PROGRESSIVE CORP/OH/
Form 10-Q
November 12, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 1O-Q

(Mark One)
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2013
or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number: 1-9518

THE PROGRESSIVE CORPORATION
(Exact name of registrant as specified in its charter)

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

(440) 461-5000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.
Common Shares, $1.00 par value: 599,996,304 outstanding at September 30, 2013

PART I—FINANCIAL INFORMATION
Item 1. Financial Statements.
The Progressive Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
(unaudited)

	Three Months			Nine months		
Periods Ended September 30,	2013	2012	% Change	2013	2012	% Change
(millions—except per share amounts)						
Revenues						
Net premiums earned	$4,303.0	$4,054.8	6	$12,759.3	$11,912.4	7
Investment income	107.4	109.0	(1)	310.1	336.2	(8)
Net realized gains (losses) on securities:						
Other-than-temporary impairment (OTTI) losses:						
Total OTTI losses	(1.9)	(.4)	375	(3.6)	(6.0)	(40)
Non-credit losses, net of credit losses recognized on previously recorded non-credit OTTI losses	0	0	NM	(.1)	(.7)	(86)
Net impairment losses recognized in earnings	(1.9)	(.4)	375	(3.7)	(6.7)	(45)
Net realized gains (losses) on securities	29.8	172.3	(83)	245.1	251.4	(3)
Total net realized gains (losses) on securities	27.9	171.9	(84)	241.4	244.7	(1)
Fees and other revenues	76.0	78.4	(3)	215.3	213.5	1
Service revenues	11.3	9.9	14	30.3	28.3	7
Gains (losses) on extinguishment of debt	(4.3)	(.1)	4200	(4.3)	(1.8)	139
Total revenues	4,521.3	4,423.9	2	13,552.1	12,733.3	6
Expenses						
Losses and loss adjustment expenses	3,164.2	3,068.2	3	9,266.7	8,874.3	4
Policy acquisition costs	363.1	357.3	2	1,086.0	1,081.4	0
Other underwriting expenses	602.3	542.5	11	1,769.0	1,681.2	5
Investment expenses	5.2	3.3	58	14.5	11.3	28
Service expenses	11.1	9.6	16	30.1	27.7	9
Interest expense	30.4	30.6	(1)	91.4	93.2	(2)
Total expenses	4,176.3	4,011.5	4	12,257.7	11,769.1	4
Net Income						
Income before income taxes	345.0	412.4	(16)	1,294.4	964.2	34
Provision for income taxes	112.6	135.4	(17)	428.8	311.0	38
Net income	232.4	277.0	(16)	865.6	653.2	33
Other Comprehensive Income (Loss), Net of Tax						
Net unrealized gains (losses) on securities:						
Net non-credit related OTTI losses, adjusted for valuation changes	0	1.7	NM	.3	4.8	(94)
Other net unrealized gains (losses) on securities	57.8	60.6	(5)	2.4	209.0	(99)
Total net unrealized gains (losses) on securities	57.8	62.3	(7)	2.7	213.8	(99)
Net unrealized gains on forecasted transactions	(.9)	(.3)	200	(1.6)	(1.5)	7

Foreign currency translation adjustment	(.2)	.4	NM	(1.2)	.3	NM
Other comprehensive income (loss)	56.7	62.4	(9)	(.1)	212.6	NM
Comprehensive income	$289.1	$339.4	(15)	$865.5	$865.8	0
Computation of Net Income Per Share						
Average shares outstanding - Basic	598.9	601.9	0	599.7	604.3	(1)
Net effect of dilutive stock-based compensation	4.6	4.6	0	4.2	4.2	0
Total equivalent shares - Diluted	603.5	606.5	0	603.9	608.5	(1)
Basic: Net income per share	$.39	$.46	(16)	$1.44	$1.08	34
Diluted: Net income per share	$.39	$.46	(16)	$1.43	$1.07	34
Dividends declared per share[1]	$0	$0		$0	$0	

NM = Not Meaningful

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

See notes to consolidated financial statements.

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The Progressive Corporation and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(millions)	September 30, 2013	2012	December 31, 2012
Assets			
Investments - Available-for-sale, at fair value:			
Fixed maturities (amortized cost: $13,644.9, $11,864.0, and $11,373.9)	$13,797.7	$12,295.2	$11,774.1
Equity securities:			
Nonredeemable preferred stocks (cost: $442.1, $430.1, and $404.0)	726.0	848.4	812.4
Common equities (cost: $1,422.3, $1,101.5, and $1,370.3)	2,326.1	1,639.2	1,899.0
Short-term investments (amortized cost: $1,146.1, $2,394.1, and $1,990.0)	1,146.1	2,394.1	1,990.0
Total investments	17,995.9	17,176.9	16,475.5
Cash	100.9	192.2	179.1
Accrued investment income	91.5	88.2	90.0
Premiums receivable, net of allowance for doubtful accounts of $133.7, $133.5, and $138.6	3,500.8	3,356.0	3,183.7
Reinsurance recoverables, including $36.4, $32.5, and $38.9 on paid losses and loss adjustment expenses	1,031.9	880.5	901.0
Prepaid reinsurance premiums	82.6	72.8	66.3
Deferred acquisition costs	474.7	461.8	434.5
Net deferred income taxes	27.4	105.3	109.4
Property and equipment, net of accumulated depreciation of $665.8, $603.7, and $625.0	955.3	918.2	933.7
Other assets	247.9	235.3	321.5
Total assets	$24,508.9	$23,487.2	$22,694.7
Liabilities and Shareholders' Equity			
Unearned premiums	$5,477.9	$5,203.4	$4,930.7
Loss and loss adjustment expense reserves	8,310.3	7,760.2	7,838.4
Accounts payable, accrued expenses, and other liabilities	1,917.5	1,906.3	1,855.5
Debt[1]	2,010.6	2,062.7	2,063.1
Total liabilities	17,716.3	16,932.6	16,687.7
Common Shares, $1.00 par value (authorized 900.0; issued 797.6, 797.7, and 797.7, including treasury shares of 197.6, 193.0, and 193.1)	600.0	604.7	604.6
Paid-in capital	1,123.0	1,048.6	1,077.0
Retained earnings	4,198.7	3,996.2	3,454.4
Accumulated other comprehensive income, net of tax:			
Net non-credit related OTTI losses, adjusted for valuation changes	0	(.6)	(.3)
Other net unrealized gains (losses) on securities	865.4	897.2	863.0
Total net unrealized gains (losses) on securities	865.4	896.6	862.7
Net unrealized gains on forecasted transactions	4.5	6.4	6.1
Foreign currency translation adjustment	1.0	2.1	2.2
Total accumulated other comprehensive income	870.9	905.1	871.0
Total shareholders' equity	6,792.6	6,554.6	6,007.0
Total liabilities and shareholders' equity	$24,508.9	$23,487.2	$22,694.7

[1]Consists of both short- and long-term debt. See Note 4 - Debt.
See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

