.3	.95	AAA	19.1
	686.9	1.00	AAA	28.0
Commercial Mortgage-Backed Obligations (CMB)[3]	889.6	4.14	AA-	68.3
CMB-Interest-Only Certificates	263.4	3.08	AAA	8.1
	1,153.0	3.90	AA	76.4
Other asset-backed securities[4]	710.5	1.86	AAA-	25.2
Total asset-backed securities[5]	$ 2,550.4	2.55	AA+	$ 129.6

[1]Weighted average Nationally Recognized Securities Rating Organization.

[2]The single largest unrealized loss in any individual CMO security was $.1 million and in any CMB security was $2.2 million at December 31, 2002.

[3]Individual security sensitivity to prepayment risk is reduced by prepayment lock out and yield maintenance provisions.

[4]Home equity loans represent $384.8 million, or 54.2%, and manufactured housing loans represent $100.8 million, or 14.2%, of the other asset-backed securities; the remainder of the portfolio is comprised of equipment leases, auto loans, credit card receivables and other structured loans.

[5]The majority of asset-backed securities are liquid with available market quotes and contain no residual interests.

An additional exposure to the fixed-income portfolio is credit risk, which is limited by managing to an average minimum credit quality rating of A+, as defined by nationally recognized rating agencies, and limiting non-investment-grade securities to a maximum of 5% of the fixed-income portfolio. Concentration in single issuers is limited to no more than 6% of the Company's shareholders' equity, except for U.S. treasury and agency bonds; state general obligations are limited to 12% of shareholders' equity.

The quality distribution of the fixed-income portfolio was as follows:

Rating	December 31, 2002	December 31, 2001
AAA	65.7%	58.0%
AA	8.2	10.6
A	12.6	15.3
BBB	11.3	14.0
Non Rated/Other	2.2	2.1
	100.0%	100.0%

The Company monitors the composition and performance of the common stock portfolio to ensure compliance with the objectives.

Common equities, which generally have greater risk and volatility of market value, have a target allocation of 15% and may range from 0 to 25% of the portfolio. At December 31, 2002 and 2001, excluding the net unsettled security transactions, these securities comprised 13.2% and 15.6%, respectively, of the total portfolio. Common stocks are the majority of the common equity portfolio and are managed externally to track the Russell 1000 index within +/- 50 basis points. To maintain high correlation with the Russell 1000, the Company holds approximately 700 of the common stocks comprising the index. Individual holdings are measured based on their contribution to the correlation with the index. The Company's common equity allocation and management strategy are intended to provide diversification for the total portfolio and focuses on the change in value of the equity portfolio relative to the change in value of the index on an annual basis as noted in the following table:

(millions)	Market Value at December 31, 2002	Market Value at December 31, 2001	Total Return[1]
Common Stocks[2]	$ 1,275.0	$ 1,201.0	(21.5)%
Russell 1000 Index[3]	466.2	604.9	(21.7)

[1]Includes gross dividends reinvested and price appreciation/depreciation.

[2]The market value at December 31, 2002, includes appreciation/depreciation in the value of the underlying securities as well as dividend income received and net cash infusions/withdrawals made during the year needed to maintain the Company's 85%/15% fixed income to equity allocation.

[3]This broad-based index, which is used for comparative benchmarking, incepted December 31, 1986, with a base valuation of $130. Amounts shown represent changes in valuation based on growth and declines of the index members.

Other risk investments include private equity investments and limited partnership interests in private equity and mezzanine investment funds which have no off-balance-sheet exposure or contingent obligations, except for the open funding commitments discussed in Note 2 – Investments. Exposures are evaluated individually and as a whole, considering the effects of cross correlation. The Company is no longer initiating investments in these types of securities and expects to reduce its current holdings over time.

The Company monitors the value at risk of the fixed-income and equity portfolios as well as the total portfolio to evaluate the potential maximum expected loss. For further information, see the *Quantitative Market Risk Disclosures* supplementally provided in this Annual Report.

As of December 31, 2002, the Company's portfolio had $249.9 million in net unrealized gains, compared to $186.8 million at year-end 2001. The increase was the result of declining interest rates and the recognition of $78.6 million of net realized losses in 2002, offset by the general decline in the equity markets. The realized losses during 2002 were primarily the result of write-downs in securities determined to have an other-than-temporary decline in market value and rebalancing of the common stock portfolio to the Russell 1000 index during the year. The weighted average fully taxable equivalent book yield of the portfolio was 5.6% for the year ended December 31, 2002, 6.2% for 2001 and 6.4% for 2000. The pretax recurring book yield of the portfolio was 5.1%, 5.6% and 5.7% for the years ended December 31, 2002, 2001 and 2000, respectively.

