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2008

Management's Discussion and Analysis – Statutory Basis

for

UNITED FINANCIAL CASUALTY COMPANY

UNITED FINANCIAL CASUALTY COMPANY
2008 MANAGEMENT'S DISCUSSION AND ANALYSIS
NAIC GROUP CODE: 155; NAIC COMPANY CODE: 11770
(All amounts in $000)

OVERVIEW

This discussion provides an assessment by management of the current financial position, results of operations, and cash flow and liquidity for United Financial Casualty Company (the "Company"), an Ohio-based insurance company. The discussion contains supplemental information, which should be read in conjunction with the Company's 2008 Annual Statement. (Summarized financial statements appear at the end of this discussion.)

The Company is a member of the Progressive Insurance Group (the "Group") and is wholly-owned by Progressive Commercial Holdings, Inc. ("PCH"), a holding company incorporated in Delaware. PCH is a wholly-owned subsidiary of The Progressive Corporation ("TPC"), a publicly traded holding company incorporated in Ohio.

The Company owns 100% of the common stock of Progressive Commercial Casualty Company ("PRCOM"), an insurance affiliate domiciled in Ohio.

The Company primarily writes Commercial Automobile insurance. The Company's Commercial Automobile business consists primarily of liability and physical damage insurance for automobiles and trucks owned by small businesses, with the majority of customers insuring three or fewer vehicles. The business is written primarily through independent insurance agencies that represent the Company as well as brokerages in New York and California. In addition, the Company writes business directly online and over the phone ("Direct channel"). The Company also writes private passenger automobile liability and physical damage coverage through the Direct channel in Maine.

The Company participates in management and service agreements with several of its insurance affiliates and a non-insurance affiliate. Under the terms of the agreements, the affiliates are provided underwriting and loss adjustment services for business produced in exchange for a management fee based on their use of services.

The Company participates in joint management services agreements with several of its insurance affiliates. Under the terms of the agreements, the Company provides these affiliates with underwriting and loss adjustment services for specific business produced, and they provide the Company with similar services for other specific business produced. In exchange for these services, the companies charge management fees based on each company's use of the other's services.

The Company participates in an investment services agreement with Progressive Capital Management Corp., a non-insurance affiliate. Under the terms of the agreement, the Company is provided investment and capital management services in exchange for an investment management fee based on its use of services.

The Company participates in quota-share reinsurance agreements with three of its non-pooled insurance affiliates. Under the terms of the agreements, the three affiliates cede 90% of their premiums, loss and loss adjustment expenses ("LAE"), and underwriting expenses to the Company.

All intercompany agreements are approved by the participating insurance companies' states of domicile when established. Upon redomestication, intercompany agreements are not required to be approved by the new state of domicile.

FINANCIAL CONDITION

Assets

The Company invests in fixed-income and common equity securities. Fixed income securities include fixed-maturity securities, short-term investments, and preferred stocks. At December 31, 2008, 86% of the bond, short-term investment, and preferred stock portfolio was invested in National Association of Insurance Commissioners ("NAIC") designated Class 1 securities.

The investment mix as of December 31, 2008 and 2007, was as follows:

	2008	2007
Bonds	90.8 %	75.2 %
Preferred stocks - unaffiliated	5.0	8.7
Common stocks - affiliates	--	1.0
Common stocks - unaffiliated	4.1	15.0
Cash equivalents and short term investments	0.1	--
Other invested assets	--	0.1
Total invested assets	100.0 %	100.0 %

During the year, management took significant steps to restructure the portfolio to a lower risk profile by allocating more of the Company's invested assets to fixed income securities.

In accordance with admissibility requirements of Statement of Statutory Accounting Principles No. 97 – Investments in Subsidiary, Controlled, and Affiliated Entities, the Company non-admitted its investment in PRCOM in 2008 as PRCOM was granted an exemption from the annual statutory audit requirement by the Ohio Department of Insurance as a result of not yet commencing to write business.

As of December 31, 2008, the Company held $395,883 of collateralized securities, which represented 28% of the total investment portfolio. Collateralized securities are liquid with fair values determined by available market inputs. These securities contain no residual interests.

As of December 31, 2008, the Company's portfolio had $1,530 in unrealized gains compared to $5,396 in unrealized gains in 2007. Total unrealized gains included $1,171 in 2008 and $451 in 2007 for PRCOM.

Investments in the Company's investment portfolio have varying degrees of risk. A portion of the investment portfolio is invested in marketable equity securities providing risk/reward balance and diversification. Equity securities generally have greater risks than the non-equity portion of the portfolio since these securities are subordinate to the rights of debt holders and other creditors of the issuer. Common stocks are managed to track the Russell 1000 Index.

The Company's management routinely monitors its portfolio for pricing changes that might indicate potential impairments and performs detailed reviews of securities with unrealized losses based on predetermined guidelines. In such cases, changes in fair value are evaluated to determine the extent to which such changes are attributable to (i) fundamental factors specific to the issuer, such as financial conditions, business prospects or other factors or (ii) market-related factors, such as interest rates or equity market declines (e.g., negative returns at either a sector index level or the broader market level).