Nine months ended September 30,	2013	2012
(millions)		
Cash Flows From Operating Activities		
Net income	$865.6	$653.2
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	74.9	69.1
Amortization of fixed-income securities	111.4	145.3
Amortization of equity-based compensation	49.8	45.8
Net realized (gains) losses on securities	(241.4)	(244.7)
Net (gains) losses on disposition of property and equipment	4.1	4.8
(Gains) losses on extinguishment of debt	4.3	1.8
Changes in:		
Premiums receivable	(317.4)	(426.2)
Reinsurance recoverables	(130.9)	(62.5)
Prepaid reinsurance premiums	(16.3)	(3.0)
Deferred acquisition costs	(40.2)	(28.2)
Income taxes	77.3	45.7
Unearned premiums	548.0	624.0
Loss and loss adjustment expense reserves	472.0	514.4
Accounts payable, accrued expenses, and other liabilities	277.4	306.6
Other, net	9.4	19.2
Net cash provided by operating activities	1,748.0	1,665.3
Cash Flows From Investing Activities		
Purchases:		
Fixed maturities	(6,070.8)	(3,997.0)
Equity securities	(260.2)	(176.1)
Sales:		
Fixed maturities	2,352.8	2,416.0
Equity securities	308.0	737.4
Maturities, paydowns, calls, and other:		
Fixed maturities	1,338.7	1,094.1
Equity securities	0	4.0
Net (purchases) sales of short-term investments—other	843.0	(842.9)
Net unsettled security transactions	154.6	14.5
Purchases of property and equipment	(105.6)	(84.2)
Sales of property and equipment	2.4	3.4
Net cash used in investing activities	(1,437.1)	(830.8)
Cash Flows From Financing Activities		
Proceeds from exercise of stock options	0	.5
Tax benefit from exercise/vesting of equity-based compensation	10.3	5.6
Payment of debt	0	(350.0)
Reacquisition of debt	(58.1)	(32.5)
Dividends paid to shareholders[1]	(175.6)	(252.4)
Acquisition of treasury shares	(164.8)	(170.1)
Net cash used in financing activities	(388.2)	(798.9)
Effect of exchange rate changes on cash	(.9)	.9

Increase (decrease) in cash	(78.2)	36.5
Cash, January 1	179.1	155.7
Cash, September 30	$100.9	$192.2

[1]Progressive maintains an annual dividend program. See Note 8 - Dividends for further discussion.
See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(unaudited)

Note 1 Basis of Presentation — The consolidated financial statements include the accounts of The Progressive Corporation, its subsidiaries, a mutual insurance company affiliate, and a limited partnership investment affiliate. All of the subsidiaries and affiliates are wholly owned or controlled. The consolidated financial statements reflect all normal recurring adjustments that, in the opinion of management, were necessary for a fair statement of the results for the interim periods presented. The results of operations for the period ended September 30, 2013, are not necessarily indicative of the results expected for the full year. These consolidated financial statements and the notes thereto should be read in conjunction with Progressive's audited financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2012.

Consistent with the presentation in our Annual Report on Form 10-K for the year ended December 31, 2012, we revised the presentation of our Statements of Comprehensive Income for the third quarter and first nine months of 2012, to correctly classify $78.4 million and $213.5 million, respectively, of fees and other revenues as a component of total revenues. Previously, these items were presented net within our other underwriting expenses. These revisions had no effect on the results of operations (net or comprehensive income), financial condition (shareholders' equity), or cash flows and are not considered to be material.

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

($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses)[1]	Fair Value	% of Total Fair Value
September 30, 2013						
Fixed maturities:						
U.S. government obligations	$3,691.2	$61.8	$(11.3)	$0	$3,741.7	20.8 %
State and local government obligations	2,125.7	29.9	(17.0)	0	2,138.6	11.9
Foreign government obligations[2]	15.9	0	0	0	15.9	.1
Corporate debt securities	3,118.8	67.0	(28.9)	.7	3,157.6	17.6
Residential mortgage-backed securities	994.9	31.5	(16.5)	0	1,009.9	5.6
Commercial mortgage-backed securities	2,224.1	49.0	(33.1)	0	2,240.0	12.4
Other asset-backed securities	1,143.3	7.4	(2.0)	.2	1,148.9	6.4
Redeemable preferred stocks	331.0	24.5	(10.4)	0	345.1	1.9
Total fixed maturities	13,644.9	271.1	(119.2)	.9	13,797.7	76.7
Equity securities:						
Nonredeemable preferred stocks	442.1	280.5	(4.8)	8.2	726.0	4.0
Common equities	1,422.3	908.8	(5.0)	0	2,326.1	12.9
Short-term investments:						
Other short-term investments	1,146.1	0	0	0	1,146.1	6.4
Total portfolio[3,4]	$16,655.4	$1,460.4	$(129.0)	$9.1	$17,995.9	100.0 %

($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses)[1]	Fair Value	% of Total Fair Value
September 30, 2012						
Fixed maturities:						
U.S. government obligations	$3,433.7	$110.4	$(.1)	$0	$3,544.0	20.6 %
State and local government obligations	1,898.9	61.0	(.4)	0	1,959.5	11.4
Foreign government obligations	0	0	0	0	0	0
Corporate debt securities	2,687.8	128.8	(.4)	6.3	2,822.5	16.4
Residential mortgage-backed securities	399.5	21.6	(12.4)	0	408.7	2.4
Commercial mortgage-backed securities	1,998.2	90.7	(1.3)	0	2,087.6	12.2
Other asset-backed securities	1,077.9	14.5	(.1)	0	1,092.3	6.4
Redeemable preferred stocks	368.0	27.1	(14.5)	0	380.6	2.2
Total fixed maturities	11,864.0	454.1	(29.2)	6.3	12,295.2	71.6
Equity securities:						
Nonredeemable preferred stocks	430.1	416.8	0	1.5	848.4	4.9
Common equities	1,101.5	543.8	(6.1)	0	1,639.2	9.6
Short-term investments:						
Other short-term investments	2,394.1	0	0	0	2,394.1	13.9
Total portfolio[3,4]	$15,789.7	$1,414.7	$(35.3)	$7.8	$17,176.9	100.0 %

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

[1]Represents net holding period gains (losses) on certain hybrid securities (discussed below).
[2]Reflects an Australian government obligation at September 30, 2013.
[3]At September 30, 2013, we had $63.7 million of net unsettled security transactions, including collateral on open derivative positions, recognized in other liabilities, compared to $32.4 million and $90.9 million recognized in other

assets at September 30, 2012 and December 31, 2012, respectively.

[4]The total fair value of the portfolio at September 30, 2013 and 2012, and December 31, 2012 included $1.3 billion, $1.6 billion, and $1.4 billion, respectively, of securities held in a consolidated, non-insurance subsidiary of the holding company.

