PROGRESSIVE CORP/OH/
Form 10-Q
May 03, 2017

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 March 31, 2017
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	34-0963169
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6300 Wilson Mills Road, Mayfield Village, Ohio	44143
(Address of principal executive offices)	(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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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: 580,902,022 outstanding at March 31, 2017

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

Three Months Ended March 31,	2017	2016	% Change
(millions—except per share amounts)			
Revenues			
Net premiums earned	$6,026.7	$5,317.4	13
Investment income	129.2	118.8	9
Net realized gains (losses) on securities:			
Net impairment losses recognized in earnings	(1.0)	0	NM
Net realized gains (losses) on securities	52.9	17.4	204
Total net realized gains (losses) on securities	51.9	17.4	198
Fees and other revenues	85.2	78.9	8
Service revenues	28.5	25.0	14
Gains on extinguishment of debt	0.2	0	NM
Total revenues	6,321.7	5,557.5	14
Expenses			
Losses and loss adjustment expenses	4,263.4	3,913.4	9
Policy acquisition costs	502.9	440.3	14
Other underwriting expenses	845.6	755.8	12
Investment expenses	5.6	4.8	17
Service expenses	25.9	21.6	20
Interest expense	36.8	34.2	8
Total expenses	5,680.2	5,170.1	10
Net Income			
Income before income taxes	641.5	387.4	66
Provision for income taxes	211.2	128.7	64
Net income	430.3	258.7	66
Net (income) loss attributable to noncontrolling interest (NCI)	(6.0)	(0.5)	NM
Net income attributable to Progressive	$424.3	$258.2	64
Other Comprehensive Income (Loss)			
Changes in:			
Total net unrealized gains (losses) on securities	$132.4	$69.5	91
Net unrealized losses on forecasted transactions	2.3	(0.3)	NM
Foreign currency translation adjustment	0.3	0.5	(40)
Other comprehensive income	135.0	69.7	94
Other comprehensive (income) loss attributable to NCI	(0.9)	(2.1)	(57)
Comprehensive income attributable to Progressive	$558.4	$325.8	71
Computation of Per Share Earnings Attributable to Progressive			
Average shares outstanding - Basic	580.3	583.2	0
Net effect of dilutive stock-based compensation	3.0	2.3	30
Total average equivalent shares - Diluted	583.3	585.5	0
Basic: Earnings per share	$0.73	$0.44	65
Diluted: Earnings per share	$0.73	$0.44	65
Dividends declared per share[1]	$0	$0	

NM = Not Meaningful
[1] Progressive maintains an annual dividend program. See Note 9 – Dividends for further discussion.
See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(millions)	March 31, 2017	2016	December 31, 2016
Assets			
Investments - Available-for-sale, at fair value:			
Fixed maturities (amortized cost: $17,444.8, $13,892.3, and $16,287.1)	$17,474.3	$13,966.4	$ 16,243.8
Equity securities:			
Nonredeemable preferred stocks (cost: $710.3, $731.9, and $734.2)	809.8	832.2	853.5
Common equities (cost: $1,451.5, $1,524.0, and $1,437.5)	2,978.1	2,705.0	2,812.4
Short-term investments (amortized cost: $3,040.8, $3,826.9, and $3,572.9)	3,040.8	3,826.9	3,572.9
Total investments	24,303.0	21,330.5	23,482.6
Cash	214.5	203.9	211.5
Restricted cash[1]	0.5	6.0	14.9
Accrued investment income	110.1	93.6	103.9
Premiums receivable, net of allowance for doubtful accounts of $174.5, $157.6, and $186.8	4,850.7	4,378.9	4,509.2
Reinsurance recoverables, including $88.6, $59.5, and $83.8 on paid losses and loss adjustment expenses	1,939.0	1,568.2	1,884.8
Prepaid reinsurance premiums	182.7	216.7	170.5
Deferred acquisition costs	679.5	600.0	651.2
Property and equipment, net of accumulated depreciation of $881.7, $799.6, and $845.8	1,166.0	1,061.9	1,177.1
Goodwill	449.4	447.6	449.4
Intangible assets, net of accumulated amortization of $125.0, $62.9, and $109.5	417.3	479.4	432.8
Other assets	497.8	334.9	339.6
Total assets	$34,810.5	$30,721.6	$ 33,427.5
Liabilities			
Unearned premiums	$7,945.0	$7,140.7	$ 7,468.3
Loss and loss adjustment expense reserves	11,628.9	10,286.7	11,368.0
Net deferred income taxes	168.4	113.9	111.3
Dividends payable	0	0	395.4
Accounts payable, accrued expenses, and other liabilities	2,939.4	2,451.4	2,495.5
Debt[2]	3,111.7	2,701.6	3,148.2
Total liabilities	25,793.4	22,694.3	24,986.7
Redeemable noncontrolling interest (NCI)[3]	494.2	467.4	483.7
Shareholders' Equity			
Common shares, $1.00 par value (authorized 900.0; issued 797.5, 797.6, and 797.5 including treasury shares of 216.6, 214.6, and 217.6)	580.9	583.0	579.9
Paid-in capital	1,331.1	1,231.3	1,303.4
Retained earnings	5,543.4	4,877.6	5,140.4
Accumulated other comprehensive income:			
Net unrealized gains (losses) on securities	1,072.0	878.5	939.6
Net unrealized losses on forecasted transactions	(7.1)	(8.5)	(9.4)
Foreign currency translation adjustment	(0.8)	(1.0)	(1.1)
Accumulated other comprehensive (income) loss attributable to NCI	3.4	(1.0)	4.3
Total accumulated other comprehensive income attributable to Progressive	1,067.5	868.0	933.4
Total shareholders’ equity	8,522.9	7,559.9	7,957.1