Included in the net realized gains/losses on securities for the years ended 2002, 2001 and 2000, are write-downs on securities determined to have an other-than-temporary decline in market value. 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.

Fixed income and equity securities with declines attributable to issuer-specific fundamentals are reviewed to identify all available evidence, circumstances and influences to estimate the potential for and timing of recovery of the investment's impairment. An other-than-temporary impairment loss is deemed to have occurred when the potential for and timing of recovery does not satisfy the guidance set forth in Staff Accounting Bulletin (SAB) 59, "Noncurrent Marketable Equity Securities," Statement of Financial Accounting Standards (SFAS) 115, "Accounting for Certain Investments in Debt and Equity Securities" and other related guidance.

For fixed income investments with unrealized losses due to market or industry-related declines where the Company has the intent and ability to hold the investment for the period of time necessary to recover a significant portion of the investment's original principal and interest obligation, declines are not deemed to qualify as other than temporary. The Company's policy for equity securities with market-related declines is to recognize impairment losses on individual securities with losses that are not reasonably expected to be recovered under historical market conditions when the security has been in a loss position for three consecutive quarters.

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. All other unrealized gains or losses are reflected in shareholders' equity. The write-down activity for the years ended December 31 was as follows:

(millions)	Total Write-downs	Write-downs On Securities Subsequently Sold	Write-downs On Securities Held at Period End
2002			
Fixed income	$ 45.6	$ 19.7	$ 25.9
Common equities[1]	156.5	45.9	110.6
Total portfolio	$ 202.1	$ 65.6	$ 136.5
2001			
Fixed income	$ 17.1	$ 4.2	$ 12.9
Common equities	42.9	19.8	23.1
Total portfolio	$ 60.0	$ 24.0	$ 36.0
2000			
Fixed income	$ 3.4	$ 3.4	$ —
Common equities	43.1	—	43.1
Total portfolio	$ 46.5	$ 3.4	$ 43.1

[1]At December 31, 2002, the Company had $3.6 million of losses on similar securities that have only been in a loss position for two consecutive quarters.

Market related write-downs on equity securities represent the Company's largest component of write-downs in 2002. The following is a summary of equity security market write-downs by sector (both market-related and issuer specific):

(millions)

Sector	Amount of Write-down	Equity Portfolio Allocation	Russell 1000 Allocation	Russell 1000 Sector Return	Remaining Gross Unrealized Loss
Auto and Transportation	$ 3.6	2.5%	2.2%	(14.7)%	$ 1.2
Consumer Discretionary	24.9	12.4	14.6	(24.2)	15.4
Consumer Staples	1.2	8.9	8.1	(5.3)	6.1
Financial Services	6.2	22.8	22.8	(15.3)	32.7
Health Care	15.9	14.6	14.8	(20.4)	20.3
Integrated Oil	—	4.6	4.2	(12.7)	9.0
Materials and Processing	—	3.6	3.4	(8.6)	3.1
Other Energy	2.6	1.4	1.4	(20.6)	.6
Producer Durables	1.2	3.7	3.7	(15.9)	4.9
Technology	50.8	12.5	13.4	(38.7)	16.9
Utilities	16.2	8.2	7.4	(33.1)	20.4
Other Equities	20.7	4.8	4.0	(29.6)	1.8
Total Common Stocks	143.3	100.0%	100.0%	(21.7)%	132.4
Other Risk Assets	13.2				.9
Total Common Equities	$ 156.5				$ 133.3

Trading securities are entered into for the purpose of near-term profit generation. 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.

From time to time, the Company invests in derivative instruments, which are primarily used to manage the risks and enhance the returns 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 recognized net losses on derivatives used to manage risk in the available-for-sale portfolio of $0, compared to $2.7 million in 2001 and $2.3 million in 2000. During 2002 and 2001, the Company

entered into hedges on forecasted transactions in anticipation of its debt issuances. See Note 2 – Investments and Note 4 – Debt for further discussion of these hedges. The Company had no open positions at December 31, 2002.

Derivative instruments may also be used for trading purposes. Derivatives used for trading purposes generated net gains (losses) of $(.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 and other factors. Exposure to credit risk is limited to the carrying value; collateral may be required to limit credit risk.

During 2002, the Company entered into repurchase commitment transactions, whereby the Company loans Treasury or U.S. Government agency securities to accredited brokerage firms in exchange for cash equal to the fair market value of the securities. These internally managed transactions are typically overnight arrangements. The cash proceeds are invested in AA or higher financial institution paper with yields that exceed the Company's interest obligation on the borrowed cash. The Company is able to borrow the cash at low rates since the securities loaned are in short supply. The Company's interest rate exposure does not increase or decrease since the borrowing and investing periods match. During the year ended December 31, 2002, the Company's largest single outstanding balance of repurchase commitments was $1,271.6 million which was open for one business day, with an average daily balance of $549.8 million for the year. The Company had no open repurchase commitments at December 31, 2002 and 2001. The Company earned income of $2.8 million, $4.1 million and $.9 million on repurchase commitments during 2002, 2001 and 2000, respectively.