Our other short-term investments include commercial paper, reverse repurchase transactions, and other investments that are expected to mature within one year. We had $278.1 million, $798.1 million, and $581.0 million of open reverse repurchase commitments at September 30, 2013 and 2012, and December 31, 2012, respectively. At these dates, we did not hold any repurchase transactions where we lent collateral. To the extent our repurchase transactions were with the same counterparty and subject to an enforceable master netting arrangement, we could elect to offset these transactions. Historically, we have chosen to report these transactions on a gross basis on our balance sheets.

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

	September 30,		December 31,
(millions)	2013	2012	2012
Fixed maturities:			
Corporate debt securities	$171.8	$177.5	$176.1
Other asset-backed securities	15.3	16.4	16.4
Total fixed maturities	187.1	193.9	192.5
Equity securities:			
Nonredeemable preferred stocks	57.3	50.5	52.8
Total hybrid securities	$244.4	$244.4	$245.3

Certain corporate debt securities are accounted for as hybrid securities since they were acquired at a substantial premium and contain a change-in-control put option (derivative) that permits the investor, at its sole option if and when a change in control is triggered, to put the security back to the issuer at a 1% premium to par. Due to this change-in-control put option and the substantial market premium paid to acquire these securities, there is the potential that the election to put, upon the change in control, could result in an acceleration of the remaining premium paid on these securities, which would result in a loss of $12.3 million as of September 30, 2013, if all of the bonds experienced a simultaneous change in control and we elected to exercise all of our put options. The put feature limits the potential loss in value that could be experienced in the event a corporate action occurs that results in a change in control that materially diminishes the credit quality of the issuer. We are under no obligation to exercise the put option we hold if a change in control occurs.

The other asset-backed security in the table above represents one hybrid security that was acquired at a deep discount to par due to a failing auction, and contains a put option that allows the investor to put that security back to the auction at par if the auction is restored. This embedded derivative has the potential to more than double our initial investment yield.

The hybrid securities in our nonredeemable preferred stock portfolio are perpetual preferred stocks that have call features with fixed-rate coupons, whereby the change in value of the call features is a component of the overall change in value of the preferred stocks.

Our securities are reported at fair value, with the changes in fair value of these securities (other than hybrid securities and derivative instruments) reported as a component of accumulated other comprehensive income, net of deferred income taxes. The changes in fair value of the hybrid securities and derivative instruments are recorded as a component of net realized gains (losses) on securities.

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

(millions)	Cost	Fair Value
Less than one year	$2,032.1	$2,063.1
One to five years	8,610.3	8,767.3
Five to ten years	2,834.8	2,794.5
Ten years or greater	114.2	119.3
Total[1]	$13,591.4	$13,744.2

[1]Excludes $53.5 million related to our open interest rate swap positions.

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

Gross Unrealized Losses As of September 30, 2013, we had $124.0 million of gross unrealized losses in our fixed-income securities (i.e., fixed-maturity securities, nonredeemable preferred stocks, and short-term investments) and $5.0 million in our common equities. We currently do not intend to sell the fixed-income securities and determined that it is more likely than not that we will not be required to sell these securities for the period of time necessary to recover their cost bases. A review of our fixed-income securities indicated that the issuers were current with respect to their interest obligations and that there was no evidence of any deterioration of the current cash flow projections that would indicate we would not receive the remaining principal at maturity. In addition, 88% of our common stock portfolio was indexed to the Russell 1000; as such, this portfolio may contain securities in a loss position for an extended period of time, subject to possible write-downs, as described below. We may retain these securities as long as the portfolio and index correlation remain similar. To the extent there is issuer specific deterioration, we may write-down the securities of that issuer. The remaining 12% of our common stocks are part of a managed equity strategy selected and administered by external investment advisors. If our strategy were to change and these securities were determined to be other-than-temporarily impaired, we would recognize a write-down in accordance with our stated policy.
The following tables show the composition of gross unrealized losses by major security type and by the length of time that individual securities have been in a continuous unrealized loss position:

			Less than 12 Months		12 Months or Greater	
(millions)	Total Fair Value	Gross Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2013						
Fixed maturities:						
U.S. government obligations	$969.1	$(11.3)	$969.1	$(11.3)	$0	$0
State and local government obligations	728.3	(17.0)	666.7	(16.2)	61.6	(.8)
Corporate debt securities	1,174.2	(28.9)	1,113.4	(28.5)	60.8	(.4)
Residential mortgage-backed securities	663.0	(16.5)	585.5	(12.4)	77.5	(4.1)
Commercial mortgage-backed securities	993.3	(33.1)	993.2	(33.0)	.1	(.1)
Other asset-backed securities	282.8	(2.0)	282.8	(2.0)	0	0
Redeemable preferred stocks	158.4	(10.4)	36.2	(.2)	122.2	(10.2)
Total fixed maturities	4,969.1	(119.2)	4,646.9	(103.6)	322.2	(15.6)
Equity securities:						
Nonredeemable preferred stocks	123.6	(4.8)	123.6	(4.8)	0	0
Common equities	47.3	(5.0)	43.0	(4.7)	4.3	(.3)
Total equity securities	170.9	(9.8)	166.6	(9.5)	4.3	(.3)
Total portfolio	$5,140.0	$(129.0)	$4,813.5	$(113.1)	$326.5	$(15.9)

(millions)	Total Fair Value	Gross Unrealized Losses	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses
September 30, 2012						
Fixed maturities:						
U.S. government obligations	$83.1	$(.1)	$83.1	$(.1)	$0	$0
State and local government obligations	61.4	(.4)	29.1	(.2)	32.3	(.2)
Corporate debt securities	35.9	(.4)	14.2	(.1)	21.7	(.3)
Residential mortgage-backed securities	177.2	(12.4)	30.0	(.5)	147.2	(11.9)
Commercial mortgage-backed securities	44.0	(1.3)	31.4	(.1)	12.6	(1.2)
Other asset-backed securities	21.0	(.1)	9.0	0	12.0	(.1)
Redeemable preferred stocks	164.1	(14.5)	24.7	(.4)	139.4	(14.1)
Total fixed maturities	586.7	(29.2)	221.5	(1.4)	365.2	(27.8)
Equity securities:						
Nonredeemable preferred stocks	0	0	0	0	0	0
Common equities	80.8	(6.1)	54.4	(3.4)	26.4	(2.7)
Total equity securities	80.8	(6.1)	54.4	(3.4)	26.4	(2.7)
Total portfolio	$667.5	$(35.3)	$275.9	$(4.8)	$391.6	$(30.5)

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

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

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

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

	Three Months Ended September 30, 2013		
	Mortgage-Backed		
(millions)	Residential	Commercial	Total
Balance at June 30, 2013	$26.9	$.5	$27.4
Credit losses for which an OTTI was previously recognized	0	0	0
Credit losses for which an OTTI was not previously recognized	0	0	0
Reductions for securities sold/matured	0	0	0
Change in recoveries of future cash flows expected to be collected[1]	(2.4)	(.1)	(2.5)
Reductions for previously recognized credit impairments written-down to fair value[2]	0	0	0
Balance at September 30, 2013	$24.5	$.4	$24.9