Total liabilities, redeemable NCI, and shareholders’ equity	$34,810.5	$30,721.6	$ 33,427.5

[1] See Note 7 – Supplemental Cash Flow Information for further discussion.
[2] Consists of both short-term and long-term debt. See Note 4 – Debt for further discussion.
[3] See Note 12 – Redeemable Noncontrolling Interest for further discussion.
See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries
Consolidated Statements of Changes in Shareholders’ Equity
(unaudited)

Three Months Ended March 31, (millions — except per share amounts)	2017	2016
Common Shares, $1.00 Par Value		
Balance, Beginning of period	$579.9	$583.6
Treasury shares purchased	(0.6)	(2.3)
Net restricted equity awards issued/vested/(forfeited)	1.6	1.7
Balance, End of period	$580.9	$583.0
Paid-In Capital		
Balance, Beginning of period	$1,303.4	$1,218.8
Tax benefit from vesting of equity-based compensation	0	6.6
Treasury shares purchased	(1.3)	(4.8)
Net restricted equity awards (issued)/(vested)/forfeited	(1.6)	(1.7)
Amortization of equity-based compensation	30.5	12.8
Reinvested dividends on restricted stock units	0.3	(0.3)
Adjustment to carrying amount of redeemable noncontrolling interest	(0.2)	(0.1)
Balance, End of period	$1,331.1	$1,231.3
Retained Earnings		
Balance, Beginning of period	$5,140.4	$4,686.6
Net income attributable to Progressive	424.3	258.2
Treasury shares purchased	(19.5)	(63.2)
Cash dividends declared on common shares	0	0.2
Reinvested dividends on restricted stock units	(0.3)	0.3
Other, net	(1.5)	(4.5)
Balance, End of period	$5,543.4	$4,877.6
Accumulated Other Comprehensive Income Attributable to Progressive		
Balance, Beginning of period	$933.4	$800.4
Attributable to noncontrolling interest	(0.9)	(2.1)
Other comprehensive income	135.0	69.7
Balance, End of period	$1,067.5	$868.0
Total Shareholders’ Equity	$8,522.9	$7,559.9

There are 20.0 million Serial Preferred Shares authorized; no such shares are issued or outstanding.
There are 5.0 million Voting Preference Shares authorized; no such shares have been issued.
See notes to consolidated financial statements.

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

Three Months Ended March 31,	2017			2016		
Cash Flows From Operating Activities						
Net income	$	430.3		$	258.7	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation	41.0			27.5		
Amortization of intangible assets	15.5			15.5		
Net Amortization of fixed-income securities	22.1			20.5		
Amortization of equity-based compensation	30.9			12.8		
Net realized (gains) losses on securities	(51.9		)	(17.4		)
Net (gains) losses on disposition of property and equipment	1.3			0.1		
(Gains) losses on extinguishment of debt	(0.2		)	0		
Changes in:						
Premiums receivable	(341.4		)	(391.1		)
Reinsurance recoverables	(54.2		)	(79.4		)
Prepaid reinsurance premiums	(12.2		)	(17.4		)
Deferred acquisition costs	(28.3		)	(35.9		)
Income taxes	212.7			91.8		
Unearned premiums	476.3			518.6		
Loss and loss adjustment expense reserves	260.8			247.6		
Accounts payable, accrued expenses, and other liabilities	137.4			200.1		
Restricted cash	14.4			(5.7		)
Other, net	(35.7		)	(27.5		)
Net cash provided by operating activities	1,118.8			818.8		
Cash Flows From Investing Activities						
Purchases:						
Fixed maturities	(3,203.9		)	(2,468.2		)
Equity securities	(52.5		)	(180.1		)

Sales:				
Fixed maturities	1,014.1		2,105.9	
Equity securities	86.5		97.9	
Maturities, paydowns, calls, and other:				
Fixed maturities	1,006.5		1,829.8	
Equity securities	26.6		0	
Net sales (purchases) of short-term investments	536.8		(1,653.0	)
Net unsettled security transactions	83.2		70.4	
Collateral on derivative positions	(136.1	)	0	
Purchases of property and equipment	(35.0	)	(54.3	)
Sales of property and equipment	11.2		2.0	
Net cash used in investing activities	(662.6	)	(249.6	)
Cash Flows From Financing Activities				
Proceeds from exercise of equity options	0.5		0	
Tax benefit from vesting of equity-based compensation	0		6.6	
Payments of debt	(6.2	)	(6.8	)
Reacquisition of debt	(30.7	)	0	
Dividends paid to shareholders	(395.4	)	(519.0	)
Acquisition of treasury shares for restricted stock tax liabilities	(21.4	)	(18.9	)
Acquisition of treasury shares acquired in open market	0		(51.4	)
Net cash used in financing activities	(453.2	)	(589.5	)
Effect of exchange rate changes on cash	0		0.1	
Increase (decrease) in cash	3.0		(20.2	)
Cash, January 1	211.5		224.1	
Cash, March 31	$ 214.5		$ 203.9	

See notes to consolidated financial statements.

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

Note 1 Basis of Presentation — The accompanying consolidated financial statements include the accounts of The Progressive Corporation and ARX Holding Corp. (ARX), and their respective wholly owned insurance and non-insurance subsidiaries and affiliates, in which Progressive or ARX has a controlling financial interest. The Progressive Corporation owned 69.0% of the outstanding capital stock of ARX at March 31, 2017 and 69.2% at March 31, 2016 and December 31, 2016. The decrease reflects ARX employee stock options that were exercised during the first quarter 2017. All intercompany accounts and transactions are eliminated in consolidation.

