REPORT ON EXAMINATION

OF THE

PROGRESSIVE NORTHEASTERN INSURANCE COMPANY

AS OF

DECEMBER 31, 1998

DATE OF REPORT	AUGUST 31, 2000
EXAMINER	GILBERT W. DENTON

TABLE OF CONTENTS

STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

August 31, 2000

Honorable Neil Levin
Superintendent of Insurance
Albany, NY 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with instructions contained in Appointment Number 21295, dated August 7, 1998, attached hereto, I have made an examination into the condition and affairs of the Progressive Northeastern Insurance Company as of December 31, 1998 and submit the following report thereon.

The examination was conducted at the Company's administrative offices located at 6300 Wilson Mills Road, Mayfield Village, Ohio.

Wherever the designations "PNIC" or "the Company" appears herein without qualification, they should be understood to indicate the Progressive Northeastern Insurance Company.

1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1994. This examination covers the four-year period from January 1, 1995 through December 31, 1998 and was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, inter-company balances, loss and loss adjustment expense reserves and the provision for reinsurance. The examination included a review of income, disbursements and company records deemed necessary to accomplished such analysis or verification, and utilized to the extent considered appropriate, work performed by the Company's independent public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

History of the Company
Management and control
Corporate records
Fidelity bonds and other insurance
Territory and plan of operation
Market conduct activities
Growth of the Company
Business in force by states
Reinsurance
Accounts and records
Financial statements

This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

The Company was incorporated on September 28, 1992 under the name, Paragon Insurance Company of New York (Paragon). Paragon is wholly-owned by the Progressive Corporation, an Ohio domiciled holding company.

Paragon issued 1,000 shares of $1,000 par value per share common stock on March 30, 1994, for $4,600 per share, resulting in a paid-in capital of $1,000,000 and gross paid-in and contributed surplus of $3,600,000.

On September 19, 1994, Paragon Insurance Company of New York's name was changed to Progressive Northeastern Insurance Company. The name change was submitted to and approved by this Department. The Company began writing business in April 1995.

The Company has received surplus contributions of $500,000, $15,000,000 and $9,000,000 in 1995, 1996, and 1997, respectively from its parent, The Progressive Corporation. All the above contributions were approved by the Department.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of thirteen members. The board is scheduled to meet four times during each calendar year. The directors as of December 31, 1998 were as follows:

Name and Residence	Principal Business Affiliation
Alan R. Bauer Moreland, OH	Director, Progressive Casualty Insurance Corporation
Timothy R. Case Waterford, NY	Claims Manager II, Progressive Casualty Insurance Company
Charles B. Chokel Pepper Pike, OH	Treasurer, Progressive Casualty Insurance Corporation
W. Thomas Forrester, II Moreland, OH	Treasurer, Progressive Casualty Insurance Company
William H. Graves Austin, TX	Claims Process Leader, Progressive Casualty Insurance Company
Robin A. Harbage Pittsfield, NY	General Manager, Progressive Casualty Insurance Company
Daniel R. Lewis Miami, FL	General Manager, Progressive Casualty Insurance Company
Peter B. Lewis Beachwood, OH	Chairman of the Board and President, The Progressive Corporation
Robert J. McMillan Colorado Springs, CO	Product Process Leader, Progressive Casualty Insurance Company
Victor Politzi Loudonville, NY	General Manager, Progressive Casualty Insurance Company
David M. Schneider Pepper Pike, OH	Secretary, The Progressive Corporation
Tiona M. Thompson Moreland, OH	Chief Human Resources Officer, Progressive Casualty Insurance Company
Robert T. Williams, Jr. Aurora, OH	Division President, Progressive Casualty Insurance Company

At December 31, 1998, the principal officers of the Company were as follows:

Name	Title
Peter B. Lewis	President
Robin A. Harbage	Vice President
Robert T. Williams, Jr.	Vice President
Kathleen M. Cerny	Assistant Secretary
Janet A. Dolohanty	Assistance Vice President and Assistant Treasurer
Charles B. Chokel	Treasurer
David M. Schneider	Secretary