	Nine Months Ended September 30, 2013		
	Mortgage-Backed		
(millions)	Residential	Commercial	Total
Balance at December 31, 2012	$27.1	$.6	$27.7
Credit losses for which an OTTI was previously recognized	0	0	0
Credit losses for which an OTTI was not previously recognized	0	0	0
Reductions for securities sold/matured	0	0	0
Change in recoveries of future cash flows expected to be collected[1]	(2.4)	(.2)	(2.6)
Reductions for previously recognized credit impairments written-down to fair value[2]	(.2)	0	(.2)
Balance at September 30, 2013	$24.5	$.4	$24.9

	Three Months Ended September 30, 2012		
	Mortgage-Backed		
(millions)	Residential	Commercial	Total
Balance at June 30, 2012	$28.1	$.7	$28.8
Credit losses for which an OTTI was previously recognized	0	0	0
Credit losses for which an OTTI was not previously recognized	0	0	0
Reductions for securities sold/matured	0	0	0
Change in recoveries of future cash flows expected to be collected[1]	(.4)	(.1)	(.5)
Reductions for previously recognized credit impairments written-down to fair value[2]	0	0	0
Balance at September 30, 2012	$27.7	$.6	$28.3

	Nine Months Ended September 30, 2012		
	Mortgage-Backed		
(millions)	Residential	Commercial	Total
Balance at December 31, 2011	$34.5	$1.3	$35.8
Credit losses for which an OTTI was previously recognized	.1	0	.1
Credit losses for which an OTTI was not previously recognized	.2	0	.2
Reductions for securities sold/matured	0	(.2)	(.2)
Change in recoveries of future cash flows expected to be collected[1]	(3.1)	(.2)	(3.3)
Reductions for previously recognized credit impairments written-down to fair value[2]	(4.0)	(.3)	(4.3)
Balance at September 30, 2012	$27.7	$.6	$28.3

[1]Reflects expected recovery of prior period impairments that will be accreted into income over the remaining life of the security, net of any current quarter decreases in expected cash flows on previously recorded reductions.
[2]Reflects reductions of prior credit impairments where the current credit impairment requires writing securities down to fair value (i.e., no remaining non-credit loss).

Although we determined that it is more likely than not that we will not be required to sell the securities prior to the recovery of their respective cost bases (which could be maturity), we are required to measure and report the amount of credit losses on the securities that were determined to be other-than-temporarily impaired. In that process, we considered a number of factors and inputs related to the individual securities. The methodology and significant inputs used to measure the amount of credit losses in our portfolio included: current performance indicators on the underlying assets (e.g., delinquency rates, foreclosure rates, and default rates); credit support (via current levels of subordination); historical credit ratings; and updated cash flow expectations based upon these performance indicators. In order to determine the amount of credit loss, if any, the net present value of the cash flows expected (i.e., expected recovery value) was calculated using the current book yield for each security, and was compared to its current amortized value. In the event that the net present value was below the amortized value, a credit loss was deemed to exist, and the security was written down.

Realized Gains/Losses

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

	Three Months		Nine months	
(millions)	2013	2012	2013	2012
Gross realized gains on security sales				
Fixed maturities:				
U.S. government obligations	$3.1	$.2	$6.8	$9.8
State and local government obligations	0	0	6.8	12.1
Corporate and other debt securities	1.7	23.0	38.4	49.1
Residential mortgage-backed securities	.3	.6	2.4	.6
Commercial mortgage-backed securities	.1	9.5	8.4	14.0
Other asset-backed securities	0	.9	0	.9
Redeemable preferred stocks	0	.1	0	.5
Total fixed maturities	5.2	34.3	62.8	87.0
Equity securities:				
Nonredeemable preferred stocks	11.9	20.6	113.1	57.5
Common equities	11.1	153.4	26.1	163.2
Subtotal gross realized gains on security sales	28.2	208.3	202.0	307.7
Gross realized losses on security sales				
Fixed maturities:				
U.S. government obligations	(.8)	(.5)	(2.2)	(1.4)
Corporate and other debt securities	(2.1)	(.6)	(3.1)	(.6)
Commercial mortgage-backed securities	0	0	(.7)	0
Redeemable preferred stocks	0	(.3)	(.1)	(.3)
Total fixed maturities	(2.9)	(1.4)	(6.1)	(2.3)
Equity securities:				
Nonredeemable preferred stocks	0	(1.1)	0	(1.1)
Common equities	(.1)	(22.5)	(.4)	(27.0)
Subtotal gross realized losses on security sales	(3.0)	(25.0)	(6.5)	(30.4)
Net realized gains (losses) on security sales				
Fixed maturities:				
U.S. government obligations	2.3	(.3)	4.6	8.4
State and local government obligations	0	0	6.8	12.1
Corporate and other debt securities	(.4)	22.4	35.3	48.5
Residential mortgage-backed securities	.3	.6	2.4	.6
Commercial mortgage-backed securities	.1	9.5	7.7	14.0
Other asset-backed securities	0	.9	0	.9
Redeemable preferred stocks	0	(.2)	(.1)	.2
Total fixed maturities	2.3	32.9	56.7	84.7
Equity securities:				
Nonredeemable preferred stocks	11.9	19.5	113.1	56.4
Common equities	11.0	130.9	25.7	136.2
Subtotal net realized gains (losses) on security sales	25.2	183.3	195.5	277.3
Other-than-temporary impairment losses				
Fixed maturities:				
Residential mortgage-backed securities	(.1)	(.4)	(.5)	(1.4)
Commercial mortgage-backed securities	0	0	0	(.1)
Total fixed maturities	(.1)	(.4)	(.5)	(1.5)
Equity securities:				

Common equities	(1.8)	0	(3.2)	(.7)
Subtotal other-than-temporary impairment losses	(1.9)	(.4)	(3.7)	(2.2)
Other gains (losses)				
Hybrid securities	3.5	5.2	2.3	12.1
Derivative instruments	(1.2)	(16.3)	45.0	(42.8)
Litigation settlements	2.3	.1	2.3	.3
Subtotal other gains (losses)	4.6	(11.0)	49.6	(30.4)
Total net realized gains (losses) on securities	$27.9	$171.9	$241.4	$244.7

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

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

Derivative Instruments We have invested in the following derivative exposures at various times: interest rate swaps, asset-backed credit default swaps, U.S. corporate debt credit default swaps, cash flow hedges, and equity options.

For all derivative positions discussed below, realized holding period gains and losses are netted with any upfront cash that may be exchanged under the contract to determine if the net position should be classified either as an asset or liability. To be reported as an asset and a component of the available-for-sale portfolio, the inception-to-date realized gain on the derivative position at period end would have to exceed any upfront cash received (net derivative asset). On the other hand, a net derivative liability would include any inception-to-date realized loss plus the amount of upfront cash received (or netted, if upfront cash was paid) and would be reported as a component of other liabilities. These net derivative assets/liabilities are not separately disclosed on the balance sheet due to their immaterial effect on our financial condition and cash flows.