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 March 31, 2017, 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 Exhibit 13 to our Annual Report on Form 10-K for the year ended December 31, 2016 ("2016 Annual Report to Shareholders").

Other assets on the consolidated balance sheets include properties that are considered "held for sale," if any. At March 31, 2017, no properties were held for sale. At March 31, 2016 and December 31, 2016, the fair value of these properties, less the estimated cost to sell them, were $8.7 million.

Note 2 Investments — 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.

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. The net holding period gains (losses) represent the amounts realized on our hybrid securities only.

($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Holding Period Gains (Losses)	Fair Value	% of Total Fair Value
March 31, 2017						
Fixed maturities:						
U.S. government obligations	$3,345.5	$0.9	$(20.6)	$0	$3,325.8	13.7 %
State and local government obligations	2,475.8	23.3	(10.7)	0	2,488.4	10.2
Foreign government obligations	22.9	0	0	0	22.9	0.1
Corporate debt securities	5,199.6	23.1	(15.0)	0.3	5,208.0	21.4
Residential mortgage-backed securities	1,393.9	24.6	(11.0)	2.1	1,409.6	5.8
Agency residential pass-through obligations	39.1	0.1	(0.7)	0	38.5	0.2
Commercial mortgage-backed securities	2,216.1	13.7	(16.3)	0	2,213.5	9.1
Other asset-backed securities	2,562.4	5.4	(3.1)	0.2	2,564.9	10.6
Redeemable preferred stocks	189.5	14.3	(1.1)	0	202.7	0.8
Total fixed maturities	17,444.8	105.4	(78.5)	2.6	17,474.3	71.9
Equity securities:						
Nonredeemable preferred stocks	710.3	111.3	(11.8)	0	809.8	3.3
Common equities	1,451.5	1,531.4	(4.8)	0	2,978.1	12.3
Short-term investments	3,040.8	0	0	0	3,040.8	12.5
Total portfolio[1,2]	$22,647.4	$1,748.1	$(95.1)	$2.6	$24,303.0	100.0 %

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($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Holding Period Gains (Losses)	Fair Value	% of Total Fair Value
March 31, 2016						
Fixed maturities:						
U.S. government obligations	$1,375.8	$ 12.2	$ 0	$ 0	$1,388.0	6.5 %
State and local government obligations	2,452.0	57.4	(1.2)	0	2,508.2	11.8
Foreign government obligations	21.9	0	0	0	21.9	0.1
Corporate debt securities	3,795.2	50.6	(6.2)	0.4	3,840.0	18.0
Residential mortgage-backed securities	1,810.9	19.5	(28.5)	(0.4)	1,801.5	8.4
Agency residential pass-through obligations	46.5	0.2	(0.1)	0	46.6	0.2
Commercial mortgage-backed securities	2,418.7	26.4	(18.9)	0	2,426.2	11.4
Other asset-backed securities	1,706.3	1.3	(4.2)	0.3	1,703.7	8.0
Redeemable preferred stocks	265.0	14.2	(48.9)	0	230.3	1.1
Total fixed maturities	13,892.3	181.8	(108.0)	0.3	13,966.4	65.5
Equity securities:						
Nonredeemable preferred stocks	731.9	124.7	(24.4)	0	832.2	3.9
Common equities	1,524.0	1,186.7	(5.7)	0	2,705.0	12.7
Short-term investments	3,826.9	0	0	0	3,826.9	17.9
Total portfolio[1,2]	$19,975.1	$ 1,493.2	$ (138.1)	$ 0.3	$21,330.5	100.0 %

($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Holding Period Gains (Losses)	Fair Value	% of Total Fair Value
December 31, 2016						
Fixed maturities:						
U.S. government obligations	$2,899.2	$ 0	$ (29.1)	$ 0	$2,870.1	12.2 %
State and local government obligations	2,509.5	13.8	(20.7)	0	2,502.6	10.7
Foreign government obligations	24.5	0	0	0	24.5	0.1
Corporate debt securities	4,557.8	17.3	(24.3)	0.1	4,550.9	19.4
Residential mortgage-backed securities	1,448.5	23.7	(15.0)	1.5	1,458.7	6.2
Agency residential pass-through obligations	41.2	0	(0.6)	0	40.6	0.2
Commercial mortgage-backed securities	2,266.9	12.0	(25.5)	0	2,253.4	9.6
Other asset-backed securities	2,350.7	4.6	(4.4)	0.2	2,351.1	10.0
Redeemable preferred stocks	188.8	5.1	(2.0)	0	191.9	0.8
Total fixed maturities	16,287.1	76.5	(121.6)	1.8	16,243.8	69.2
Equity securities:						
Nonredeemable preferred stocks	734.2	135.4	(16.1)	0	853.5	3.6
Common equities	1,437.5	1,377.0	(2.1)	0	2,812.4	12.0
Short-term investments	3,572.9	0	0	0	3,572.9	15.2
Total portfolio[1,2]	$22,031.7	$ 1,588.9	$ (139.8)	$ 1.8	$23,482.6	100.0 %

[1]Our portfolio reflects the effect of unsettled security transactions and collateral on open derivative positions; at March 31, 2017 and 2016, and December 31, 2016, we had $111.0 million, $47.3 million, and $27.8 million, respectively, included in "other liabilities." In addition, at March 31, 2017, we had $136.1 million of margin collateral on an open derivative position, which was included in "other assets."