Results of Operations Direct premiums written increased 31% to $9,665.7 million in 2002, compared to $7,379.2 million in 2001 and $6,402.1 million in 2000. For 2002, 2001 and 2000, net premiums written increased 30%, 17% and 1%, respectively, to $9,452.0 million, $7,260.1 million and $6,196.1 million. The difference between direct and net premiums written is attributable to premiums written under state-mandated involuntary Commercial Auto Insurance Procedures (CAIP), for which the Company retains no indemnity risk, of $119.1 million in 2002, $80.5 million in 2001 and $50.9 million in 2000, and reinsurance the Company maintains in its auto and non-auto programs. Rate adequacy, improved customer retention and new business growth drove the increase in premium growth in 2002. Prior years' premium growth was negatively affected by the shift from 12-month to 6-month policies. At year-end 2002 and 2001, substantially all of the Company's new auto policies were written for six-month terms, compared to 80% at December 31, 2000.

Premiums earned, which are a function of the premiums written in the current and prior periods and are recognized into income over the policy term using a mid-month convention, are not affected by the shift in policy term. Therefore, during the transition period, the Company believes that net premiums earned was a more meaningful measure of growth. For 2002, 2001 and 2000, premiums earned increased 24%, 13% and 12%, respectively. The majority of the growth in 2002 was a result of an increase in policies in force, while prior years' growth was due primarily to increased rate levels. During 2002, the Company implemented 95 auto rate revisions in various states, with aggregate filed rate changes of approximately 5% for its Personal Lines business. The Company currently expects its rate needs to be at this level, or slightly higher, in 2003.

For the years ended December 31, 2002, 2001 and 2000, the Company generated net income of $667.3 million, $411.4 million and $46.1 million, respectively. Following is a reconciliation of the Company's net income to operating income:

	2002		2001		2000	
(millions, except per share amounts)	$	Per Share	$	Per Share	$	Per Share
Net income	$ 667.3	$ 2.99	$ 411.4	$ 1.83	$ 46.1	$ .21
Reconciling items (after-tax):						
Net realized (gains) losses on securities	51.1	.23	72.7	.32	(11.0)	(.05)
Nonrecurring items:						
Termination of strategic alliance relationship	—	—	—	—	13.0	.06
Foreign currency translation loss	—	—	—	—	4.2	.02
Termination of defined benefit pension plan	—	—	—	—	2.0	.01
Severance and other costs[1]	—	—	1.4	.01	1.1	—
Operating income	$ 718.4	$ 3.22	$ 485.5	$ 2.16	$ 55.4	$ .25

[1]2001 related to the Company's reduction in force in New York; 2000 is associated with the Company's reorganization at the general manager level.

The Company defines operating income, which is a non-GAAP disclosure, as net income excluding the after-tax effect of net realized gains and losses on securities and nonrecurring items. By excluding items which are not of a recurring nature, the Company believes that operating income provides a useful measure of the Company's operating results and more accurately reflects the trends in the Company's financial performance. However, since operating income is not a term defined by GAAP, the Company's operating results may not be comparable to similarly titled measures reported by other companies. The increase in operating income in 2002 is primarily a result of improved underwriting results. The GAAP combined ratio (CR) was 92.4 in 2002, 95.2 in 2001 and 104.4 in 2000.

The Company's Personal Lines business units write insurance for private passenger automobiles and recreation vehicles and currently represent 88% of the Company's total net premiums written. Personal Lines net premiums written grew 29% in 2002, grew 15% in 2001 and declined 1% in 2000; net premiums earned grew 22% in 2002 and 11% in both 2001 and 2000. The Personal Lines business is generated either by an Agent or written directly by the Company. The Agent channel includes business written by the Company's network of 30,000 independent insurance agencies and through strategic alliance business relationships (other insurance companies, financial institutions, employers and national brokerage agencies). Direct business includes business written through 1-800-PROGRESSIVE, online at progressive.com and on behalf of affinity groups.

The Company's Commercial Auto Business unit writes primary liability, physical damage and other auto-related insurance for automobiles and trucks owned by small businesses. The Commercial Auto Business represents 11% of the Company's total year-to-date net premiums written. Commercial Auto net premiums written grew 51% in 2002 and 2001 and 38% in 2000. Although the Commercial Auto Business differs from Personal Lines auto, it requires the same fundamental skills that drive the Company's Personal Lines auto business, which include disciplined underwriting and pricing, as well as excellent claim service. The Company's Commercial Auto Business is primarily distributed through the independent agent channel. The Company estimates that its Commercial Auto Business currently ranks fifth in market share nationally based on data reported by A. M. Best Company Inc.