The minutes of all board of directors' meetings and committees thereof held during the examination period were reviewed. The board met 14 times, holding regular meetings in accordance with its by-laws. The meetings were well attended; however, the following directors failed to attend at least half of the meetings that they were eligible to attend: Timothy R. Case, Robin A. Harbage and Victor Politzi.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that the board may reach appropriate policy decisions. Individuals who fail to attend at least one-half of the regular meetings do not fulfill such criteria. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

B. Territory and Plan of Operation

As of December 31, 1998, the Company is only licensed to transact business in the State of New York. The annual total direct premiums written during the examination period were, $14,130,190, $238,343,705, $206,359,340 and $198,665,066 for 1995, 1996, 1997 and 1998, respectively.

Effective July 1, 1995, the Company entered into a 90% quota share reinsurance agreement with Progressive Casualty Insurance Company, an affiliate.

As of December 31, 1998, the Company was licensed to transact the kinds of business defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

Paragraph	Line of Business
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
12	Collision
13	Personal injury liability
14	Property damage liability
16	Fidelity and surety
19	Motor vehicle and aircraft physical damage
20	Inland marine only
30	Substantially similar kinds of insurance

Based upon the lines of business for which the Company is licensed, and the Company's current capital structure, and pursuant to the requirement of Articles 13 and 41 of the New York Insurance Law, Progressive Northeastern Insurance Company is required to maintain a minimum surplus to policyholders in the amount of $2,400,000.

The Company writes personal and commercial automobile liability and physical damage liability as well as selected specialty insurance coverages. The Company utilizes independent agents to secure business.

C. Reinsurance

As of the examination date, the Company had no assumed reinsurance contracts.

All ceded reinsurance contracts effected during the examination period were reviewed. All contracts contained the required standard clauses, including the insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

The Schedule F data contained in the Company's filed annual statements for the years covered by the examination period was found to accurately reflect its reinsurance transactions.

A summary of the Company's ceded reinsurance in effect as of the examination date follows:

Quota Share Reinsurance Agreement

Effective July 1, 1995 the Company entered into a 90% quota share reinsurance agreement with an affiliate, Progressive Casualty Insurance Company (PCIC). Pursuant to the agreement, approved by the Department, the Company ceded 90% of its premiums, losses and loss adjustment expenses and underwriting expenses to Progressive Casualty Insurance Company after the effect of all other reinsurance agreements with non-affiliated companies. The Company only retains 10% of its initial business.

Lines of Business	Type of Cessions	Limits
Private passenger auto/ special lines policies per strategic alliance	Quota Share	50% with maximum of $500,000 gross and $250,000 net exposure
Private passenger auto/ special lines policies per marketing agreement	Quota Share	30% with maximum gross $500,000 gross and $350,000 net exposure
Private passenger auto/ special lines policies per the agency agreement	Quota Share	30% with maximum gross exposure $500,000 and $350,000 net exposure

Lines of Business	Type of Cessions	Limits
Private passenger auto/ special lines policies per marketing agreement	Quota Share	10% with maximum $500,000 gross and $450,000 net exposure

Excess of loss

Type of Treaty	Coverage
First Layer	95% of $1,500,000 in excess of $500,000 per occurrence, subject to aggregate recovery of $2,850,000 during the term of the agreement
Second Layer	95% of $2,000,000 in excess of $2,000,000 per occurrence, subject to aggregate recovery of $3,800,000 during the term of the agreement