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

(millions)					Balance Sheet[2]				Comprehensive Income S			
						Assets (Liabilities) Fair Value			Net Realized Gains (Losses) on Securi			
	Notional Value[1]								Three months ended		Nine mo ended	
	September 30,		Dec. 31,			September 30,		Dec. 31,	September 30,		Septemb	
Derivatives designated as:	2013	2012	2012	Purpose	Classification	2013	2012	2012	2013	2012	2013	2
Hedging instruments												
Closed:												
Ineffective cash flow hedge	$54	$31	$31	Manage interest rate risk	NA	$0	$0	$0	$.8	$0	$.8	$
Non-hedging instruments												
Assets:												
Interest rate swaps	750	0	0	Manage portfolio duration	Investments—fixed maturities	53.5	0	0	(2.0)	0	48.2	(
Corporate credit default swaps	0	25	0	Manage credit risk	Investments—fixed maturities	0	.3	0	0	(.4)	0	(
Liabilities:												
Interest rate swaps	0	1,263	1,263	Manage portfolio duration	Other liabilities	0	(101.6)	(95.5)	0	(15.9)	0	(
Closed:												
Interest rate swaps	1,263	0	0	Manage portfolio duration	NA	0	0	0	0	0	(4.0)	(
Corporate credit default swaps	0	0	25	Manage credit risk	NA	0	0	0	0	0	0	(
Total	NA	NA	NA			$53.5	$(101.3)	$(95.5)	$(1.2)	$(16.3)	$45.0	$

NA= Not Applicable

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

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

CASH FLOW HEDGES

During both the third quarter and first nine months of 2013, we repurchased, in the open market, $54.1 million, in aggregate principal amount of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 (the "6.70% Debentures"), compared to $0.5 million, $30.9 million, and $30.9 million, during the third quarter, first nine months, and full year of 2012, respectively. For the portion of the 6.70% Debentures we repurchased, we reclassified $0.8 million, on a pretax basis, of the unrealized gain on forecasted transactions from accumulated other comprehensive income on the balance sheet to net realized gains on securities on the comprehensive income statement during both the third quarter and first nine months of 2013, compared to $0, $0.6 million, and $0.6 million, during the third quarter, first nine months, and full year of 2012, respectively.

INTEREST RATE SWAPS

During the periods ended September 30, 2013 and 2012, and December 31, 2012, we invested in interest rate swap positions, primarily to manage the fixed-income portfolio duration. During the beginning of the second quarter 2013, we opened three ten-year interest rate swap positions; in each case, we are paying a fixed rate and receiving a variable rate, effectively shortening the duration of our fixed-income portfolio. We closed three interest rate swap positions during the beginning of the second quarter 2013. The closed positions were a 9-year interest rate swap position (opened in 2009) and two 5-year interest rate swap positions (opened in 2011); in each case, we were paying a fixed rate and receiving a variable rate.

The fair value gain of $53.5 million, as reflected on the balance sheet, on the $750 million notional value swaps was the result of rising interest rates since the positions were opened, while the fair value losses of $101.6 million and $95.5 million on the $1,263 million notional value swaps resulted from an overall decline in interest rates from the inception of the trades. As of September 30, 2013, the balance of the cash collateral that we had received from the applicable counterparties on the open positions was $49.3 million. As of September 30, 2012 and December 31, 2012, the balance of the cash collateral that we had delivered to the applicable counterparty on the then open positions was $107.2 million and $105.0 million, respectively.

CORPORATE CREDIT DEFAULT SWAPS

Financial Services Sector – We held no credit default swaps in this sector during 2013 or at December 31, 2012. During the three and nine months ended September 30, 2012, we held one position, which was opened during the third quarter 2008, on a corporate issuer within the financial services sector for which we bought credit default protection in the form of a credit default swap for a 5-year time horizon. We held this protection to reduce some of our exposure to additional valuation declines on a preferred stock position of the same issuer. As of September 30, 2012, the balance of the cash collateral that we had received from the counterparty on the then open position was $0.3 million.

Note 3 Fair Value — We have categorized our financial instruments, based on the degree of subjectivity inherent in the method by which they are valued, into a fair value hierarchy of three levels, as follows:

- Level 1: Inputs are unadjusted quoted prices in active markets for identical instruments at the measurement date (e.g., U.S. government obligations, active exchange-traded equity securities, and certain short-term securities).

- Level 2: Inputs (other than quoted prices included within Level 1) that are observable for the instrument either directly or indirectly (e.g., certain corporate and municipal bonds and certain preferred stocks). This includes: (i) quoted prices for similar instruments in active markets, (ii) quoted prices for identical or similar instruments in markets that are not active, (iii) inputs other than quoted prices that are observable for the instruments, and (iv) inputs that are derived principally from or corroborated by observable market data by correlation or other means.

- Level 3: Inputs that are unobservable. Unobservable inputs reflect our subjective evaluation about the assumptions market participants would use in pricing the financial instrument (e.g., certain structured securities and privately held investments).

Determining the fair value of the investment portfolio is the responsibility of management. As part of the responsibility, we evaluate whether a market is distressed or inactive in determining the fair value for our portfolio. We review certain market level inputs to evaluate whether sufficient activity, volume, and new issuances exist to create an active market. Based on this evaluation, we concluded that there was sufficient activity related to the sectors and securities for which we obtained valuations.

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

	Fair Value				
(millions)	Level 1	Level 2	Level 3	Total	Cost
September 30, 2013					
Fixed maturities:					
U.S. government obligations	$3,741.7	$0	$0	$3,741.7	$3,691.2
State and local government obligations	0	2,138.6	0	2,138.6	2,125.7
Foreign government obligations	15.9	0	0	15.9	15.9
Corporate debt securities	0	3,157.6	0	3,157.6	3,118.8
Subtotal	3,757.6	5,296.2	0	9,053.8	8,951.6
Asset-backed securities:					
Residential mortgage-backed	0	1,009.7	.2	1,009.9	994.9
Commercial mortgage-backed	0	2,208.7	31.3	2,240.0	2,224.1
Other asset-backed	0	1,148.9	0	1,148.9	1,143.3
Subtotal asset-backed securities	0	4,367.3	31.5	4,398.8	4,362.3
Redeemable preferred stocks:					
Financials	0	134.2	0	134.2	115.7
Utilities	0	65.3	0	65.3	64.9
Industrials	0	145.6	0	145.6	150.4
Subtotal redeemable preferred stocks	0	345.1	0	345.1	331.0
Total fixed maturities	3,757.6	10,008.6	31.5	13,797.7	13,644.9
Equity securities:					
Nonredeemable preferred stocks:					
Financials	244.0	429.1	36.1	709.2	427.9
Utilities	0	16.8	0	16.8	14.2
Subtotal nonredeemable preferred stocks	244.0	445.9	36.1	726.0	442.1
Common equities:					
Common stocks	2,287.4	0	0	2,287.4	1,419.2
Other risk investments	0	0	38.7	38.7	3.1
Subtotal common equities	2,287.4	0	38.7	2,326.1	1,422.3
Total fixed maturities and equity securities	6,289.0	10,454.5	106.3	16,849.8	15,509.3
Short-term investments:					
Other short-term investments	751.5	394.6	0	1,146.1	1,146.1
Total portfolio	$7,040.5	$10,849.1	$106.3	$17,995.9	$16,655.4
Debt	$0	$2,231.4	$0	$2,231.4	$2,010.6