[2]The total fair value of the portfolio at March 31, 2017 and 2016, and December 31, 2016 included $0.7 billion, $0.7 billion, and $1.3 billion, respectively, of securities held in a consolidated, non-insurance subsidiary of the holding company, net of any unsettled security transactions.

Short-Term Investments Our short-term investments may include commercial paper and other investments that are expected to mature within one year. We did not enter into any repurchase commitment transactions during the first three months of 2017 or 2016, and we had no open repurchase commitments at March 31, 2017 and 2016, or December 31, 2016.
Also included in short-term investments are reverse repurchase commitment transactions, where we loan cash to approved counterparties and receive U.S. Treasury Notes pledged as collateral against the cash borrowed. Our exposure to credit risk is limited due to the nature of the collateral (i.e., U.S. Treasury Notes) received. We have counterparty exposure on these trades in the event of a counterparty default to the extent the collateral security's value is below the amount of cash we delivered to acquire the collateral. The short-term duration of the transactions (primarily overnight) reduces that exposure.

We had no open reverse repurchase commitments at March 31, 2017 and 2016, or December 31, 2016. We did not enter into any reverse repurchase commitments for the three months ended March 31, 2017. During the three months ended March 31, 2016, our largest outstanding balance of reverse repurchase commitments was $265.0 million, which was open for one day. For the 10 days we invested in these transactions, the average daily balance of reverse repurchase commitments was $160.7 million.

To the extent our repurchase and reverse repurchase transactions were with the same counterparty and subject to an enforceable master netting arrangement, we could elect to offset these transactions. Consistent with past practice, we have elected not to offset these transactions and therefore report these transactions on a gross basis on our balance sheets.

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

	March 31,		December 31,
(millions)	2017	2016	2016
Fixed maturities:			
Corporate debt securities	$44.5	$39.2	$ 40.1
Residential mortgage-backed securities	186.6	174.4	170.5
Other asset-backed securities	8.3	10.6	8.9
Total fixed maturities	239.4	224.2	219.5
Equity securities:			
Nonredeemable preferred stocks	0	49.5	0
Total hybrid securities	$239.4	$273.7	$ 219.5

Certain corporate debt securities are accounted for as hybrid securities since they were acquired at a 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, would result in an acceleration of the recognition of the remaining premium paid on these securities in our results of operations. This would result in a loss of $3.1 million as of March 31, 2017, 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 residential mortgage-backed securities accounted for as hybrid securities are obligations of the issuer with payments of principal based on the performance of a reference pool of loans. This embedded derivative results in the securities incorporating the risk of default from both the issuer and the related loan pool.

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 had the potential to more than double our initial investment yield at acquisition.

During 2016, we sold the nonredeemable preferred stocks referred to in the table above. These securities were perpetual preferred stocks with fixed-rate coupons that have call features, whereby the change in value of the call features is a component of the overall change in value of the preferred stocks.

Fixed Maturities The composition of fixed maturities by maturity at March 31, 2017, was:

(millions)	Cost	Fair Value
Less than one year	$4,370.5	$4,382.3
One to five years	9,988.3	9,995.8
Five to ten years	3,030.3	3,030.0
Ten years or greater	55.7	66.2
Total	$17,444.8	$17,474.3

Asset-backed securities are classified in the maturity distribution table based upon their projected cash flows. All other securities which do not have a single maturity date are reported based upon expected average maturity. 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 March 31, 2017, we had $90.3 million of gross unrealized losses in our fixed-income securities (i.e., fixed-maturity securities, nonredeemable preferred stocks, and short-term investments) and $4.8 million in our common equities. We currently do not intend to sell the fixed-income securities and determined that it is more likely 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. For common equities, 96% 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 4% of our common stocks were part of a managed equity strategy selected and administered by an external investment advisor. If our review of loss position securities were to indicate there was a fundamental, or market, impairment on these securities that was determined to be other-than-temporary, 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:

($ in millions)	Total No. of Sec.	Total Fair Value	Gross Unrealized Losses	Less than 12 Months No. of Sec.	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater No. of Sec.	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses
March 31, 2017									
Fixed maturities:									
U.S. government obligations	34	$2,747.0	$ (20.6)	34	$2,747.0	$ (20.6)	0	$0	$ 0
State and local government obligations	340	986.3	(10.7)	310	906.5	(9.5)	30	79.8	(1.2)
Corporate debt securities	147	2,494.7	(15.0)	139	2,415.1	(14.9)	8	79.6	(0.1)
Residential mortgage-backed securities	182	880.9	(11.0)	82	264.4	(1.1)	100	616.5	(9.9)
Agency residential pass-through obligations	65	35.4	(0.7)	56	32.7	(0.6)	9	2.7	(0.1)
Commercial mortgage-backed securities	92	1,131.9	(16.3)	73	985.7	(14.2)	19	146.2	(2.1)
Other asset-backed securities	118	1,601.6	(3.1)	112	1,521.4	(2.8)	6	80.2	(0.3)
Redeemable preferred stocks	1	11.4	(1.1)	0	0	0	1	11.4	(1.1)
Total fixed maturities	979	9,889.2	(78.5)	806	8,872.8	(63.7)	173	1,016.4	(14.8)

Equity securities:									
Nonredeemable preferred stocks	9	197.0	(11.8)	5	78.5	(0.7)	4	118.5	(11.1)
Common equities	68	49.2	(4.8)	61	48.3	(4.8)	7	0.9	0
Total equity securities	77	246.2	(16.6)	66	126.8	(5.5)	11	119.4	(11.1)
Total portfolio	1,056	$10,135.4	$ (95.1)	872	$8,999.6	$ (69.2)	184	$1,135.8	$ (25.9)