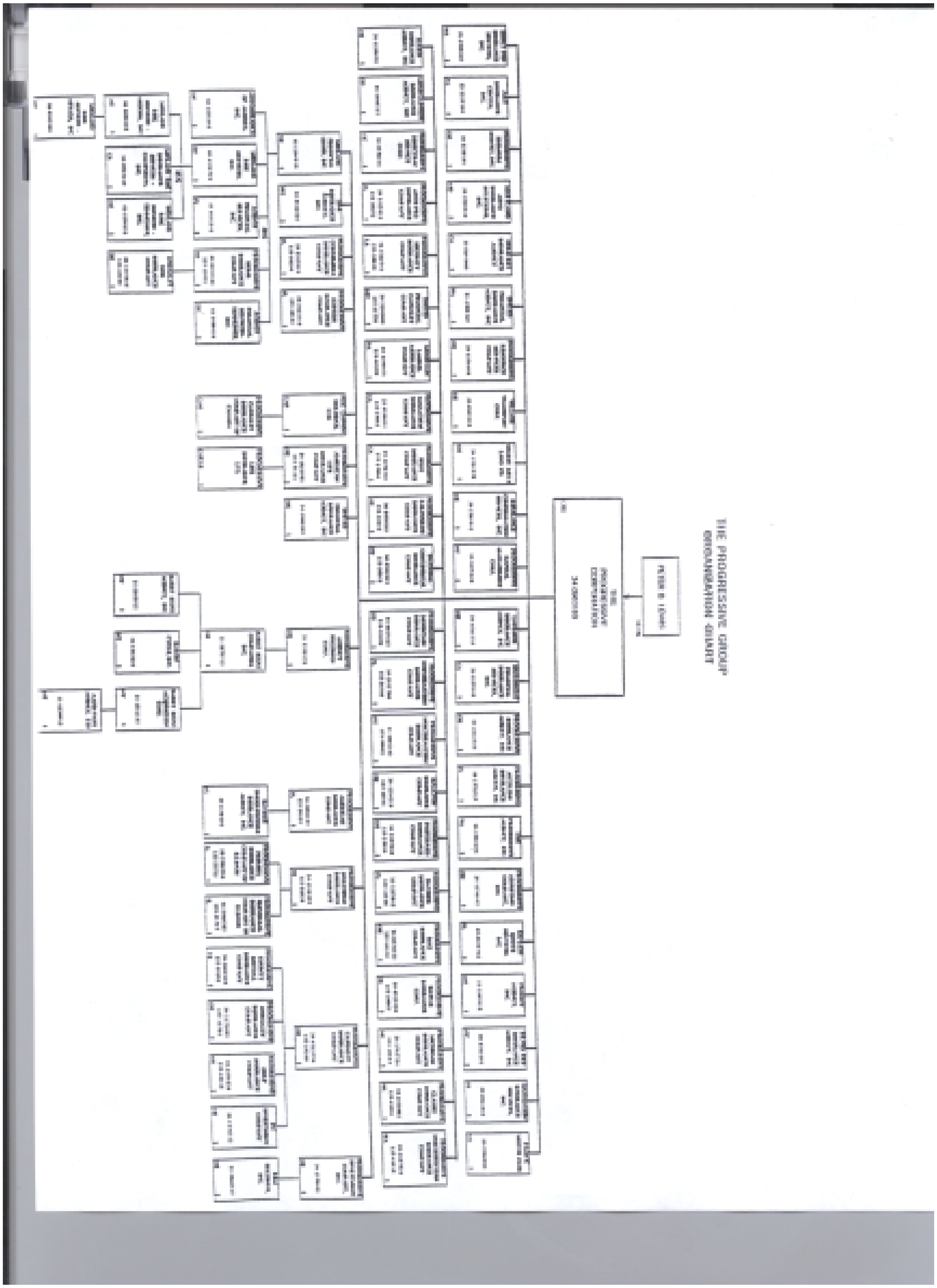
D. Holding Company System

The Company is a wholly-owned subsidiary of the Progressive Corporation, an Ohio insurance holding company.