	Fair Value				
(millions)	Level 1	Level 2	Level 3	Total	Cost
September 30, 2012					
Fixed maturities:					
U.S. government obligations	$3,544.0	$0	$0	$3,544.0	$3,433.7
State and local government obligations	0	1,959.5	0	1,959.5	1,898.9
Foreign government obligations	0	0	0	0	0
Corporate debt securities	0	2,822.5	0	2,822.5	2,687.8
Subtotal	3,544.0	4,782.0	0	8,326.0	8,020.4
Asset-backed securities:					
Residential mortgage-backed	0	358.8	49.9	408.7	399.5
Commercial mortgage-backed	0	2,065.0	22.6	2,087.6	1,998.2
Other asset-backed	0	1,092.0	.3	1,092.3	1,077.9
Subtotal asset-backed securities	0	3,515.8	72.8	3,588.6	3,475.6
Redeemable preferred stocks:					
Financials	0	133.9	0	133.9	120.8
Utilities	0	66.9	0	66.9	65.9
Industrials	0	179.8	0	179.8	181.3
Subtotal redeemable preferred stocks	0	380.6	0	380.6	368.0
Total fixed maturities	3,544.0	8,678.4	72.8	12,295.2	11,864.0
Equity securities:					
Nonredeemable preferred stocks:					
Financials	265.2	524.4	29.3	818.9	407.3
Utilities	0	29.5	0	29.5	22.8
Subtotal nonredeemable preferred stocks	265.2	553.9	29.3	848.4	430.1
Common equities:					
Common stocks	1,627.2	0	0	1,627.2	1,098.3
Other risk investments	0	0	12.0	12.0	3.2
Subtotal common equities	1,627.2	0	12.0	1,639.2	1,101.5
Total fixed maturities and equity securities	5,436.4	9,232.3	114.1	14,782.8	13,395.6
Short-term investments:					
Other short-term investments	2,120.7	273.4	0	2,394.1	2,394.1
Total portfolio	$7,557.1	$9,505.7	$114.1	$17,176.9	$15,789.7
Debt	$0	$2,405.9	$0	$2,405.9	$2,062.7

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

Our portfolio valuations classified as either Level 1 or Level 2 in the above tables are priced exclusively by external sources, including: pricing vendors, dealers/market makers, and exchange-quoted prices. We did not have any transfers between Level 1 and Level 2 during the third quarter or first nine months of 2013. During 2012, we had one redeemable preferred security with a value of $25.0 million that was transferred from Level 1 to Level 2 as it was no longer traded on an exchange. We recognize transfers between levels at the end of the reporting period.

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

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At September 30, 2013, vendor-quoted prices represented 59% of our Level 1 classifications (excluding short-term investments), compared to 65% at September 30, 2012 and 57% at December 31, 2012. The securities quoted by vendors in Level 1 represent our holdings in U.S. Treasury Notes and an Australian government obligation, which are frequently traded and the quotes are considered similar to exchange-traded quotes. The balance of our Level 1 pricing comes from quotes obtained directly from trades made on an active exchange and our interest rate swap derivative positions that have a very similar market to the U.S. Treasury Note market.

At September 30, 2013, vendor-quoted prices comprised 97% of our Level 2 classifications (excluding short-term investments), while dealer-quoted prices represented 3%, compared to 96% and 4% at September 30, 2012 and 98% and 2% at December 31, 2012. In our process for selecting a source (e.g., dealer, pricing service) to provide pricing for securities in our portfolio, we reviewed documentation from the sources that detailed the pricing techniques and methodologies used by these sources and determined if their policies adequately considered market activity, either based on specific transactions for the particular security type or based on modeling of securities with similar credit quality, duration, yield, and structure that were recently transacted. Once a source is chosen, we continue to monitor any changes or modifications to their processes by reviewing their documentation on internal controls for pricing and market reviews. We review quality control measures of our sources as they become available to determine if any significant changes have occurred from period to period that might indicate issues or concerns regarding their evaluation or market coverage.

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

To allow us to determine if our initial source is providing a price that is outside of a reasonable range, we review our portfolio pricing on a weekly basis. We frequently challenge prices from our sources when a price provided does not match our expectations based on our evaluation of market trends and activity. Initially, we perform a global review of our portfolio by sector to identify securities whose prices appear outside of a reasonable range. We then perform a more detailed review of fair values for securities disclosed as Level 2. We review dealer bids and quotes for these and/or similar securities to determine the market level context for our valuations. We then evaluate inputs relevant for each class of securities disclosed in the preceding hierarchy tables.

For our structured debt securities, including commercial, residential, and asset-backed securities, we evaluate available market-related data for these and similar securities related to collateral, delinquencies, and defaults for historical trends and reasonably estimable projections, as well as historical prepayment rates and current prepayment assumptions and cash flow estimates. We further stratify each class of our structured debt securities into more finite sectors (e.g., planned amortization class, first pay, second pay, senior, subordinated, etc.) and use duration, credit quality, and coupon to determine the appropriate fair value.

For our corporate debt and preferred stock (redeemable and nonredeemable) portfolios, we review securities by duration, coupon, and credit quality, as well as changes in interest rate and credit spread movements within that stratification. The review also includes recent trades, including: volume traded at various levels that establish a market, issuer specific fundamentals, and industry specific economic news as it comes to light.

For our municipal securities (e.g., general obligations, revenue, and housing), we stratify the portfolio to evaluate securities by type, coupon, credit quality, and duration to review price changes relative to credit spread and interest rate changes. Additionally, we look to economic data as it relates to geographic location as an indication of price-to-call or maturity predictors. For municipal housing securities, we look to changes in cash flow projections, both historical and reasonably estimable projections, to understand yield changes and their effect on valuation.

Lastly, for our short-term securities, we look at acquisition price relative to the coupon or yield. Since our short-term securities are typically 90 days or less to maturity, with the majority listed in Level 2 being seven days or less to redemption, acquisition price is the best estimate of fair value.

We also review data assumptions as supplied by our sources to determine if that data is relevant to current market conditions. In addition, we independently review each sector for transaction volumes, new issuances, and changes in spreads, as well as the overall movement of interest rates along the yield curve to determine if sufficient activity and liquidity exists to provide a credible source for our market valuations.

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

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

With limited exceptions, our Level 3 securities are also priced externally; however, due to several factors (e.g., nature of the securities, level of activity, and lack of similar securities trading to obtain observable market level inputs), these valuations are more subjective in nature. Certain private equity investments and fixed-income investments included in the Level 3 category are valued using external pricing supplemented by internal review and analysis.