($ in millions)	Total No. of Sec.	Total Fair Value	Gross Unrealized Losses	Less than 12 Months No. of Sec.	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater No. of Sec.	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses
March 31, 2016									
Fixed maturities:									
U.S. government obligations	5	$74.9	$ 0	5	$74.9	$ 0	0	$0	$ 0
State and local government obligations	112	267.8	(1.2)	63	132.8	(0.3)	49	135.0	(0.9)
Corporate debt securities	60	672.3	(6.2)	21	169.2	(0.4)	39	503.1	(5.8)
Residential mortgage-backed securities	157	1,345.1	(28.5)	52	426.9	(3.9)	105	918.2	(24.6)
Agency residential pass-through obligations	25	9.1	(0.1)	3	0.4	0	22	8.7	(0.1)
Commercial mortgage-backed securities	130	1,185.4	(18.9)	49	395.4	(2.2)	81	790.0	(16.7)
Other asset-backed securities	86	1,175.2	(4.2)	70	999.3	(3.2)	16	175.9	(1.0)
Redeemable preferred stocks	9	198.8	(48.9)	4	88.0	(16.1)	5	110.8	(32.8)
Total fixed maturities	584	4,928.6	(108.0)	267	2,286.9	(26.1)	317	2,641.7	(81.9)
Equity securities:									
Nonredeemable preferred stocks	13	344.4	(24.4)	4	79.0	(2.6)	9	265.4	(21.8)
Common equities	73	87.4	(5.7)	67	84.3	(5.5)	6	3.1	(0.2)
Total equity securities	86	431.8	(30.1)	71	163.3	(8.1)	15	268.5	(22.0)
Total portfolio	670	$5,360.4	$ (138.1)	338	$2,450.2	$ (34.2)	332	$2,910.2	$ (103.9)

($ in millions)	Total No. of Sec.	Total Fair Value	Gross Unrealized Losses	Less than 12 Months No. of Sec.	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater No. of Sec.	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses
December 31, 2016									
Fixed maturities:									
U.S. government obligations	30	$2,774.0	$ (29.1)	30	$2,774.0	$ (29.1)	0	$0	$ 0
State and local government obligations	618	1,497.9	(20.7)	584	1,404.3	(19.6)	34	93.6	(1.1)
Corporate debt securities	184	2,615.1	(24.3)	175	2,559.9	(24.0)	9	55.2	(0.3)
Residential mortgage-backed securities	178	917.7	(15.0)	69	175.8	(1.1)	109	741.9	(13.9)
Agency residential pass-through obligations	55	36.0	(0.6)	48	33.9	(0.6)	7	2.1	0
Commercial mortgage-backed securities	111	1,347.3	(25.5)	85	1,061.2	(22.9)	26	286.1	(2.6)
Other asset-backed securities	103	1,605.2	(4.4)	89	1,423.3	(3.9)	14	181.9	(0.5)
Redeemable preferred stocks	2	31.0	(2.0)	0	0	0	2	31.0	(2.0)
Total fixed maturities	1,281	10,824.2	(121.6)	1,080	9,432.4	(101.2)	201	1,391.8	(20.4)
Equity securities:									
Nonredeemable preferred stocks	13	329.6	(16.1)	8	175.2	(3.8)	5	154.4	(12.3)
Common equities	75	22.1	(2.1)	69	19.7	(1.7)	6	2.4	(0.4)
Total equity securities	88	351.7	(18.2)	77	194.9	(5.5)	11	156.8	(12.7)
Total portfolio	1,369	$11,175.9	$ (139.8)	1,157	$9,627.3	$ (106.7)	212	$1,548.6	$ (33.1)

Since March 31, 2016, the number of securities in our fixed-maturity portfolio with unrealized losses increased, primarily the result of rising interest rates during the latter part of 2016. A decline in credit spreads for the first three months of 2017 resulted in a decrease in the number of fixed-maturity securities with unrealized losses since December 31, 2016. We had no material decreases in valuation as a result of credit rating downgrades on our fixed-maturity securities. All of the fixed-maturity securities in an unrealized loss position at March 31, 2017 in the table above are current with respect to required principal and interest payments. Since December 31, 2016, our nonredeemable preferred stocks with unrealized losses decreased to nine securities, averaging approximately 6% of their total cost. The decrease in the number of securities is the result of valuation increases in the portfolio. We reviewed these securities and concluded that the unrealized losses are market-related adjustments to the values, which we determined not to be other-than-temporary; we expect to recover our initial investments on these securities. The number of issuers with unrealized losses in our common stock portfolio decreased during the first three months of 2017. A review of the securities in a loss position did not uncover fundamental issues with the issuers that would indicate other-than-temporary impairments existed. Additionally, market expectations for recovery in the next 12 months would put the fair values at or above our current book values. Lastly, we determined, as of the balance sheet date, that it was not likely these securities would be sold prior to that recovery.