It is noted that the Company reported Peter B. Lewis, Chairman, President and Chief Executive Officer of the Progressive Corporation and the Progressive Corporation as ultimate controlling person on its Form B Insurance Company System Annual Registration Statement dated March 27, 1998. The Registration Statement indicated Mr. Lewis as the owner of 14.2% of the voting securities of the Progressive Corporation. The Registration Statement, Item 3, contained the following wording:

> "Because Mr. Lewis owns approximately 14.2% of the voting securities of the Progressive Corporation and has not filed a disclaimer of control, there is a statutory presumption that he is the ultimate controlling person. Mr. Lewis neither confirms nor denies that he is the ultimate controlling person."

The following chart depicts the holding company system at December 31, 1998:


THE PROGRESSIVE GROUP
ORGANIZATION CHART

The Company has entered into the following agreements with members of its holding company system, all of which have been non-disapproved by the Department pursuant to the provisions of Section 1505 of the New York Insurance Law:

1. <u>Reinsurance Agreement between Progressive Casualty Insurance Company and Progressive Northeastern Insurance Company</u>

Effective July 1, 1995, the Company entered in a 90% quota share reinsurance agreement with Progressive Casualty Insurance Company. Pursuant to the agreement the Company cedes 90% of its business to the reinsurer.

2 <u>Cash Management Agreement between Progressive Casualty Insurance Company and Progressive Northeastern Insurance Company and Certain Affiliates</u>

This agreement, effective January 1, 1998, provided for the Company's participation in the Progressive Casualty Insurance Company's central cash management system (cashier account) in which all the cash of the Progressive holding company system's companies are deposited. Pursuant to the agreement, Progressive Casualty Insurance Company is responsible in a fiduciary capacity for the Company's cash, and performs all the Company's duties and operations as they pertain to cash, including the payment of the Company's obligations.

3. <u>Interest Agreement between Progressive Casualty Insurance Company and Progressive Northeastern Insurance Company and Certain Affiliates</u>

The Company became a participant, effective November 25, 1985, to the existing interest agreement among the Progressive Casualty Insurance Company and members of the holding company system. Pursuant to the Agreement, the Company agrees to pay Progressive Casualty Insurance Company or to receive credit from Progressive Casualty Insurance Company for any balances owed to Progressive

Casualty Insurance Company or owed by Progressive Casualty Insurance Company as a result of the activity in the cashier account per the Cash Management Agreement.

4. Investment Services Agreement between Progressive Capital Management Corporation, Progressive Northeastern Insurance Company and Certain Affiliates

Pursuant to this agreement, effective July 16, 1992, Progressive Capital Management Corporation provides investment management services to the Company as well as other affiliated members. Costs of the investment services are shared among the members of the holding company system.

5. Service Agreement between Progressive Casualty Insurance Company and Progressive Northeastern Insurance Company

Effective January 1, 1996, the Company entered in a service agreement with Progressive Casualty Insurance Company. Pursuant to the agreement, the Company utilizes the personnel, property and facilities of PCIC. PCIC also provides services relating to the insurance operations, including administrative and record keeping for the Company. The Company reimburses PCIC for all its identifiable expenses. The expenses that are not identifiable, are allocated based on formulas and factors consistent with the provisions of Department Regulation 30.

6. General Agency Agreement between ProgNY Agency, Inc., Progressive Northeastern Insurance Company and Certain Affiliates

Effective August 14, 1996, this agreement authorized ProgNY agency to sell insurance products for the Company.

7. <u>Producers' Agreement between United Financial Insurance Agency, Inc., United Financial Insurance Agency of Washington, Inc., Progressive Northeastern Insurance Company and Certain Affiliates</u>

Pursuant to the Agreement, effective May 15, 1996, United Financial Insurance Agency, Inc. and United Financial Insurance Agency of Washington, Inc. are authorized to sell selected insurance business for the Company in New York State.

8. <u>Premium Receivable Agreement between Progressive Northeastern Insurance Company And Progressive Investment Company, Inc.</u>

Effective December 31, 1998, the Company agrees to sell a portion of its premiums receivable to Progressive Investment Company, Inc. Under the agreement, the Company is responsible for the collection of the transferred premium receivable.