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

Underwriting results for the Company's Personal Lines, including its channel components, the Commercial Auto Business and other businesses were as follows:

(millions)	2002	2001	2000
Net Premiums Written			
Personal Lines–Agent	$ 5,832.7	$ 4,614.7	$ 4,358.4
Personal Lines–Direct	2,529.8	1,861.7	1,293.1
Total Personal Lines	8,362.5	6,476.4	5,651.5
Commercial Auto Business	1,002.9	665.7	442.0
Other businesses	86.6	118.0	102.6
Companywide	$ 9,452.0	$ 7,260.1	$ 6,196.1
Net Premiums Earned			
Personal Lines–Agent	$ 5,542.7	$ 4,706.8	$ 4,643.4
Personal Lines–Direct	2,365.1	1,787.0	1,220.6
Total Personal Lines	7,907.8	6,493.8	5,864.0
Commercial Auto Business	880.0	552.3	384.8
Other businesses	95.7	115.7	99.6
Companywide	$ 8,883.5	$ 7,161.8	$ 6,348.4
Personal Lines–Agent CR			
Loss & loss adjustment expense ratio	72.0	74.8	85.0
Underwriting expense ratio	21.0	19.9	18.8
	93.0	94.7	103.8
Personal Lines–Direct CR			
Loss & loss adjustment expense ratio	69.1	71.8	80.9
Underwriting expense ratio	22.3	25.9	29.6
	91.4	97.7	110.5
Personal Lines–Total CR			
Loss & loss adjustment expense ratio	71.1	74.0	84.1
Underwriting expense ratio	21.4	21.5	21.1
	92.5	95.5	105.2
Commercial Auto Business–CR			
Loss & loss adjustment expense ratio	70.7	70.6	75.1
Underwriting expense ratio	20.2	21.1	21.6
	90.9	91.7	96.7
Other Businesses–CR			
Loss & loss adjustment expense ratio	56.7	60.6	56.8
Underwriting expense ratio	36.1	32.4	29.6
	92.8	93.0	86.4
Companywide GAAP CR			
Loss & loss adjustment expense ratio	70.9	73.5	83.2
Underwriting expense ratio	21.5	21.7	21.2
	92.4	95.2	104.4
Companywide Accident Year			
Loss & loss adjustment expense ratio	70.9	74.9	82.0
Auto Policies in Force (at December 31)			
(thousands)			
Agent – Auto	3,386	2,779	2,821
Direct – Auto	1,541	1,209	1,026
Other Personal Lines[1]	1,642	1,383	1,200
Total Personal Lines	6,569	5,371	5,047
Commercial Auto Business	289	209	170

[1]Includes insurance for motorcycles, recreation vehicles, mobile homes, watercraft, snowmobiles, homeowners and similar items.

The Agent channel net premiums written increased 26% in 2002, compared to 6% in 2001 and an 8% decrease in 2000. As discussed above, the increase in net premiums written for 2002 was a result of both an increase in new applications and strong renewals. In addition, the Agent channel benefited from rate adequacy when competitors were playing catch-up on rate all year. Net premiums earned increased 18%, 1% and 2% in 2002, 2001 and 2000, respectively. In 2001 and 2000, the rate increases the Company had taken were partially offset by decreases in Agent auto policies in force. Agent auto policies in force increased 22% in 2002, and decreased 1% and 7% in 2001 and 2000, respectively. Continued growth in the Agent business can be affected by competitor rate activity and local market conditions. The Company was generally ahead of competitors in recognizing the increases in loss trends and filing necessary rate increases. Therefore, as competitors subsequently raised rates, the Company experienced an increase in its share of business generated in the Agent channel.

The Company's Direct channel net premiums written increased 36% in 2002, 44% in 2001 and 35% in 2000. Net premiums written grew 39% and 41% for 2002 and 2001, respectively, excluding the $37.7 million of previously ceded written premiums that were assumed by the Company upon the commutation of a reinsurance agreement that was part of a strategic alliance relationship that was terminated in the first quarter 2001. This strategic alliance relationship was terminated by mutual agreement of the Company and the other party because the business interests of the parties were no longer aligned. In addition, the Company did not envision that this relationship would help the Company in meeting its long-term profitability objectives. The commutation of the reinsurance agreement was a natural and required result of terminating the relationship (see Note 12 – Commitments and Contingencies).