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 (i.e., unadjusted for valuation changes subsequent to the original write-down):

	March 31,		December 31,
(millions)	2017	2016	2016
Fixed maturities:			
Residential mortgage-backed securities	$(43.3)	$(43.3)	$ (43.3)
Commercial mortgage-backed securities	(0.5)	(0.6)	(0.6)
Total fixed maturities	$(43.8)	$(43.9)	$ (43.9)

The following tables provide rollforwards of the amounts related to credit losses recognized in earnings for the periods ended March 31, 2017 and 2016, for which a portion 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 March 31, 2017		
	Mortgage-Backed		
(millions)	Residential	Commercial	Total
Balance at December 31, 2016	$11.1	$ 0.4	$11.5
Reductions for securities sold/matured	0	(0.3)	(0.3)
Change in recoveries of future cash flows expected to be collected[1]	0.3	0	0.3
Balance at March 31, 2017	$11.4	$ 0.1	$11.5

	Three Months Ended March 31, 2016		
	Mortgage-Backed		
(millions)	Residential	Commercial	Total
Balance at December 31, 2015	$12.4	$ 0.4	$12.8
Reductions for securities sold/matured	0	0	0
Change in recoveries of future cash flows expected to be collected[1]	(0.3)	0	(0.3)
Balance at March 31, 2016	$12.1	$ 0.4	$12.5

[1]Reflects the current period change in the expected recovery of prior impairments that will be accreted into income over the remaining life of the security.

Although we determined it is more likely 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 the amount of potential credit losses on the securities that were in an unrealized loss position. 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 business model or 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 would be deemed to exist, and the security would be written down. We did not have any credit impairment write-downs for the three months ended March 31, 2017 or 2016.

Realized Gains (Losses) The components of net realized gains (losses) for the three months ended March 31, were:

	Three Months	
(millions)	2017	2016
Gross realized gains on security sales		
Fixed maturities:		
U.S. government obligations	$0.4	$14.3
State and local government obligations	0.5	10.9
Corporate and other debt securities	4.1	12.5
Residential mortgage-backed securities	0.1	0.9
Commercial mortgage-backed securities	1.2	3.6
Other asset-backed securities	0.3	0
Redeemable preferred stocks	0.3	0
Total fixed maturities	6.9	42.2
Equity securities:		
Nonredeemable preferred stocks	45.4	1.6
Common equities	7.4	9.5
Subtotal gross realized gains on security sales	59.7	53.3
Gross realized losses on security sales		
Fixed maturities:		
U.S. government obligations	(3.2)	(0.4)
State and local government obligations	(0.1)	(0.1)
Corporate and other debt securities	(0.9)	(0.4)
Commercial mortgage-backed securities	(2.4)	(2.7)
Total fixed maturities	(6.6)	(3.6)
Equity securities:		
Nonredeemable preferred stocks	(1.2)	(1.0)
Common equities	(0.1)	(4.9)
Subtotal gross realized losses on security sales	(7.9)	(9.5)
Net realized gains (losses) on security sales		
Fixed maturities:		
U.S. government obligations	(2.8)	13.9
State and local government obligations	0.4	10.8
Corporate and other debt securities	3.2	12.1
Residential mortgage-backed securities	0.1	0.9
Commercial mortgage-backed securities	(1.2)	0.9
Other asset-backed securities	0.3	0
Redeemable preferred stocks	0.3	0
Total fixed maturities	0.3	38.6
Equity securities:		
Nonredeemable preferred stocks	44.2	0.6
Common equities	7.3	4.6
Subtotal net realized gains (losses) on security sales	51.8	43.8
Other-than-temporary impairment losses		
Equity securities:		
Common equities	(1.0)	0
Subtotal other-than-temporary impairment losses	(1.0)	0
Other gains (losses)		
Hybrid securities	0.8	(0.7)
Derivative instruments	0	(25.7)

Litigation settlements	0.3	0
Subtotal other gains (losses)	1.1	(26.4)
Total net realized gains (losses) on securities	$51.9	$17.4

Gross realized gains and losses were predominantly the result of sales transactions in our fixed-income portfolio related to movements in credit spreads and interest rates and sales from our equity portfolios. Our preferred stock portfolio reflects a large realized gain due primarily to one issue called by the issuer at par. This security was held at a deep discount due to previous other-than-temporary impairment write-downs taken during the market crisis of 2008. Subsequent to the write-down, the security experienced significant recovery and was trading near its anticipated call price. Upon call, we recognized the difference between the consideration received and our book value as a realized gain.

In addition, gains and losses reflect recoveries from litigation settlements related to investments and holding period valuation changes on hybrids and derivatives. Also included are write-downs for securities determined to be other-than-temporarily impaired.

Net Investment Income The components of net investment income for the three months ended March 31, were:

	Three Months	
(millions)	2017	2016
Fixed maturities:		
U.S. government obligations	$12.7	$4.8
State and local government obligations	13.3	13.5
Foreign government obligations	0.1	0.1
Corporate debt securities	29.6	28.2
Residential mortgage-backed securities	9.4	12.2
Agency residential pass-through obligations	0.2	0.4
Commercial mortgage-backed securities	18.8	20.9
Other asset-backed securities	9.9	6.0
Redeemable preferred stocks	3.4	3.8
Total fixed maturities	97.4	89.9
Equity securities:		
Nonredeemable preferred stocks	11.5	11.8
Common equities	13.3	14.5
Short-term investments	7.0	2.6
Investment income	129.2	118.8
Investment expenses	(5.6)	(4.8)
Net investment income	$123.6	$114.0

The amount of investment income (interest and dividends) we recognize varies from year to year based on the average assets held during the year and the book yields of the securities in our portfolio.

Trading Securities At March 31, 2017 and 2016, and December 31, 2016, we did not hold any trading securities and did not have any net realized gains (losses) on trading securities for the three months ended March 31, 2017 and 2016.