9. <u>Allocation of Federal Income Taxes between the Progressive Corporation and Progessive Northeastern Insurance Company</u>

Effective June 1, 1994, the Company and other members of its holding company system, entered into an income tax sharing agreement with the Progressive Corporation, whereby the companies file a consolidated federal income tax return. A review of the agreement revealed that it did not contain any of the provisions required by the Department Circular Letter No. 33 (1979). However, effective March 23, 1994, the necessary requirements including the escrow agreement pursuant to Circular Letter No. 33 were established.

E. Abandoned Property Law

A review was made of the information included in the Company's Report of Abandoned Property to the Office of the Comptroller of the State of New York during the period under examination. The Company has complied with Section 1316 of the New York Abandoned Property Law during said period.

F. Accounts and Records

Accounts Receivable

During the examination period, pursuant to Section 1505 of the New York Insurance Law, the Department approved an agreement for the Company to sell (factor) its accounts receivable (agents' balances) to Progressive Casualty Insurance Company, an affiliate. It was noted that this practice would be a recurring event unless the Company makes changes to its current business operation and capital structure. Although the Department has granted approval to sell its accounts receivable, this practice by the Company should not be construed as a regular business practice.

It is noted that the selling of its accounts receivable was done with recourse, a practice inconsistent with the proposed Accounting Practices and Procedures Manual of the National Association of Insurance Commissioners, which states that the sale of accounts receivable with recourse shall not be recognized as a sale. It is recommended that the Company maintain adequate capital to settle inter-company balances and not rely on selling its accounts receivable.

Custodian Agreement

Effective March 25, 1994, the Company became a participant in a master custodian agreement dated September 1, 1991, with Bankers Trust Company and other specified affiliates of the Progressive

Corporation. The agreement was reviewed and found not to contain various provisions which meet the guidelines established by the Department for the contents of such agreement. In order to ensure appropriate safeguards and controls for its securities, it is recommended that the Company amend its custodian agreement so that it may contain the following protective covenants and provisions:

1. The agreement should contain a provision which indicates whether the custodian is covered by Bankers Blanket Bond Insurance of the broadest form available; that the Company be notified in writing of any material change in the form of such bond, the amount of the bond or of the termination of coverage.

2. The agreement should contain a provision which expresses the custodian's duty to protect the Company's property with the same degree of care it employs to protect its own property.

3. The agreement should require the custodian to furnish to the Company, at least quarterly, a list completely describing the property held.

4. The agreement should require the custodian to maintain records sufficient to verify information reported in Schedule D of the Annual Statement Blank.

G. Significant Operating Ratios

Based upon the results of this examination, the following ratios have been computed as of December 31, 1998:

Net premiums written in 1998 to Surplus as regards policyholders	.75:1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	114.05%
Premiums in course of collection to Surplus as regards policyholders	19.30%

All the above ratios except the liabilities to liquid assets fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned-incurred basis and encompass the four year period covered by this examination:

	Amounts	Ratios
Losses incurred	$33,642,666	56.93%
Loss adjustment expenses incurred	8,663,193	14.66
Other underwriting expenses incurred	16,638,209	28.16
Net underwriting income	150,429	0.25
Premiums earned	$59,094,497	100.00%

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 1998. This statement is the same as the balance sheet filed by the Company:

Assets	Ledger Assets	Non-Ledger Assets	Not-Admitted Assets	Net-Admitted Assets
Bonds	$9,916,586			$9,916,586
Premiums and agents' balances in course of collection	3,494,030		$1,398,636	2,095,394
Premiums, agents' balances and installments booked but deferred and not yet due	22,015,982			22,015,982
Reinsurance recoverable on loss and loss adjustment expense payments	30,426,938			30,426,938
Interest, dividends and real estate income due and accrued		$133,709		133,709
Miscellaneous assets	34,886		34,886	
Total assets	$65,888,422	$133,709	$1,433,522	$64,588,609