The Direct channel net premiums earned grew 32%, 46% and 64% in 2002, 2001 and 2000, respectively. The Company feels that continued growth in the Direct business is heavily dependent on the success of the Company's advertising and other marketing efforts, realizing that price sensitivity is always a factor. The Company is advertising on a national basis and supplements its coverage by local market media campaigns in over 80 designated marketing areas. Direct auto policies in force increased 27%, 18% and 45% for 2002, 2001 and 2000, respectively.

Another important element affecting growth is customer retention. The Company experienced very encouraging progress in retention in both the Agent channel and the Direct channel in 2002. One measure of improvement in customer retention is policy life expectancy (PLE), which is the estimate of the average length of time that a policy will remain in force before cancellation or non-renewal. In 2002, the Company experienced about a 20% increase in PLE, with most tiers in both channels contributing to the increase. The Company believes the improvement in the PLE is a function of internal process improvements, smaller rate changes by the Company and an external market where average premiums are increasing. Although it is difficult to identify the exact contribution of each component, the Company believes that the increases in electronic payments and quote accuracy, along with targeted messages sent at renewal explaining rate changes, are having a significant effect on the increase in PLE. Since multiple factors affect retention, such as market conditions, competitors achieving rate adequacy and the Company's mix of business, the Company is unable to predict if retention will increase, decrease or remain the same in the future.

The Company's Commercial Auto business net premiums written increased 51% in both 2002 and 2001, compared to 38% in 2000. The Company has seen the rate of growth slow during the second half of 2002, but the Company is still benefiting from competitors raising rates and restricting the business they write. Should the hard market continue into 2003, the Company would be able to increase rates while still seeing a significant increase in unit growth. The Company continues to focus on writing insurance for small business autos and trucks, with the majority of their customers insuring three or fewer vehicles. Approximately 52% of the Company's year-to-date Commercial Auto net premiums written were generated in the light and local commercial auto markets, which includes autos, vans and pick-up trucks used by contractors, artisans, landscapers and a variety of other small businesses. The remainder of the business was written in the specialty commercial auto market, which includes dump trucks, logging trucks and other short-haul commercial vehicles. The Company does not write in, and has no intention of re-entering, the long-haul trucking market. There are many similarities between the Company's commercial and personal auto business; however, since the commercial auto policies have higher limits than personal auto, the Company continues to monitor this segment closely. Commercial Auto net premiums earned increased 59% in 2002, compared to 44% in 2001 and 33% in 2000. Policies in force have increased 38%, 23% and 27% in 2002, 2001 and 2000, respectively.

During 2002, the Company generated an underwriting profit in 98% of the U.S. Personal Lines markets where it writes (48 out of 49 markets), compared to approximately 75% in 2001 and approximately 40% in 2000. The Company's top five states, which account for almost 40% of the Company's total Personal Lines net premiums written, all exceeded the Company's profit goal of a 4% underwriting profit. The Company will continue to monitor and adjust rates as needed to meet its financial goals.

Claim costs, the Company's most significant expense, represent payments made and estimated future payments to be made to or on behalf of its policyholders, including adjusting expenses needed to settle claims. These costs include a loss estimate for future assignments, based on current business, under state-mandated automobile insurance programs. Claim costs are influenced by loss severity and frequency and inflation. Accordingly, these anticipated changes in loss costs are taken into account when the Company establishes premium rates and loss reserves. Claim costs, expressed as a percentage of premiums earned, were 71% in 2002, compared to 74% in 2001 and 83% in 2000.

The Company has seen a decline in frequency, which has been partially offset by an increase in severity. Although the Company cannot completely explain the drop in loss frequency, it believes that this trend may have bottomed out. Overall, severity increased less than five percent in 2002. The Company plans to be diligent in its efforts to recognize these increasing costs when setting rates and establishing loss reserves. During the year, the Company's claims handling quality improved, as indicated by the Company's audits of claim files, and the Company has increased its hiring and training of claim representatives to handle the increase in the number of claims resulting from the Company's growth.

During 2002, the Company experienced $3.5 million of unfavorable loss reserve development, compared to $99.0 million of favorable development in 2001 and $75.8 million of unfavorable development in 2000. During 2002, the Company made no significant change to the

estimate of loss reserves recorded in prior years. A small decrease in the Personal Lines loss reserves was offset by an increase in the Commercial Auto loss reserves. The favorable development in 2001 is primarily attributable to the settlement of claims at less than amounts reserved, while the unfavorable development in 2000 reflected the Company's effort to fully recognize the loss trends that were emerging. The development in 2001 primarily relates to the 2000 accident year, while the majority of the 2000 unfavorable development related to the 1999 accident year. The Company conducts extensive reviews each month on portions of its business to help ensure that the Company is meeting its objective of always having reserves that are adequate, with minimal variation. Results would differ if different assumptions were made. See the *Critical Accounting Policies* section of *Management's Discussion and Analysis* for a discussion of the effect of changing estimates. In July 2002, the Company released its *Report on Loss Reserving Practices*, via Form 8-K, which provides a detailed discussion of the Company's loss reserving practices.