After all the valuations are received and our review is complete, if the inputs used by vendors are determined to not contain sufficient observable market information, we will reclassify the affected security valuations to Level 3. At September 30, 2013 and 2012, and December 31, 2012, securities in our fixed-maturity portfolio listed as Level 3 were comprised substantially of securities that were either: (i) private placements, (ii) thinly held and/or traded securities, or (iii) non-investment-grade securities with little liquidity. Based on these factors, it was difficult to independently verify observable market inputs that were used to generate the external valuations we received. At September 30, 2013, we held one private common equity security with a value of $38.0 million; the valuation reflects a negotiated sale that is expected to be completed by the end of 2013. At September 30, 2012 and December 31, 2012, the same private common equity security was internally priced with a value of $11.2 million. At September 30, 2013, we held one private preferred equity security, with a value of $36.1 million, that was priced internally. The same security had a value of $29.3 million at September 30, 2012 and $31.9 million at December 31, 2012. At September 30, 2013 and 2012, and December 31, 2012, we did not hold any securities in our fixed-maturity portfolio that were priced internally. Despite the lack of sufficient observable market information, we believe the valuations received in conjunction with our procedures for evaluating third-party prices support the fair values reported in the financial statements.

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

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

(millions)	Level 3 Fair Value Three months ended September 30, 2013 Fair Value at June 30, 2013	Calls/Maturities/Paydowns	Purchases	Sales	Net Realized (gain)/loss on sales	Change in Valuation	Net Transfers in (out)[1]	Fair Value at Sept. 30, 2013
Fixed maturities:								
Asset-backed securities:								
Residential mortgage-backed	$157.1	$ (17.3)	$0	$0	$0	$1.5	$(141.4)	$.2
Commercial mortgage-backed	27.6	(.3)	0	0	0	4.0	0	31.3
Other asset-backed	0	0	0	0	0	0	0	0
Total fixed maturities	184.7	(17.3)	0	0	0	5.5	(141.4)	31.5
Equity securities:								
Nonredeemable preferred stocks:								
Financials[2]	34.8	0	0	0	0	1.3	0	36.1
Common equities:								
Other risk investments	38.7	0	0	0	0	0	0	38.7
Total Level 3 securities	$258.2	$ (17.3)	$0	$0	$0	$6.8	$(141.4)	$106.3

[1]The $(141.4) million was transferred out of Level 3 and into Level 2 due to an increase in liquidity and trading volume in the market.
[2]The $1.3 million represents net holding period gains on a hybrid security which is reflected in net realized gains (losses) on securities in the comprehensive income statement.

(millions)	Level 3 Fair Value Nine months ended September 30, 2013 Fair Value at Dec. 31, 2012	Calls/Maturities/Paydowns	Purchases	Sales	Net Realized (gain)/loss on sales	Change in Valuation	Net Transfers in (out)[1]	Fair Value at Sept. 30, 2013
Fixed maturities:								
Asset-backed securities:								
Residential mortgage-backed	$45.5	$ (28.6)	$125.1	$0	$0	$(.4)	$(141.4)	$.2
Commercial mortgage-backed	25.3	(1.1)	0	0	0	7.1	0	31.3
Other asset-backed	0	0	0	0	0	0	0	0
Total fixed maturities	70.8	(29.7)	125.1	0	0	6.7	(141.4)	31.5
Equity securities:								
Nonredeemable preferred stocks:								
Financials[2]	31.9	0	0	0	0	4.2	0	36.1
Common equities:								

Other risk investments	12.0	(.1)	.3	0	(.5)	27.0	0	38.7
Total Level 3 securities	$114.7	$ (29.8)	$125.4	$0	$(.5)	$37.9	$(141.4)	$106.3

[1]The $(141.4) million was transferred out of Level 3 and into Level 2 due to an increase in liquidity and trading volume in the market.
[2]The $4.2 million represents net holding period gains on a hybrid security which is reflected in net realized gains (losses) on securities in the comprehensive income statement.

	Level 3 Fair Value Three months ended September 30, 2012							
(millions)	Fair Value at June 30, 2012	Calls/ Maturities/ Paydowns	Purchases	Sales	Net Realized (gain)/loss on sales	Change in Valuation	Net Transfers in (out)	Fair Value at Sept. 30, 2012
Fixed maturities:								
Asset-backed securities:								
Residential mortgage-backed	$54.5	$(5.0)	$0	$0	$0	$.4	$0	$49.9
Commercial mortgage-backed	23.2	(2.6)	0	0	0	2.0	0	22.6
Other asset-backed	1.1	(.8)	0	0	0	0	0	.3
Total fixed maturities	78.8	(8.4)	0	0	0	2.4	0	72.8
Equity securities:								
Nonredeemable preferred stocks:								
Financials[1]	0	0	28.5	0	0	.8	0	29.3
Common equities:								
Other risk investments	12.2	(.2)	0	0	0	0	0	12.0
Total Level 3 securities	$91.0	$(8.6)	$28.5	$0	$0	$3.2	$0	$114.1

[1]The $0.8 million represents net holding period gains on a hybrid security which is reflected in net realized gains (losses) on securities in the comprehensive income statement.

	Level 3 Fair Value Nine months ended September 30, 2012							
(millions)	Fair Value at Dec. 31, 2011	Calls/ Maturities/ Paydowns	Purchases	Sales	Net Realized (gain)/loss on sales	Change in Valuation	Net Transfers in (out)	Fair Value at Sept. 30, 2012
Fixed maturities:								
Asset-backed securities:								
Residential mortgage-backed	$62.3	$(12.8)	$0	$0	$0	$.4	$0	$49.9
Commercial mortgage-backed	21.3	(2.7)	0	0	0	4.0	0	22.6
Other asset-backed	2.6	(2.3)	0	0	0	0	0	.3
Total fixed maturities	86.2	(17.8)	0	0	0	4.4	0	72.8
Equity securities:								
Nonredeemable preferred stocks:								
Financials[1]	0	0	28.5	0	0	.8	0	29.3
Common equities:								
Other risk investments	11.5	(.2)	0	0	0	.7	0	12.0
Total Level 3 securities	$97.7	$(18.0)	$28.5	$0	$0	$5.9	$0	$114.1

[1]The $0.8 million represents net holding period gains on a hybrid security which is reflected in net realized gains (losses) on securities in the comprehensive income statement.

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

($ in millions)	Quantitative Information about Level 3 Fair Value Measurements Fair Value at Sept. 30, 2013	Valuation Technique	Unobservable Input	Unobservable Input Assumption
Fixed maturities:				
Asset-backed securities:				
Residential mortgage-backed	$.2	External vendor	Prepayment rate[1]	0
Commercial mortgage-backed	31.3	External vendor	Prepayment rate[2]	0
Total fixed maturities	31.5			
Equity securities:				
Nonredeemable preferred stocks:				
Financials	36.1	Multiple of tangible net book value	Price to book ratio multiple	1.9
Common equities:				
Other risk investments	0			
Subtotal Level 3 securities	$67.6			
Pricing exemption securities[3]	38.7			
Total Level 3 securities	$106.3			

[1]Assumes that one security has 0% of the principal amount of the underlying loans that will be paid off prematurely in each year.
[2]Assumes that two securities have 0% of the principal amount of the underlying loans that will be paid off prematurely in each year.
[3]The fair values for $0.7 million of these securities were obtained from non-binding external sources where unobservable inputs are not reasonably available to us. The remaining $38.0 million reflects a negotiated sale on a private common equity security that is expected to be completed by the end of 2013.