Derivative Instruments The following table shows the status of our derivative instruments at March 31, 2017 and 2016, and December 31, 2016, and for the three months ended March 31, 2017 and 2016:

(millions)					Balance Sheet[2]				Comprehensive Income Statement	
						Assets (Liabilities) Fair Value			Pretax Net Realized Gains (Losses) Three Months Ended	
	Notional Value[1]									
	March 31,		Dec. 31,			March 31,		Dec. 31,	March 31,	
Derivatives designated as:	2017	2016	2016	Purpose	Classification	2017	2016	2016	2017	2016
Hedging instrument										
Open:										
Interest rate swap	$850	$ 0	$ 0	Manage interest rate risk	Other assets	$4.0	$0	$ 0	$ 0	$ 0
Closed:										
Ineffective cash flow hedge	31	0	370	Manage interest rate risk	NA	0	0	0	0	0
Non-hedging instruments										
Liabilities:										
Interest rate swaps	0	565	0	Manage portfolio duration	Other liabilities	0	(18.7)	0	0	(24.0)
Closed:										
Interest rate swaps	0	185	750	Manage portfolio duration	NA	0	0	0	0	(1.9)
U.S. Treasury Note futures	0	55	135	Manage portfolio duration	NA	0	0	0	0	0.2
Total	NA	NA	NA			$4.0	$(18.7)	$ 0	$ 0	$ (25.7)

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 reported them on a gross basis on our balance sheets, consistent with our historical presentation.

CASH FLOW HEDGES

During the first quarter 2017, we entered into a forecasted debt issuance hedge, against a possible rise in interest rates, with a 30-year interest rate swap for which we were paying a fixed rate and receiving a variable rate, in anticipation of a debt issuance. The $4.0 million pretax unrealized gain was recorded as part of accumulated other comprehensive income. At March 31, 2017, the balance of our margin collateral at the clearinghouse was $136.1 million.

During 2016, we entered into a $350 million forecasted transaction to hedge against a possible rise in interest rates in anticipation of a debt offering under which we issued $500 million of 2.45% Senior Notes due 2027. The remaining portion of our ineffective cash flow hedge resulted from the repurchase of a portion of our 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 during 2017 and 2016, and we reclassified the unrealized gain on forecasted transactions to net realized gains on securities. The portion repurchased in 2017 resulted in an immaterial gain.

See Note 4 – Debt for further discussion.

INTEREST RATE SWAPS and U.S. TREASURY FUTURES

We use interest rate swaps and treasury futures contracts from time to time to manage the fixed-income portfolio duration. We did not hold any interest rate swap positions at March 31, 2017 or December 31, 2016. At March 31, 2016, we held interest rate swap positions for which we were paying a fixed rate and receiving a variable rate, effectively shortening the duration of our fixed-income portfolio. As of March 31, 2016, the balance of the cash collateral that we delivered to the applicable counterparties on the then open interest rate swaps was $20.6 million. We did not open any U.S. treasury futures during 2017. During 2016, we opened and closed treasury futures; no positions were outstanding at the end of the first quarter or year end.

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 and our outstanding debt was:

	Fair Value				
(millions)	Level 1	Level 2	Level 3	Total	Cost
March 31, 2017					
Fixed maturities:					
U.S. government obligations	$3,325.8	$0	$0	$3,325.8	$3,345.5
State and local government obligations	0	2,488.4	0	2,488.4	2,475.8
Foreign government obligations	22.9	0	0	22.9	22.9
Corporate debt securities	0	5,208.0	0	5,208.0	5,199.6
Subtotal	3,348.7	7,696.4	0	11,045.1	11,043.8
Asset-backed securities:					
Residential mortgage-backed	0	1,409.6	0	1,409.6	1,393.9
Agency residential pass-through obligations	0	38.5	0	38.5	39.1
Commercial mortgage-backed	0	2,213.5	0	2,213.5	2,216.1
Other asset-backed	0	2,564.9	0	2,564.9	2,562.4
Subtotal asset-backed securities	0	6,226.5	0	6,226.5	6,211.5
Redeemable preferred stocks:					
Financials	0	63.2	0	63.2	60.4
Utilities	0	31.4	0	31.4	30.6
Industrials	0	108.1	0	108.1	98.5
Subtotal redeemable preferred stocks	0	202.7	0	202.7	189.5
Total fixed maturities	3,348.7	14,125.6	0	17,474.3	17,444.8
Equity securities:					
Nonredeemable preferred stocks:					
Financials	131.1	678.7	0	809.8	710.3
Subtotal nonredeemable preferred stocks	131.1	678.7	0	809.8	710.3
Common equities:					
Common stocks	2,977.8	0	0	2,977.8	1,451.2
Other risk investments	0	0	0.3	0.3	0.3
Subtotal common equities	2,977.8	0	0.3	2,978.1	1,451.5
Total fixed maturities and equity securities	6,457.6	14,804.3	0.3	21,262.2	19,606.6
Short-term investments	2,226.7	814.1	0	3,040.8	3,040.8
Total portfolio	$8,684.3	$15,618.4	$0.3	$24,303.0	$22,647.4
Debt	$0	$3,198.3	$121.1	$3,319.4	$3,111.7