Because the Company is primarily an insurer of motor vehicles, it has limited exposure as an insurer of 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. These exposures are not expected to have a material effect on the Company's liquidity, financial condition, cash flows or results of operations.

Policy acquisition costs and other underwriting expenses as a percentage of premiums earned were 22% in both 2002 and 2001, and 21% in 2000. Policy acquisition costs are amortized over the policy period in which the related premiums are earned (see Note 1 – Reporting and Accounting Policies). The increase in "other underwriting expenses," as shown in the income statement, in 2002 was primarily a result of growth, the settlement of class-action lawsuits and an increase in payouts under the Company's incentive compensation programs resulting from improved operating performance. The Agent channel expense ratio, which includes the settlement of the alternative commission programs lawsuits (see Note 11 – Litigation), is in line with the Company's expectations. The Company continues to see improvement in the Direct business expense ratio, which is primarily the result of an increase in the conversion rates. The Company's advertising costs in 2002 were approximately the same as 2001, with the Company experiencing greater efficiency and yield. Based on this experience, the Company believes it can effectively leverage an anticipated increase in advertising spending in 2003.

During 2002, the Company incurred $21.2 million of guaranty fund exposure, compared to $14.6 million in 2001 and $2.0 million in 2000. The 2002 expense was primarily related to the Reliance Insurance Company and Aries Insurance Company insolvencies; 2001 primarily related to Reliance. The Company believes that any assessment for known insolvencies in excess of its current reserves will not materially affect the Company's financial condition, cash flows or results of operations.

The Company is named as a defendant in a number of putative class action lawsuits, such as those alleging damages as a result of the Company's use of after-market parts, total loss evaluation methodology, use of credit in underwriting, charging betterment in first party physical damage claims, using preferred provider rates for payment of personal injury protection claims, worker classification issues, use of third-party vendors to analyze the propriety of payment of medical bills, offering alternative commission programs or the alleged diminution of value to vehicles which are involved in accidents, and cases challenging other aspects of the Company's claims and marketing practices and business operations. Other insurance companies face many of these same issues. During 2002, the Company settled several long-standing class-action lawsuits relating to diminution of value, handling of betterment in claim settlements, use of alternative agent commissions programs and a California-specific labor classification claim. See Note 11 – Litigation for a more detailed discussion.

Critical Accounting Policies The Company is required to make certain estimates and assumptions when preparing its financial statements and accompanying notes in conformity with GAAP. Actual results could differ from those estimates in a variety of areas. The two areas that the Company views as most critical with respect to the application of estimates and assumptions are its method of determining impairments in its investment portfolio and the establishment of its loss reserves.

Other than Temporary Impairment – SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities" and SAB 59, "Noncurrent Marketable Equity Securities" requires companies to perform periodic reviews of individual securities in its investment portfolio to determine whether a decline in the value of a security is other than temporary. A review for other than temporary impairment (OTI) requires companies to make certain forward-looking assumptions regarding the probability, extent and timing of a valuation recovery, the materiality of the decline and its effect on the financial statements, and the Company's ability and intent to hold the security. The scope of this review is broad and requires a forward-looking assessment of the fundamental characteristics of a security, as well as market-related prospects of the issuer and its industry.

The Company assesses valuation declines 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. This evaluation reflects the Company's estimates of current conditions as well as predictions of uncertain future events that may have a material impact on the financial statements related to security valuation.

For fixed income investments with unrealized losses due to market or industry-related declines, the declines are not deemed to qualify as other than temporary where the Company has the intent and ability to hold the investment for the period of time necessary to recover a significant portion of the investment's original principal and interest obligation. The Company's policy for equity securities with market-related declines is to recognize impairment losses on individual securities with losses that are not reasonably expected to be recovered under historical market conditions when the security has been in a loss position for three consecutive quarters.

When persuasive evidence exists that causes the Company to evaluate a decline in market value 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. All other unrealized gains or losses are reflected in shareholders' equity. Senior management provides a summary of the Company's OTI review to the audit committee of the Company's Board of Directors.

As of December 31, 2002, the Company's total portfolio had $160.5 million in gross unrealized losses, compared to $95.9 million in gross unrealized losses in 2001. The increase during 2002 was the result of continued equity market declines, as evidenced by the Russell 1000 Index return of (21.7)%. The year-end unrealized losses were mitigated by the fact that, during the year, the Company recognized $202.1 million of OTI and additional gross realized losses of $83.2 million from security sales, as well as from the positive effect of declining interest rates on the Company's bond portfolio.