($ in millions)	Quantitative Information about Level 3 Fair Value Measurements Fair Value at Sept. 30, 2012	Valuation Technique	Unobservable Input	Unobservable Input Assumption
Fixed maturities:				
Asset-backed securities:				
Residential mortgage-backed	$15.3	External vendor	Prepayment rate[1]	0,16
Commercial mortgage-backed	0			
	15.3			

Total fixed maturities					
Equity securities:					
Nonredeemable preferred stocks:					
Financials	29.3	Multiple of tangible net book value	Price to Book Ratio Multiple	1.9	
Common equities:					
Other risk investments	11.2	Discounted consolidated equity	Discount for lack of marketability	20	%
Subtotal Level 3 securities	$55.8				
Pricing exemption securities[2]	58.3				
Total Level 3 securities	$114.1				

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

Quantitative Information about Level 3 Fair Value Measurements

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

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

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

Note 4 Debt — Debt consisted of:

(millions)	September 30, 2013		September 30, 2012		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value
7% Notes due 2013	$150.0	$150.0	$149.8	$159.0	$149.9	$157.1
3.75% Senior Notes due 2021	497.5	516.7	497.3	551.0	497.3	549.1
6 5/8% Senior Notes due 2029	295.3	362.0	295.1	393.7	295.2	385.0
6.25% Senior Notes due 2032	394.6	478.2	394.5	521.7	394.5	513.5
6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067	673.2	724.5	726.0	780.5	726.2	789.7

Total	$2,010.6	$2,231.4	$2,062.7	$2,405.9	$2,063.1	$2,394.4

During both the third quarter and first nine months of 2013, we repurchased, in the open market, $54.1 million in aggregate principal amount of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 (the "6.70% Debentures"), compared to repurchases of $0.5 million, $30.9 million, and $30.9 million during the third quarter, first nine months, and full year of 2012, respectively. Since the amount paid exceeded the carrying value of the debt we repurchased, we recognized losses on these extinguishments of $4.3 million during both the third quarter and first nine months of 2013, compared to $0.1 million, $1.8 million, and $1.8 million during the third quarter, first nine months, and full year of 2012, respectively. In addition, for the portion of the 6.70% Debentures we repurchased, we reclassified $0.8 million on a pretax basis, of the unrealized gain on forecasted transactions from accumulated other comprehensive income on the balance sheet to net realized gains on securities on the comprehensive income statement during both the third quarter and first nine months of 2013, compared to $0, $0.6 million, and $0.6 million during the third quarter, first nine months, and full year of 2012, respectively.

As of September 30, 2013, our next scheduled debt maturity was $150 million of our 7% Notes due 2013; these Notes were paid at maturity on October 1, 2013.

Note 5 Income Taxes — At September 30, 2013 and 2012, and December 31, 2012, we determined that we did not need a valuation allowance on our deferred tax asset. Although realization of the deferred tax asset is not assured, management believes that it is more likely than not that the deferred tax asset will be realized based on our expectation that we will be able to fully utilize the deductions that are ultimately recognized for tax purposes. For the nine months ended September 30, 2013, there have been no material changes in our uncertain tax positions.

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

	Nine Months Ended September 30,	
(millions)	2013	2012
Income taxes, net of refunds	$340.0	$259.1
Interest	81.9	92.8

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

Following are the operating results for the respective periods:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2013		2012		2013		2012	
(millions)	Revenues	Pretax Profit (Loss)	Revenues	Pretax Profit (Loss)	Revenues	Pretax Profit (Loss)	Revenues	Pretax Profit (Loss)
Personal Lines								
Agency	$2,162.7	$122.0	$2,047.7	$52.3	$6,421.4	$428.4	$6,032.3	$237.9
Direct	1,693.4	107.3	1,582.7	105.9	5,020.4	360.5	4,660.1	193.2
Total Personal Lines[1]	3,856.1	229.3	3,630.4	158.2	11,441.8	788.9	10,692.4	431.1
Commercial Lines	446.8	26.3	424.3	7.5	1,317.3	73.7	1,219.2	61.0
Other indemnity	.1	(6.2)	.1	(.5)	.2	(9.7)	.8	(3.1)
Total underwriting operations	4,303.0	249.4	4,054.8	165.2	12,759.3	852.9	11,912.4	489.0
Fees and other revenues[2]	76.0	NA	78.4	NA	215.3	NA	213.5	NA
Service businesses	11.3	.2	9.9	.3	30.3	.2	28.3	.6
Investments[3]	135.3	130.1	280.9	277.6	551.5	537.0	580.9	569.6
Gains (losses) on extinguishment of debt	(4.3)	(4.3)	(.1)	(.1)	(4.3)	(4.3)	(1.8)	(1.8)
Interest expense	NA	(30.4)	NA	(30.6)	NA	(91.4)	NA	(93.2)
Consolidated total	$4,521.3	$345.0	$4,423.9	$412.4	$13,552.1	$1,294.4	$12,733.3	$964.2

[1]Personal auto insurance accounted for 91% of the total Personal Lines segment net premiums earned in all periods; insurance for our special lines products (e.g., motorcycles, ATVs, RVs, mobile homes, watercraft, and snowmobiles) accounted for the balance of the Personal Lines net premiums earned.

[2]Pretax profit (loss) for fees and other revenues are allocated to operating segments.

[3]Revenues represent recurring investment income and total net realized gains (losses) on securities; pretax profit is net of investment expenses.
NA = Not Applicable

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Our management uses underwriting margin and combined ratio as primary measures of underwriting profitability. Underwriting profitability is calculated by subtracting losses and loss adjustment expenses, policy acquisition costs, and other underwriting expenses from the total of net premiums earned and “fees and other revenues.” The underwriting margin is the pretax underwriting profit (loss) expressed as a percentage of net premiums earned (i.e., revenues from underwriting operations). Combined ratio is the complement of the underwriting margin. Following are the underwriting margins/combined ratios for our underwriting operations for the respective periods:

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2013			2012			2013			2012		
	Under-writing Margin		Combined Ratio	Under-writing Margin		Combined Ratio	Under-writing Margin		Combined Ratio	Under-writing Margin		Combined Ratio
Personal Lines												
Agency	5.6	%	94.4	2.6	%	97.4	6.7	%	93.3	3.9	%	96.1
Direct	6.3		93.7	6.7		93.3	7.2		92.8	4.1		95.9
Total Personal Lines	5.9		94.1	4.4		95.6						