At December 31, 2008, the Company reported a $39,256 receivable from affiliates. This balance is due to the timing of security purchases and cash collections and disbursements under the Group's centralized cash management system and the reinsurance and management agreements in which the Company participates. The intercompany balances are settled quarterly.

Liabilities
The Company is required to make certain estimates and assumptions when preparing its financial statements and accompanying notes in conformity with NAIC statutory accounting practices. Actual results may differ from those estimates. Material estimates that are susceptible to significant changes in the near term include the loss and LAE reserves. Loss and LAE reserves represent the Company's best estimate of its ultimate liability for losses and LAE relating to events that occurred prior to the end of any given accounting period but have not yet been paid. The Company reviews a large majority of its reserves by product/state combination on a quarterly time frame, with the remaining reserves generally reviewed on a semiannual basis. A change in the Company's scheduled reviews of a particular subset of the business depends on the size of the subset or emerging issues relating to the product or state.

Loss and LAE reserves increased $120,150 (16%) in 2008 primarily due to reserve strenghtening as a result of unfavorable prior accident year loss reserve development resulting from an increase in the number of late reported Commercial Automobile claims in 2007 and 2008 and an increase in estimated bodily injury severity.

Surplus
Surplus decreased $64,934 (16%) in 2008 primarily due to a dividend to stockholder of $45,000 and an increase in non-admitted assets of $49,130 due to an increase in non-admitted deferred tax assets as a result of investment write-downs (see Investments section), offset by an overall increase in net deferred income tax of $34,037 (see Subsequent Event section).

Off-Balance Sheet Arrangements
The Company does not have any off-balance sheet arrangements.

RESULTS OF OPERATIONS

Underwriting Operations
Direct premiums written decreased $71,031 (10%) in 2008 primarily due to a decrease in the Company's Commercial Automobile business of $72,155. The decrease is primarily due to a decrease in new business applications and the downturn in the economy in 2008 which significantly affected the Commercial Automobile market.

Assumed premiums written remained relatively constant from 2007 to 2008.

Premiums earned, which are a function of the amount of premiums written in the current and prior year, decreased $67,522 (5%) in 2008 primarily due to the decline in the Company's Commercial Automobile business.

The Company's underwriting ratios as of December 31 are as follows:

	2008	2007
Loss ratio	60.7 pts.	60.7 pts.
LAE ratio	11.7	10.9
Underwriting expense ratio	20.6	19.8
Combined ratio	93.0 pts.	91.4 pts.

Claims costs represent payments made, and estimated future payments to be made, to or on behalf of the Company's policyholders, including expenses needed to adjust or settle claims. Claims costs are defined by loss severity and frequency and are influenced by the rate of inflation, driving patterns, among other factors. Accordingly, anticipated changes in these factors are taken into account when the Company establishes premium rates and loss reserves. Results would differ if different assumptions were made.

Although commercial automobile differs from private passenger automobile in its customer base and products written, both businesses require the same fundamental skills, including disciplined underwriting and pricing, as well as excellent claims service. Since commercial automobile policies have higher limits than private passenger automobile, the Company's management analyzes the large loss trends and reserving in more detail to allow it to react quickly to changes in this exposure.

The Company's management continues to focus on its loss reserve analysis, attempting to enhance accuracy and to further its understanding of the Company's loss costs.

The Company's combined ratio remained fairly consistent from year to year.

Investments
The Company had a net investment loss of $42,940 in 2008 primarily due to the recognition of net realized losses of $107,906 during the year. The Company's net realized losses were primarily the result of write-downs of securities determined to have other-than-temporary declines in market value. The write-downs were principally in preferred stocks which were affected by the market-related issues associated with the disruption in the mortgage and other credit markets, as well as deterioration in fundamentals relating to certain financial industry issuers.

The average pre-tax investment yield on the total investment portfolio, excluding realized gains and losses and net of investment expense, was 4.8% and 4.5% in 2008 and 2007, respectively.

The investment strategy recognizes the need to maintain capital adequate to support the insurance operations. The Company evaluates the risk/reward tradeoffs of investment opportunities, measuring their effects on stability, diversity, overall quality and liquidity, and the potential return of the investment portfolio.

Federal Income Tax
The effective Federal income tax rate was 102% in 2008 compared to the statutory rate of 35%. The higher effective tax rate was primarily due to the tax effect of increases in investment write-downs, offset by tax-exempt interest income. The Company wrote down $110,241 in securities determined to have other-than-temporary declines in market value (see Investments section).

CASH FLOW AND LIQUIDITY

Cash Flow
The Company receives substantial cash from premium collections, investment income, proceeds from sales and maturities of portfolio investments, receivable from affiliates, and finance and service revenue. The principal outflows of cash are purchases of investments, payments of claims and operating expenses, net liabilities relating to the quota-share reinsurance agreements and a dividend to stockholder.