Liabilities

Losses	$ 7,792,635
Loss adjustment expenses	1,947,671
Contingent commissions and other similar charges	79,249
Other expenses	104,543
Taxes, licenses and fees	458,474
Unearned premiums	10,239,257
Remittances and items not allocated	1,437,408
Excess of statutory reserves over statement reserves	14,000
Drafts outstanding	8,580,544
Payable to parent, subsidiaries and affiliates	4,430,664
Other liabilities	2,741,377
State Plan Liability	181,188
Total liabilities	$38,007,010
Common capital stock	$ 1,000,000
Gross paid in and contributed surplus	28,100,000
Unassigned funds	(2,518,401)
Surplus as regards policyholders	$ 26,581,599
Total liabilities and surplus	$ 64,588,609

Note: The Internal Revenue Service has completed its audits of the consolidated income tax returns filed on behalf of the Company for the years 1995 and 1996. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. Audits covering tax years 1997 and 1998 are currently in progress, while the audit covering tax year 1999 has yet to commence. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased $21,981,599 during the four-year examination period, January 1, 1995 to December 31, 1998, detailed as follows:

Statement of Income

Underwriting Income		
Premiums earned		$59,094,497
Deductions:		
Losses incurred	$33,642,666	
Loss adjustment expenses incurred	8,663,193	
Other underwriting expenses incurred	16,638,209	
Total underwriting deductions		58,944,068
Net underwriting income		$150,429
Investment Income		
Net investment income earned	$2,047,883	
Net investment gain		2,047,883
Other Income		
Agents' balances charged off	$(730,711)	
Miscellaneous loss	(6,912)	
Total other income		(737,623)
Net income before federal income taxes		$1,460,689
Federal income taxes incurred		(2,531,568)
Net loss		$(1,070,879)

Capital and Surplus Account

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders December 31, 1994, per report on examination			$4,600,000
Net loss	$	$1,070,879	
Change in not-admitted assets		1,433,522	
Change in excess of statutory reserves over statement reserves		14,000	
Surplus paid-in	24,500,000		
Total gains and losses	$24,500,000	$2,518,401	
Increase in surplus			$21,981,599
Surplus as regards policyholders December 31, 1998, per report on examination			$26,581,599

Summary of Surplus as Regards Policyholders

	December 31, 1994	December 31, 1998	Change
Capital paid in	$1,000,000	$1,000,000	
Gross paid in and Contributed surplus	3,600,000	28,100,000	$24,500,000
Unassigned funds (surplus)		(2,518,401)	(2,518,401)
Surplus as regards policyholders	$4,600,000	$26,581,599	$21,981,599

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities for the above captioned accounts totaling $7,792,635 and $1,947,671 respectively are the same as the amounts reported by the Company in its filed annual statement. The examination analysis was conducted in accordance with generally accepted actuarial principles and was based on statistical information contained in the Company's internal records and in its filed annual statements.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained no comments or recommendations.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM NO.		PAGE NO.
A.	Management	
	It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	5
B.	Accounts and Records	
	i. It is recommended that the Company maintain adequate capital to settle inter-company balances and not rely on selling its accounts receivable.	13
	ii It is recommended that the Company amend its custodian agreement to include the protective covenants and provisions which meet the guidelines established by the Department for the contents of such agreements.	14

Respectfully submitted,

/S/

Gilbert W. Denton
Senior Insurance Examiner

STATE OF NEW YORK)
) SS.
)
COUNTY OF NEW YORK)

GILBERT W. DENTON, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

/S/

Gilbert Denton

Subscribed and sworn to before me

this _____ day of _________ 2000.

Appointment No. 21295

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, Neil D. Levin, *Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

Gilbert Denton

as proper person to examine into the affairs of the

PROGRESSIVE NORTHEASTERN INSURANCE COMPANY

and to make a report to me in writing of the condition of the said

Company

with such other information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by the name and affixed the official Seal of this Department, at the City of New York,

this 7th day *of* August 1998

NEIL D. LEVIN
Superintendent of Insurance

(by) ~~*Deputy*~~ *Superintendent*