The following table stratifies the gross unrealized losses in the Company's portfolio at December 31, 2002, by duration in a loss position and magnitude of the loss as a percentage of book value. The individual amounts represent the additional OTI the Company could have recognized in the income statement if its policy for market-related declines was different than that stated above.

(millions)	**Total Gross**	**Percent Decline of Investment Value**			
Total Portfolio	**Unrealized Losses**	**> 15%**	**> 25%**	**> 35%**	**> 45%**
Unrealized Loss for 1 Quarter	$ 12.8	$ 9.6	$ 1.5	$ —	$ —
Unrealized Loss for 2 Quarters	35.6	14.6	6.8	3.4	.2
Unrealized Loss for 3 Quarters	49.1	36.4	9.6	—	—
Unrealized Loss for > 3 Quarters	63.0	42.7	27.0	—	—
Total	$ 160.5	$ 103.3	$ 44.9	$ 3.4	$ .2

For example, if the Company decided to write down all securities in an unrealized loss position in excess of three quarters where the securities decline in value exceeded 15%, the Company would recognize an additional $42.7 million of OTI losses in the income statement. These OTI losses would decrease to $27.0 million if the threshold for market decline was greater than 25%.

Since total unrealized losses are already a component of the Company's shareholders' equity, any recognition of additional OTI losses would have no effect on the Company's comprehensive income or book value.

Loss and LAE Reserves – Loss and loss adjustment expense (LAE) reserves represent the Company's best estimate of its ultimate liability for losses and LAE that occurred prior to the end of any given accounting period but have not yet been paid. At December 31, 2002, the Company had $3.8 billion of gross loss and LAE reserves, which represents management's best estimate of ultimate loss. As a result of the detailed product review processes the Company performs (discussed below), the Company does not develop aggregate countrywide ranges for its loss reserves. The Company's carried reserve balance inherently assumes an increase in the loss and LAE severity for both personal auto liability and commercial auto liability, which represent over 95% of the Company's total reserves. These estimates are influenced by many variables that are difficult to quantify, such as medical costs, jury awards, etc., which will influence the final amount of the claim settlement. That, coupled with changes to internal claims practices, changes in the legal environment and state regulatory requirements, requires significant judgment in the reserve setting process.

The Company reviews its reserves at a combined state, product and line coverage level (the "products") on an annual, semiannual or quarterly time frame depending on size of the products or emerging issues relating to the products. By reviewing the reserves at such a detailed level, the Company has the ability to identify and measure variances in trend by state, product and line coverage that would not otherwise be seen on a consolidated basis. The Company's actuarial department reviews the results of six different estimation methods, three based on paid data and three based on incurred data, to determine if a reserve change is required. In the event of a wide variation between results generated by the different projections, the actuarial group will further analyze the data using additional techniques.

In analyzing the ultimate accident year loss experience, the Company's actuarial area reviews in detail the frequency (number of losses per earned car years), severity (dollars of loss per each claim), and the average premium (dollars of premium per earned car year). The loss ratio, a primary measure of loss experience, is equal to the frequency times severity divided by the average premium. The average premium for personal and commercial auto businesses are known and therefore are not estimated. The projection of frequency for these lines of business is generally very stable because injured parties report their claims in a reasonably short time period. The actual frequency experienced will vary depending on the change in mix by class of drivers written by the Company, but the accuracy of the projected level is generally reliable. The severity experienced by the Company, which is more difficult to estimate, is affected by changes in underlying costs, such as medical costs, jury verdicts, etc. In addition, severity will change relative to the change in the Company's limit profile.

During 2002, the Company experienced exceptional growth which creates additional uncertainty in estimating the ultimate loss costs. The contributing factors of this potential risk are the change in the Company's limit mix and mix of business by state or jurisdiction. To address this risk of uncertainty, the Company's actuarial area expanded their scope of reserve reviews by approximately 50% to accommodate the shift to high and low policy limits within the reserving product level. Even though this increased focus on needed reserves by policy limit was part of the process for the personal auto business, even more attention was given to studies regarding losses by policy limit for the commercial auto business, as the average limit of this business is much higher than personal auto and has been increasing over the last few years.

The Company's goal is to ensure total reserves are adequate to cover all loss costs while sustaining minimal variation from the time reserves are initially established until losses are fully developed. During 2002, the Company made no significant change to the estimate of loss reserves recorded in prior years. The following table shows how the Company has performed against this goal over the last ten years.