The Company primarily invests in highly liquid, readily marketable, fixed maturity securities (see Assets section), which combined with expected cash flow from operations is believed adequate to meet foreseeable payment obligations. The Company can operate without a cash balance because of its participation in the Group's centralized cash management system, which provides the Company access to sufficient funds to meet its operating needs. The Company also has access to sufficient borrowing capacity and other capital resources to support future growth (see below).

Liquidity

The Company has substantial capital resources, cash flows from operations, and borrowing capacity to support current and anticipated business, and is unaware of any trends, events or circumstances not disclosed herein that are reasonably likely to affect its capital resources in a material way. Management recognizes that market volatility presents challenges and seeks to manage the Company's investment portfolio and capital position accordingly.

On December 31, 2008, TPC entered into a 364-day Secured Liquidity Credit Facility Agreement with National City Bank ("NCB"). Under this agreement, TPC may borrow up to $125,000, which may be increased to $150,000 at TPC's request but subject to NCB's discretion. TPC had no borrowings under this arrangement. This revolving credit facility agreement replaced an uncommitted line of credit with NCB in the principal amount of $125,000, of which TPC had no borrowings.

SUBSEQUENT EVENT

Capital Contributions

The Company received a $31,000 capital contribution from PCH in January 2009.

FUTURE OUTLOOK

During 2008, the commercial automobile market was significantly affected by the downturn in the economy, as well as increased competition for commercial automobile business. Although commercial automobile business differs from personal automobile business in its customer base and products written, both businesses require the same fundamental skills, including disciplined underwriting and pricing, as well as excellent claims service.

It is critical that the Company retain its customers for longer periods, which is why retention continues to be one of the Company's most important priorities. Several initiatives are underway to improve competitiveness through further price segmentation. Adjusting rates is a continuous process and management will continue to evaluate future rate needs and react quickly, as changing trends are recognized.

As a result of financial market volatility in 2008, management has if necessary, taken significant steps to restructure the Company's investment portfolio to a lower risk profile. Management continuously monitors the investment portfolio in order to maintain sufficient surplus to support all the insurance that the Company can profitably underwrite and service.

Statements in this report that are not historical fact are forward-looking statements that are subject to certain risks and uncertainties that could cause actual events and results to differ materially from those discussed herein. These risks and uncertainties include, but are not limited to, economic and market factors, judicial rulings, the insurance industry, and uncertainties related to the Company's use of estimates, assumptions, and projections, generally.

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December 31,	2008	2007
ADMITTED ASSETS		
Bonds	$ 1,285,344	$ 1,018,527
Preferred stocks	70,421	117,549
Common stocks	57,668	217,574
Cash equivalents and short term investments	1,644	357
Other invested assets	--	826
Accrued investment income	13,815	15,619
Premiums and agents' balances receivable	266,796	291,837
Net deferred tax asset	47,614	51,155
Receivable from affiliates	39,256	49,922
Other assets	494	635
Total admitted assets	$ 1,783,052	$ 1,764,001
LIABILITIES AND SURPLUS		
Loss and loss adjustment expenses	$ 876,535	$ 756,385
Accrued underwriting expenses	5,636	10,951
Current Federal income taxes	12,364	8,082
Unearned premiums	506,466	542,621
Advance premiums	5,077	5,733
Drafts outstanding	20,865	18,987
Other liabilities	4,968	5,167
Total liabilities	1,431,911	1,347,926
Surplus	351,141	416,075
Total liabilities and surplus	$ 1,783,052	$ 1,764,001

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For the years ended December 31,	2008	2007
STATEMENTS OF INCOME		
Direct premiums written	$ 627,887	$ 698,918
Assumed premiums written	557,897	561,664
Ceded premiums written	(12)	8
Net premiums written	$ 1,185,796	$ 1,260,574
Premiums earned	$ 1,221,951	$ 1,289,473
Losses incurred	742,243	782,105
Loss adjustment expenses incurred	143,104	140,040
Underwriting expenses	247,340	256,276
Net underwriting gain	89,264	111,052
Net investment gain (loss)		
(net of capital gains tax (benefit) of ($8,261) and $523, respectively)	(42,940)	55,933
Other income	2,628	6,932
Income before Federal income taxes	48,952	173,917
Federal income taxes incurred	49,930	55,525
Net income (loss)	$ (978)	$ 118,392
STATEMENTS OF CHANGES IN SURPLUS		
Surplus at beginning of year	$ 416,075	$ 426,371
Net income (loss)	(978)	118,392
Change in unrealized capital gains (losses)	(3,962)	3,551
Change in net deferred income tax	34,037	1,466
Change in non-admitted assets	(49,130)	3,055
Surplus paid-in (returned)	3	(39,760)
Dividend to stockholder	(45,000)	(97,000)
Other surplus	96	--
Decrease in surplus for the year	(64,934)	(10,296)
Surplus at end of year	$ 351,141	$ 416,075