	Fair Value				
(millions)	Level 1	Level 2	Level 3	Total	Cost
March 31, 2016					
Fixed maturities:					
U.S. government obligations	$1,388.0	$0	$0	$1,388.0	$1,375.8
State and local government obligations	0	2,508.2	0	2,508.2	2,452.0
Foreign government obligations	21.9	0	0	21.9	21.9
Corporate debt securities	0	3,840.0	0	3,840.0	3,795.2
Subtotal	1,409.9	6,348.2	0	7,758.1	7,644.9
Asset-backed securities:					
Residential mortgage-backed	0	1,801.5	0	1,801.5	1,810.9
Agency residential pass-through obligations	0	46.6	0	46.6	46.5
Commercial mortgage-backed	0	2,416.7	9.5	2,426.2	2,418.7
Other asset-backed	0	1,703.7	0	1,703.7	1,706.3
Subtotal asset-backed securities	0	5,968.5	9.5	5,978.0	5,982.4
Redeemable preferred stocks:					
Financials	0	91.7	0	91.7	81.8
Utilities	0	51.6	0	51.6	65.1
Industrials	0	87.0	0	87.0	118.1
Subtotal redeemable preferred stocks	0	230.3	0	230.3	265.0
Total fixed maturities	1,409.9	12,547.0	9.5	13,966.4	13,892.3
Equity securities:					
Nonredeemable preferred stocks:					
Financials	153.8	678.4	0	832.2	731.9
Subtotal nonredeemable preferred stocks	153.8	678.4	0	832.2	731.9
Common equities:					
Common stocks	2,704.7	0	0	2,704.7	1,523.7
Other risk investments	0	0	0.3	0.3	0.3
Subtotal common equities	2,704.7	0	0.3	2,705.0	1,524.0
Total fixed maturities and equity securities	4,268.4	13,225.4	9.8	17,503.6	16,148.2
Short-term investments	3,730.0	96.9	0	3,826.9	3,826.9
Total portfolio	$7,998.4	$13,322.3	$9.8	$21,330.5	$19,975.1
Debt	$0	$2,789.2	$158.1	$2,947.3	$2,701.6

(millions)	Fair Value Level 1	Level 2	Level 3	Total	Cost
December 31, 2016					
Fixed maturities:					
U.S. government obligations	$2,870.1	$0	$0	$2,870.1	$2,899.2
State and local government obligations	0	2,502.6	0	2,502.6	2,509.5
Foreign government obligations	24.5	0	0	24.5	24.5
Corporate debt securities	0	4,550.9	0	4,550.9	4,557.8
Subtotal	2,894.6	7,053.5	0	9,948.1	9,991.0
Asset-backed securities:					
Residential mortgage-backed	0	1,458.7	0	1,458.7	1,448.5
Agency residential pass-through obligations	0	40.6	0	40.6	41.2
Commercial mortgage-backed	0	2,253.1	0.3	2,253.4	2,266.9
Other asset-backed	0	2,351.1	0	2,351.1	2,350.7
Subtotal asset-backed securities	0	6,103.5	0.3	6,103.8	6,107.3
Redeemable preferred stocks:					
Financials	0	59.5	0	59.5	59.8
Utilities	0	30.9	0	30.9	30.5
Industrials	0	101.5	0	101.5	98.5
Subtotal redeemable preferred stocks	0	191.9	0	191.9	188.8
Total fixed maturities	2,894.6	13,348.9	0.3	16,243.8	16,287.1
Equity securities:					
Nonredeemable preferred stocks:					
Financials	138.1	715.4	0	853.5	734.2
Subtotal nonredeemable preferred stocks	138.1	715.4	0	853.5	734.2
Common equities:					
Common stocks	2,812.0	0	0	2,812.0	1,437.1
Other risk investments	0	0	0.4	0.4	0.4
Subtotal common equities	2,812.0	0	0.4	2,812.4	1,437.5
Total fixed maturities and equity securities	5,844.7	14,064.3	0.7	19,909.7	18,458.8
Short-term investments	3,009.3	563.6	0	3,572.9	3,572.9
Total portfolio	$8,854.0	$14,627.9	$0.7	$23,482.6	$22,031.7
Debt	$0	$3,188.5	$127.3	$3,315.8	$3,148.2

Our portfolio valuations, excluding short-term investments, 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 2017 or 2016. 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 30 days or less to redemption. These securities are held at their original cost, adjusted for any accretion of discount, since that value very closely approximates what an active market participant would be willing to pay for such 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 typically 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.

At March 31, 2017, vendor-quoted prices represented 54% of our Level 1 classifications (excluding short-term investments), compared to 37% and 52% at March 31, 2016 and December 31, 2016, respectively. The securities quoted by vendors in Level 1 primarily represent our holdings in U.S. Treasury Notes, 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 active exchanges.
At March 31, 2017 and 2016, and December 31, 2016, vendor-quoted prices comprised 99%, 98%, and 99%, respectively, of our Level 2 classifications (excluding short-term investments), while dealer-quoted prices represented 1%, 2%, and 1%, respectively. 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. When necessary, we 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 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 if the fair value is appropriate.

For our corporate debt and preferred stock (redeemable and nonredeemable) portfolios, as well as the notes and debentures issued by The Progressive Corporation (see Note 4–Debt), 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, we believe that 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 for our securities.
Except as described below, 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 March 31, 2017 and 2016, and December 31, 2016, 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 or non-rated 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. Despite the lack of sufficient observable market information for our Level 3 securities, 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 did not hold any internally priced securities at March 31, 2017 and 2016, or December 31, 2016.
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. During 2017 or 2016, there were no material assets or liabilities measured at fair value on a nonrecurring basis. 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 months ended March 31, 2017 and 2016:

	Level 3 Fair Value Three Months Ended March 31, 2017							
(millions)	Fair Value at December 31, 2016	Calls/ Maturities/ Paydowns	Purchases	Sales	Net Realized (Gain) Loss on Sales	Change in Valuation	Net Transfers In (Out)	Fair Value at March 31, 2017
Fixed maturities:								
Asset-backed securities:								

Commercial mortgage-backed	$0.3	$ (0.3)	$ 0	$ 0	$ 0	$ 0	$ 0