(millions)

For the years ended December 31,	1992	1993	1994[3]	1995	1996	1997	1998	1999	2000	2001	2002
Loss and LAE reserves[1]	$956.4	$1,012.4	$1,098.7	$1,314.4	$1,532.9	$1,867.5	$1,945.8	$2,200.2	$2,785.3	$3,069.7	$3,632.1
Re-estimated reserves as of:											
One year later	857.9	869.9	1,042.1	1,208.6	1,429.6	1,683.3	1,916.0	2,276.0	2,686.3	3,073.2	
Two years later	765.5	837.8	991.7	1,149.5	1,364.5	1,668.5	1,910.6	2,285.4	2,708.3		
Three years later	737.4	811.3	961.2	1,118.6	1,432.3	1,673.1	1,917.3	2,277.7			
Four years later	725.2	794.6	940.6	1,137.7	1,451.0	1,669.2	1,908.2				
Five years later	717.3	782.9	945.5	1,153.3	1,445.1	1,664.7					
Six years later	711.1	780.1	952.7	1,150.1	1,442.0						
Seven years later	709.2	788.6	952.6	1,146.2							
Eight years later	714.6	787.5	949.7								
Nine years later	713.3	787.0									
Ten years later	713.0										
Cumulative development: conservative/(deficient)	$ 243.4	$ 225.4	$ 149.0	$ 168.2	$ 90.9	$ 202.8	$ 37.6	$ (77.5)	$ 77.0	$(3.5)	
Percentage[2]	25.5	22.3	13.6	12.8	5.9	10.9	1.9	(3.5)	2.8	(.1)	

The chart represents the development of the property-casualty loss and LAE reserves for 1992 through 2001. The reserves are re-estimated based on experience as of the end of each succeeding year and are increased or decreased as more information becomes known about the frequency and severity of claims for individual years. The cumulative development represents the aggregate change in the estimates over all prior years. Since the characteristics of the loss reserves for both personal auto and commercial auto are similar, the Company reports development in the aggregate rather than by segment.

[1]Represents loss and LAE reserves net of reinsurance recoverables on unpaid losses at the balance sheet date.

[2]Cumulative development ÷ loss and LAE reserves.

[3]In 1994, based on a review of its total loss reserves, the Company eliminated its $71.0 million “supplemental reserve.”

The Company experienced continually favorable reserve development through 1998 primarily due to the decreasing bodily injury severity. From the fourth quarter 1993 continuously through the third quarter 1998, the Company’s bodily injury severity decreased each quarter when compared to the same quarter the prior year. This period of decreasing severity for the Company was not only longer than that experienced by the industry, but also longer than any time in Progressive’s history. The reserves established as of the end of each year assumed the current accident year’s severity to increase over the prior accident year’s estimate. As the experience continued to be evaluated at later dates, the realization of the decreased severity resulted in favorable reserve development.

The Company believes that the assumption with the highest likelihood of change that would materially affect the carried loss and LAE reserves is the estimated severity for the 2002 accident year. If the Company changed its estimate of severity by 1%, the 2002 required reserves for personal auto liability and commercial auto liability would have changed by approximately $30 million and $4 million, respectively.

Because the Company is primarily an insurer of motor vehicles, it has minimal exposure as an insurer of environmental, asbestos and general liability claims.

For a more detailed discussion on the Company’s loss reserving practices and how loss reserves affect the Company’s financial results, see the Company’s *Report on Loss Reserving Practices*, which was filed in July 2002 via Form 8-K and is available on the Company’s Web site at progressive.com/investors.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995: Statements in this Annual Report that are not historical fact are forward-looking statements that are subject to certain risks and uncertainties that could cause actual events and results to differ materially from those discussed herein. These risks and uncertainties include, without limitation, uncertainties related to estimates, assumptions and projections generally; inflation and changes in economic conditions (including changes in interest rates and financial markets); the effectiveness of the Company’s advertising campaigns; the accuracy and adequacy of the Company’s pricing methodologies; pricing competition and other initiatives by competitors; ability to obtain regulatory approval for requested rate changes and the timing thereof; legislative and regulatory developments; the outcome of litigation pending against the Company; weather conditions (including the severity and frequency of storms, hurricanes, snowfalls, hail and winter conditions); changes in driving patterns and loss trends; acts of war and terrorist activities; court decisions and trends in litigation and health care and auto repair costs; and other matters described from time to time by the Company in releases and publications, and in periodic reports and other documents filed with the United States Securities and Exchange Commission. In addition, investors should be aware that generally accepted accounting principles prescribe when a company may reserve for particular risks, including litigation exposures. Accordingly, results for a given reporting period could be significantly affected if and when a reserve is established for a major contingency. Reported results may therefore appear to be volatile in certain accounting periods.